

Evolution of Professional Skepticism and Its Thought Background^(*)

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Abstract

With the advent of The Philosophy of Auditing by Mautz and Sharaf (1961) which became a cornerstone on the path to establish auditing theory, auditor's Skepticism, which is called Professional Skepticism (PS) in audit standards began to gradually permeate professionals' mind sets. Cohen commission report (1978) published in US had introduced the auditor's posture of neutrality to be sought, and it explored the ways to fill the "expectation gap" hindrances. Exposure of PS as a term had been initiated from US SAS 53 (1988) and, among others, the two POB reports (1993 and 2000). Those are the initial professional publications to be recalled in order to pursue fraud risk-averse audit, availing the effect of PS which is applicable to audit.

This article is mostly devoted to shed light on the evolution of PS which could be observed historically in critical audit publications. In addition, it is the author's intention to draw attention to the "healthy PS" which could be understood with the context of audit standard that typically asserts auditor's neutrality, i.e. "the auditor neither assumes that management is dishonest nor assumes unquestioned honesty" (US AU230 ¶09). That is, as practices to be understood between the outcomes of idealism and pragmatism, auditors eventually have to observe reasonableness and they should do neither run the risk of α (risk of losing efficiency), nor β (risk of losing effectiveness) .

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At present of 21st century, however, neutrality could no longer be conceived as auditor's ideal posture, and professionals are now required to have more rigorous attitude, i.e., Presumptive Doubt (PD) foundation on applying PS. Thought background of PS has been evolved constantly to date.

Key words: Professional Skepticism (PS), Presumptive Doubt (PD), Neutrality, Reasonable Assurance, Belief Accumulation (anchoring), β Risk, α Risk.

Jel Classification: M41, M42

Introduction - Professional Skepticism And Mautz= Sharaf

Scholars who introduced the philosophical thoughts of skepticism into the auditing to establish the foundation of its theory were Mautz and Sharaf, and it was the booklet titled *The Philosophy of Auditing* (1961). That work is remembered as the classic which set the tone of audit "ideology", but Mautz and Sharaf themselves did not intend to be complete philosophers. They merely believed audit theory should be established on the ground including philosophy which is uniquely designable. With such belief, Mautz and Sharaf extensively adopted the framework of W.P. Montague (1873-1953), a professor of philosophy at Columbia University in the early 20th century, and tried to adopt his method of skepticism for the audit theory construction process.

Naturally, Mautz and Sharaf could neither accept old Greek pyrrhonism, nor classical agnosticism. As like a counterpart of agnosticism, they argued, for instance, "a table is its own evidence for existence. We see inventory and we are convinced that it exists" (1961, 18th printing 82). They did not doubt the quality of human recognition as to the assertion of existence, that the philosophers do, e.g. within the boundaries of agnosticism, or Cartesian skepticism.

Mautz and Sharaf mentioned that "the evidence may be such as will persuade the mind to accept the proposition. If the evidence is thus adequate, the mind is more in error when it continues to doubt than when it

accepts” (1961, 117). Mautz and Sharaf themselves would be pragmatists¹ and they were reluctant to accept rigid skepticism. On the path to explore auditing - applicable skepticism, instead, they put emphasis with the value of “persuasiveness” and “justified belief” which were originally asserted by the Montague, rather than the lukewarm human belief obtainable.

Mautz and Sharaf did not accept even the moderated skepticism elaborated by an empiricist, David Hume (1711-76). In Hume’s work, *A Treatise of Human Nature, Part VI: of the skeptical and other systems of philosophy*, it was noted that “all knowledge degenerates into probability... gradual increase of assurance is nothing but the addition of new probabilities, and is derived from the constant union of causes and effects, according to past experience and observation” (1739-40 reprinted 2003, 129). Hume did see through that the induction process would be mere additions of probabilities, and knowledge would be made by a heap of certain probabilities. Hume’s argument, for most part in denying induction, was inconvenient to Mautz and Sharaf. Hence, for the author’s point of view, they did not trace back the philosophical lineage of skepticism in their own booklet.

Mautz and Sharaf might be afraid of philosophers’, among others Hume’s thought with respect to the point that denied the value of induction², which would be necessary on every step of applying audit procedures. Hume’s skepticism might be a double-edged sword for Mautz and Sharaf. They were aware that the auditor’s skepticism had to be formed as some notion which would be inherently different from e.g., classical skepticism, agnosticism, nor Humean’s empiricism³.

1) In their work(1961, 116-117)Mautz and Sharaf did describe specifically as to the nature of pragmatism. For instance, they say “rarely is it possible to wait, for example, until the retirement of a fixed asset to determine whether the depreciation rate has been established fairly...”.

2) According to Taleb (2007, 45), “this Turkey problem also known as the problem of induction, is very old one, but for some reason it is likely to be called Hume’s problem.”

3) According to Mautz and Sharaf (1961, 18th printing 106, Footnote 5) , “The 18th century’s philosophy is associated with Locke and Hume’s empiricism. Skepticism is particularly attributed to Descartes, and intuition to Bergson.” For Mautz and Sharaf, not only Phyrhonian skepticism but Cartesian Skepticism would be classical as they admitted the possibility of justified belief.

Montague – Skeptical Foundation Taken By Mautz And Sharaf

The 20th century's contemporary philosopher W. P. Montague had believed that "justifying beliefs can give genuine knowledge" (1925, reprinted 1978, 173). Thinking "justifying belief" admissible, Montague's skepticism is not compatible with classical skepticism, especially Pyrrhonian skepticism which took impossibility of justified beliefs⁴ for granted. Montague argued that "between certainty maintained by the extreme anti-skeptics, or as Kant called them dogmatists, and the blank indifference of complete doubt maintained by the skeptics, there exists the intermediate realm of probable"(1925, reprinted 1978, 209). Montague had accepted the efficacy of probability which had been denied by classical philosophers. And he put "probability" in the continuum of which the "certainty" and "complete doubt" exist at the two extreme ends.

To deal with the probability that auditors encounter on practices, Mautz and Sharaf intended to derive the benefits from the skepticism asserted by Montague, restricting accidental discharge of "dynamite"⁵ of the classical skepticism. Indeed, Montague's argument was moderate and Mautz and Sharaf believed that they might draw certain benefits from it. Mautz and Sharaf had been successful in reflecting Montague's original notion of "persuasiveness" and "justified belief" onto *The Philosophy of Auditing*.

In the Chapter 5 of Mautz and Sharaf (1961) which dealt with the conception behind obtaining evidence, *ex facto*, they discussed Montague's belief in relation to the inherent uncertainty of auditee managements' assertions. Montague had initially assumed the five resources of human belief in his book(1925, 4th ed. 1953, 34). Those are, (1) Authoritarianism, (2) Mysticism, (3) Rationalism, (4) Empiricism, and (5) Rationalism, and on top of them, as shown in the following [Figure 1] the sixth resource of

4) M. Lammenranta(Greco 2008, 10) asserts that "It is an argument for a very strong form of global skepticism that denies the possibility of any justified beliefs." If so, PS that pursues obtaining "justified beliefs" as typically asserted by Bell et al.(2005)is not in accordance with the realm of classical skepticism in philosophy.

5) Howson (2003, Introduction) says "the Scottish philosopher David Hume published a philosophical argument that was, metaphorically, dynamite."

(6) Skepticism. In addition to the five positive resources, Montague put the sixth as negative one, of which he believed it necessary for the theory which will be eventually forged. By Montague's work named *The Ways of Knowing* (1925), skepticism was to be used as a touchstone to ascertain the validity and rigidness of certain theory sought.

Mautz and Sharaf had highly regarded the Montague's conception in particular. They applauded that "Montague's treatment of the subject is the most comprehensive. His analysis, evaluation, and objective criticism of the sources of knowledge has made his work outstanding" (1961, 107). It was almost destined that Mautz and Sharaf was to diffuse Montague's skepticism not as auditor's universal foundation but as an exemplar of desirable thought. By the contribution of Mautz and Sharaf, PS became an issue to be tackled with by the audit thinkers. But the original contribution for PS could be attributed to the framework given by Montague.

The [Figure I] below is the citation from Mautz and Sharaf (1961, 122) . In it, skepticism, as the sixth resource of human belief, is found as paramount and foremost resource in availing other resources numbered from the first through the fifth.

[Figure I] Chart showing inter-relationship of logical methods, audit evidence, and basic audit techniques of Mautz and Sharaf (1961, 18th printing 1997, 122 modified)

Resources of human belief & Logical Method	Nature of Assertion	of Audit Evidence	Applicable Technique	
(6) <u>Skepticism</u> ⁴	(4) <u>Empiricism</u> (perceptual experience)	<u>Assertion I</u> Existence of physical things present Simple quantitative conditions	Examination by auditor Physical examination and count	
	(3) <u>Rationalism</u> (reasoning from accepted and general assumptions)	<u>Assertion II</u> Mathematical	Calculation by auditor Recomputation	
	(1) <u>Authoritarianism</u> (testimony)	<u>Assertion III</u> Existence of physical things not present Past events	Statements by independent third parties Authoritative documents Statements by company personnel Subsidiary of detail records	Confirmation Examination of documents Inquiry Examination of records
	(1) <u>Authoritarianism</u> (testimony) (2) <u>Mysticism</u> (Intuition) (5) <u>Rationalism</u> (reasoning from accepted and general assumptions) <u>Fragmatism</u> (practical results)	<u>Assertion IV</u> Existence of nonphysical things Nonexistence of physical and non physical things Qualitative conditions Value-judgment qualities	Statements by independent third parties Authoritative documents Statements by company personnel Subsidiary of detail records Satisfactory internal control procedures Subsequent actions by the company and others Interrelationships with other data	Confirmation Examination of documents Inquiry Examination of records Inquiry, rechecking bookkeeping procedures, examination of documents, scanning, observation Confirmation, inquiry, examination of documents, observation Coordination with related data Scanning

⁴Marx and Shurf (1961, 128) quoted Montague's argument as "the function of skepticism is to make realize that no knowledge attainable by human mind is absolutely certain. Systems of belief, which we have considered true and must always be open to revision...it would require thereby, not certainty, but only a high degree of probability."

In relation to the above exhibited, Mautz and Sharaf explained that “skepticism has been indicated at the left of the chart as applicable to all the assertions listed and to be applied in obtaining every kind of evidence the auditor uses. This is the nature of skepticism as a logical method. Its position in the chart suggests that in many ways it is rather an attitude than a method” (1961, 123). Though they found skepticism as a premier resource of fortifying human belief, they named skepticism as mere “attitude” necessary for prudent auditors.

Inherent Limitations of Audit Postulates by Mautz and Sharaf

Mautz and Sharaf were aware that the skepticism directed for arguing absolute certainty⁷ might impair the significance of audit evidences. In fact, they mentioned that “Some philosophers have carried skepticism to the point where they are willing to believe nothing, a state of complete doubt. Montague agrees that the human mind is unable to attain absolute certainty in any field of inquiry, yet this does not necessarily lead to a condition of complete doubt...skepticism is thus an important tool in the thinker’s kit only if he uses it wisely” (1961, 117).

Mautz and Sharaf had intended to adopt skepticism with restriction. They did largely rely on the Montague’s argument, which would be typically asserted, e.g. “we have never seen all horses or the horse, but only particular horses of a particular size and color, existing at particular times and places” (1925, 4th ed. 1953, 70). Mautz and Sharaf needed to adopt Montague’s moderate and contemporary skepticism to avoid frail inductions as to the relation of universals to each individual matter⁸.

7) The othertype of skepticism which does not pursue the absolute certainty does exist, and it might be named, for example, as the New Skepticism by the P. Kurtz(1992). In his skepticism, skeptical motivation is inquiry rather than doubt, and skepticism is constructive rather than destructive.

8) This kind of worries for effect of general induction lasts even in the recent publication. For instance, Nassim Nicholas Taleb have noted in his *The Black Swan* (2007), as “this turkey problem (the problem of induction) is very old one but for some reason it is likely to be called Hume’s problem.”

Apart from the discussion of skepticism per se, Mautz and Sharaf had listed in their work (1961), eight tentative postulates of auditing. Those postulates however, might be irrelevant and far from rigid skepticism. Apparently,【Postulate 2】 below is against the rationale to maintain neutrality in auditor’s mind set. And 【Postulate 6】 would run the risk of leaving the room for unattended “anchoring”⁹.

The eight tentative postulates of Mautz and Sharaf (1961) are as follows.

【Postulate of Auditing 1】

“Financial statements and financial data are verifiable”

【Postulate of Auditing 2】

“There is no necessary conflict of interest between the auditor and the management of the enterprise”

【Postulate of Auditing 3】

“The Financial statements and other information submitted for verification are free from collusive and other unusual irregularities”

【Postulate of Auditing 4】

“The existence of a satisfactory system of internal control eliminates the probability of irregularities”

【Postulate of Auditing 5】

“Consistent application of generally accepted principles of accounting results in the fair presentation of financial position and the results of operations”

【Postulate of Auditing 6】

“In the absence of clear evidence to the contrary, what has held true in the past for the enterprise under examination will hold true in the future”

【Postulate of Auditing 7】

9) According to Kahneman et al.(1982,14), anchoring would be a heuristic bias. It would be explained, e.g. “people make estimates by starting from an initial value that is adjusted to yield the final answer... different starting points yield different estimates, which are biased toward initial value.”

“When examining financial data for the purpose of expressing an independent opinion thereon, the auditor acts exclusively in the capacity of an auditor”

【Postulate of Auditing 8】

“The professional status of the independent auditor imposes commensurate professional obligations”

Apparently because of the inclusion of the above postulate 2 and 6 in their work, Mautz and Sharaf was not, philosophically skeptic in their posture of establishing audit theory then.

Significance of Asobac and Cohen Commission Report

With regard to the implications of Mautz and Sharaf’s tentative postulates of auditing, *A Statement of Basic Auditing Concepts (ASOBAC 1973)* and *The Commission on Auditor’s Responsibilities: Report, Conclusions, and Recommendations (Cohen commission report 1978)*, those two publications had expressed certain concerns.

Though *ASOBAC* had highly regarded¹⁰ the work of Mautz and Sharaf, *ASOBAC* on the other hand, had worried with the signification of anti-skeptic attitude. It pointed out that 【Postulate of Auditing 2】 was pernicious as follows.

“Mautz and Sharaf, in their list of tentative postulates list one of these pernicious suppositions: “there is no necessary conflict of interest between the auditor and the management of the enterprise under audit.” A second assumption that seems widely accepted is: “there is no necessary conflict of interest between the management of and enterprise and other parties interested in the enterprise.” We are not suggesting (nor did Mautz and Sharaf) that such propositions are never investigated, but we do suggest that they are not specifically tested as a normal part of every audit.” (*ASOBAC 1973, 27*)

10) *ASOBAC (1973, 1)* appraised Mautz and Sharaf as follows. “A pioneer work concerned with the conceptual foundations of auditing is Mautz and Sharaf’s *Philosophy of Auditing.*”

And in ninety seventies, with the experience of Equity Funding Co's fraud case (1973)¹¹, *Commission on Auditor's Responsibilities, Report, Conclusions, and Recommendations, AICPA Cohen Commission Report* (1977) had warned that professionals should be well aware with the necessities in exerting PS. With this, Romney et al. (1980, 63) had commented that the "major conclusions of the Cohen commission was that an auditor has a duty to search for fraud, and should be expected to detect those frauds that the exercise of professional skill and care would normally uncover." That is, the usefulness of exerting PS in order to "search for" managements' fraud, though the effort would be limited on normal condition, would have been recognized with *Cohen commission report*¹². And, it is deemed that the contents of SAS released thereafter have been significantly affected by such arguments made by *Cohen commission report*.

Cohen Commission Report (1978) had underscored the skepticism as follows.

"The exercise of professional skill and care requires healthy skepticism- a disposition to question and test the validity of all material management representations. The independent auditor should approach an examination with an open mind about the integrity and good faith of management. He should neither assume management is dishonest nor take management's integrity and good faith for granted. Thus, if at any point serious doubts arise concerning the honesty, integrity, or good faith of management, the auditor should take all reasonable actions to resolve the doubts to his satisfaction."

(Cohen Commission Report 1978, 38)

11) According to Knapp(2006, Contents XV), "the huge Equity Funding scandal demonstrated the critical need for auditors to maintain a high level of skepticism when planning and carrying out an audit." Though there were many fraud cases in US in seventies, Equity Funding's scandal could be found as the direct trigger to draw attentions with the PS.

12) In fact, SAS No.16 had not been clear enough with the auditor's responsibility to detect managements' frauds and with the impetus of AICPA Cohen commission report (1978), SAS No.53 (1988) had been published and PS had then been widely employed.

In ninety seventies, by *ASOBAC* (1973) and by *Cohen commission report* (1978), auditors were imposed the duty to search for fraud, and auditee-inclined mind sets by sixties were expected to be restructured. The skepticism that Mautz and Sharaf argued was the thought framework borrowed from Montague. And it was fairly experimental in that era.

The Expectation Gap and New Sass

In 1988, Statements on Auditing Standards (SAS) No. 53 – *The Auditor’s Responsibility to Detect and Report Errors and Irregularities* – had stipulated the requirement of PS, which was recalled as one of the nine expectation gap auditing standards (No. 53 thru 61) published all at once¹³. Existence of expectation gap, i.e., the mind gap between those of the users and the auditors of financial statements had been already pointed out by the *Cohen commission report* a decade earlier. But the need of anti-fraud measures had been more clearly discussed e.g. by the *The Report of the National Commission on Fraudulent Financial Reporting* (NCFRR 1987), and the practical measures to cope with managements’ frauds were legitimately codified into the nine new expectation gap SASs in 1988.

Among them, the first auditing standard which explicitly introduced the PS as a key word had been SAS No.53, which had played a pivotal role in the nine Expectation gap auditing standards. By the SAS No. 53, the auditor’s conventional posture of assuming management’s honesty had to be denied. The earlier SAS No.16 (1977) type old mind set which tends to limit auditor’s own responsibilities had become outdated and then, had been unaccepted. The shift to enhancing PS became an apparent trend among audit professionals.

Expectation gap audit standards released at 1988 in US did include SAS No.56; Analytical Procedures¹⁴, SAS No.57; Auditing Accounting

13) In this article, PS has been discussed along with the contexts of SAS in US. However, “the idea of professional skepticism is an interesting one and one that we will find repeated in the International Standards on Auditing (ISA)” as it is pointed out, typically by (Gray and Manson, 2008, 23).

14) The first SAS, in US, which dealt with analytical review procedure, was SAS No.23 (1978). The timing of its release was close to the publication of Cohen commission report (1978). In SAS No.23, it was not compulsory to apply analytical methods in order to reduce detection risk. In SAS No.56, in contrast, the application of analytical procedures is virtually compulsory on audit planning stage and on overall review (SAS No.56, para.04).

Estimates, SAS No.61; Communication with Audit Committees. The auditor's psychological element which can be found consistently through such SASs might be the conception of PS.

Notion of skepticism first introduced to the auditors by Mautz and Sharaf about a half century ago had been emerged with modern SAS over time, and eventually it became an essential element that audit general standards would devote to.

Professional Mind Set in the 21st Century

How the auditee management's honesty would have been assumed by the auditor would be a controversial issue, and the author would discern them with historical division as follows.

Categorization of auditor's mind set with the historical view;

(1) Pro-auditee; At the period that management was generally believed as honest existence, i.e. the era up to SAS No.16 (1977)

(2) Neutrality; SAS No.53 (1988) and thereafter until the end of 20th century

(3) Presumptive Doubt (PD); In the 21st century. PD had been triggered by the publication of *O'Malley report* (POB 2000)

Cultivation of applying PS have gradually immersed notably in ninety nineties, and such trend could first be substantiated in POB report issued in 1993 (*In the Public Interest, Recommendation V-1*) with the notes that "the accounting firms should assure that auditors more consistently implement, and be more sensitive to the need to exercise PS required by the auditing standard that provides guidance on the auditor's responsibility to detect and report errors and irregularities."

Then the remarkable speech given by the SEC Chair, Arthur Levitt, Jr. (New York University 1998) would have given an impetus to the POB's panel (*O'Malley report* 2000), and eventually the new SAS No.99 –*Consideration of Fraud in a Financial Statement Audit*— in 2002 had introduced PS on the rigorous level that *O'Malley report* had assumed.

O'Malley report (POB 2000) required the Presumptive Doubt (PD) as a postural foundation of exerting PS. admittedly, dishonesty in management mind set had to be principally assumed, and that became the request for the auditors to nullify the accumulated, unconsciously made belief. It would be an intended, forced reversion of auditor's mind to the blank slate i.e. "tabula rasa" condition at the interval of each engagement.

In 2002, The Sarbanes-Oxley Act (404) did stand on the pessimistic side as to the management assertions' trustworthiness. Also, KPMG and University of Illinois (UIUC), has published the booklet titled *The 21st Century Public Company Audit* (2005) and since then, PS had been required at the bosom of auditor's mind in the way that auditor would be skeptic enough as to his or her own belief accumulation process. Naturally, that sort of PS was emphasized with notations made in the booklet e.g., "inward directed" and "preemptively self-critical" attitudes.

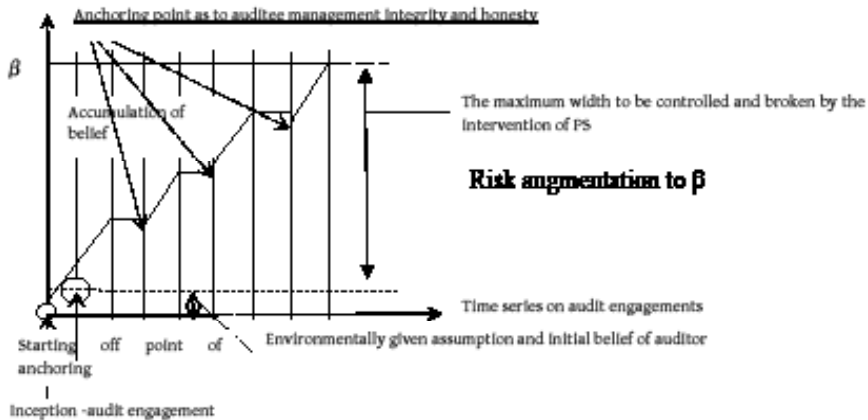
In this way, at the beginning of the 21st century, PD became an essential posture for the "best practice" seeking auditor who would practice PS in audit procedures. That is, auditors should "be skeptical ...of evidence but also of their own judgment processes" (Bell et al. 2005, Foreword) with their inner criticism on belief building process to form audit opinion.

In the following, auditor's belief accumulation versus belief destruction process would be shed light, using [Figure II] and [Figure III], which are germane to PS's functioning thought background.

Auditor's Belief Accumulation and Destruction Process

The following [Figure II] would exhibit the β risk caused by "anchoring", which has to be prevented by the exertion of PS on PD. Here, anchoring is with the meaning intended by Kahneman et al.(1981.14), noted as "estimates by starting from an initial value that is adjusted to yield final answer....different starting points yield different estimates, which are biased toward initial values." That is, by anchoring unconsciously made by the auditor, intimacy towards auditee managements may augment, and auditors belief will be accumulated positively and such belief would tend to be the one favorable to the auditee, despite the true given condition.

[Figure II] Anti-skepticism: Case of auditor's anti PS exerted, which causes β risk

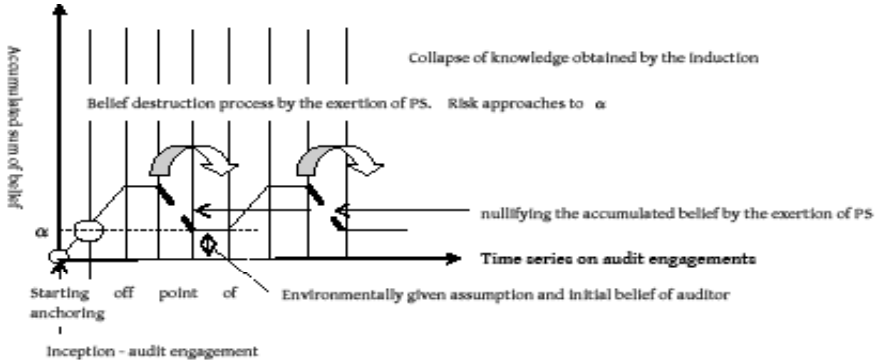


In contrast with the above mode of belief accumulation [Figure II], the [Figure III] below would represent the belief destruction process triggered by the exertion of PS.

The [Figure III] exhibits the case that PS has rigorously affected to the level of bringing anti-anchoring outcomes. In this [Figure], at the end of each audit engagement, auditor's belief accumulated could be fully wiped out and removed. In the following engagement, auditor would create belief from the scratch condition.

However, this case of [Figure III] will entail the α risk, that is the risk that auditor erroneously rejects the valid and useful audit evidences by having wrong PD. And, the audit cost endlessly increases and efficiency would be inevitably deteriorated.

[Figure III] Skepticism: Case of auditor's PS which causes α risk



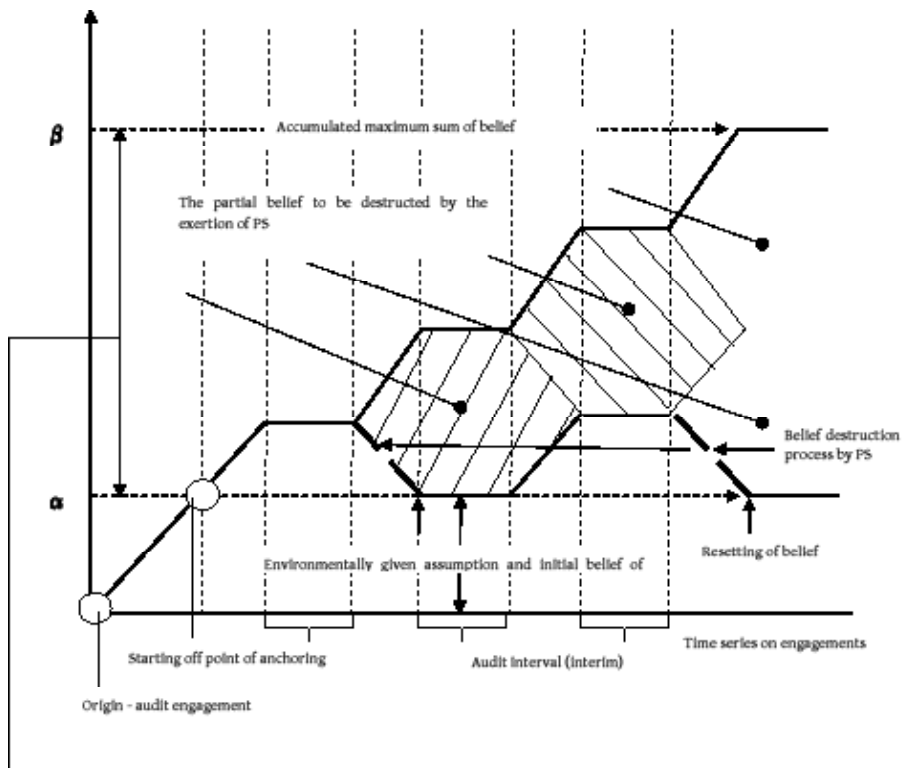
The following [Figure IV] would exhibit the superposed image of those two, i.e. belief accumulation and its destruction. That is, the case that auditor's belief would be accumulated based on the assumption that auditee managements are honest existence (it eventually reaches to the β and its conceivable risks), and in its sharp contrast, destruction of accumulated knowledge by the intervention of PS (it eventually reaches to the α and its conceivable risks).

As noted earlier, in the US, *Cohen commission report* (1978) had introduced the notion of neutrality, and SAS No. 53 (1988) and SAS No. 82(1997) had consistently observed such stances which lead to the healthy skepticism. Neutrality is the position laid somewhere in between β and α . However, since the *O'Malley report* (POB 2000) and SAS No.99 (2002), auditor's PD had been required as mental attitude and α risk assumption is naturally and inevitably taken for granted in 21st century's current audit theory.

In the following [Figure IV], note β risk as the condition that effectiveness of audit will be lost due to the accumulation of inappropriate belief even though the audit cost would be eventually minimal. In contrast, note α risk as the condition that efficiency of audit would be jeopardized due to the destruction of auditor's belief at the end of each engagement even though the effectiveness of audit will be guarded.

Further, if the auditor believes in the rigid, philosophical skepticism including agnosticism and/or a sort of Cartesian skepticism, no justifiable belief would be made and even the destruction of belief would be needless. The author may dare call it as σ risk that no audit engagement would be made and the total “blank slate” would remain intact.

[Figure IV] Superposed image of belief accumulation and destruction process.



β : Risks taken by the time of SAS 16 and the argument of Mautz and Sharaf (1961)’s tentative postulate

α : Risks taken after O’Malley report(2000), SAS No.99 (2002)

$\beta - \alpha$: Width that PS intervenes (Cohen Commission 1978, SAS No.53, 1988 and SAS No.82, 1997)

Ps and the Perspective of Relevant Risk and Cost

At present of the 21st century, the requirement of PS for the auditor has become more prevalent not only in the forensic type but for the financial statements audit in general. However, as a risk would augment, audit professions should foresee the economy and functional aspect, i.e. the balance of PS's effects and costs. [Figure V] and [Figure VI] hereafter are conception of functioning PS and the perspective of relevant risk and cost.

Firstly, [Figure V, 1 (β)] and [Figure VI (upper horizontal broken line)] exhibits the condition that we would think the managements are honest, and thereby the auditors would act at most, as the prudent practitioner "with the degree of skill commonly possessed by other professionals¹⁵." Here, auditor's attitude to search for fraud could not be sought and thereby a risk would exist.

With such circumstances the auditor would believe that the auditee is honest, and as a natural extension from such thoughts, auditor will not be skeptical to the assertions made by managements. Here, on such occasions, Mautz and Sharaf's **【Postulate 2】** discussed earlier would be left intact. Naturally, auditor will not be introspective enough with his or her own belief making process.

At any engagement, psychological anchoring may unconsciously affect the auditors judgment process. And the resultant auditee inclined, pro-auditee belief may be layered from one engagement to the following engagement. Leaving such anti-PS nurturing process free, cost of audit will be reduced superficially. However, recklessness in practitioners' minds will eventually cause to bring the risk and, in the long run, the society, the audit environment and capital markets will bear the resultant cost (β') by the subsequent occurrence of fraud cases. As noted earlier, even in the Mautz and Sharaf's work (1961), it had been admitted to assume these risks.

15) Cited from Cooley on Torts, a legal treatise, as to obligation for due care. Noted in the AU§230.03.

On the other hand, the neutrality type mindset of auditor, which had been required by *Cohen commission report* (1978), may be some mid-point, “hang around” case between β and α , i.e. [Figure V. 2 ($\beta > * > \alpha$)]. Auditor’s neutrality would be an attitude of representing “the auditor neither assumes that management is dishonest nor assumes unquestioned honesty¹⁶”, and it had been codified in the SAS No. 53 (1988) and SAS No.82 (1997).

Under this neutrality type mind set model, the extent of immediate audit cost incurrence would be, at a floor minimum in case of assuming audittee management’s honesty acceptance – i.e., (β) risk. And, it would be at the maximum cost incurrence by holding PD – i.e., (α) risk. In reality, risk and cost would be found somewhere between the floor and ceiling with variable values.

Finally, the case of adhering PD [Figure V, 3 (α)] and [Figure VI(α risk broken line)] i.e. The 21st century’s rigorous attitude could be made on logical imagination. PD as a fundamental mind set sustains PS of the higher level and it will reduce detection risk as well as anchoring risk on auditor’s belief accumulation process. PS, however, would constantly require additional audit evidences, and it entails the incremental cost of audit in short term.

On the other hand, PS in the long run, will be expected to reduce fraud undetected “cost” which may be unconsciously borne environmentally. PS naturally will, though it may be in retard and indirect way, deter or limit the crash or deterioration of stock markets, and resultantly succeed to maintain the trust from the investors.

16) Cited from AU§230.09.(SAS No.82)

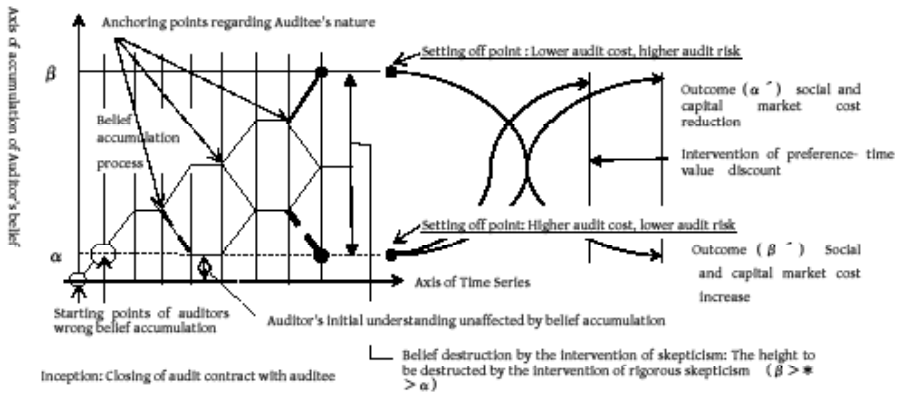
[Figure V] Skepticism and the Perspective of relevant risk and cost

Foundation of PS against Auditee	Risk of Auditor's mindset	Level and extent of PS exerted	Inclination-acceptance of assertion	Anchoring risk	Audit (detection) risk	Cost of Audit	Cost at capital market
Era up to SAS No.16(1977) including Mautz and Sharaf : i.e.pro auditee mind set							
1.Auditee inclined	β	Low	High	High	High	Low	to High
Cohen report (1978) and thereafter: i.e. introduction of healthy PS							
2. Neutrality	$\beta > * > \alpha$	Middle	Middle	Middle	Middle	Var.	Middle
From the 21 st century ; O'Malley (2000) and thereafter: i.e. rigorous PS							
3. PD	α	High	None or Low*1	None or Low	Low	High*2	to Low

*1 : Exhibited in accordance with Nelson's saying "high-PS auditors are more likely to doubt evidence that an assertion is true" (Nelson 2009,4).

*2 : For instance, Nelson(2009,3-4) refers to Bell et al.(2005), by saying "Bell et al. (2005) suggest that we may see a shift from a neutral to a presumptive doubt perspective on PS, which in turn increase the minimum levels of evidence necessary to justify audit opinions."

[FigureVI] Inverse relationships - Anchoring risk, Audit cost, and Cost of Markets



Here, expansion of PS would be understood with the following risk factors.

β : Risk caused by assuming auditee management's honesty (e.g., Notion held by SAS No.16)

$\beta > * > \alpha$: Width of possible belief destruction by auditor and where neutrality drifts (e.g. SAS No.82)

α : PD and belief resetting (to null). Risk of efficiency deterioration (e.g. what SAS No.99 purports)

Conclusion

Classical skepticism per se is a conception inherited from the great philosophers, and its stance was on agnosticism or it had argued the impossibility of justified belief. Even in relatively modern philosophy, value and validity of making inductive reasoning has been challenged.

With such background, audit professionals should not be simply relieved by employing the word of skepticism in the contexts of SASs. Professions may dare expel the keyword of PS from the auditing standards to be more realistic and pragmatic in discharging their duties. Otherwise, professions may encounter the new, additional expectation gap by the word of PS in audit standards. Professions should not intend to derive direct utility

from using such word of which its substance is left ill defined, nor the cost and benefit can be directly controlled.

Cohen commission report (1978) had been, among others, epoch making in departing from pro-auditedmindset. It had made a historical cornerstone for audit thinkers. It tried to introduce the skepticism which stands on neutrality, and it criticized the inconsistencies in what Mautz and Sharaf did hold out in their work. *Cohen commission report* had been successful in foreseeing the existences of both β and α risk and had concerns to avoid them, by introducing modern audit-compatible skepticism.

Even in the 21st century's audit environment, we have not yet succeeded to shed light on relevant risk and cost incurrence pattern of PS. And, in balancing the efficiency and effectiveness on practice, Cohen commission arguing healthy skepticism i.e. both β and α averse realistic PS would have its lasting value.

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