Professional Skepticism in Practice:
An Examination of the Influence of Accountability on Professional Skepticism

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SUMMARY

Professional skepticism (PS) is an important component of the auditor's mindset and exercising appropriate PS is an essential characteristic of a quality auditor. However, the Public Company Accounting Oversight Board (PCAOB) suggests that auditors may not be consistently or diligently applying PS. While existing literature (Hurtt, Brown-Liburd, Earley, and Krishnamoorthy 2013) suggests that PS can be affected by various internal and external factors, the question arises regarding how PS is currently being operationalized and employed in practice. Since PS is a multifaceted construct, we employ an in-depth survey using both quantitative and qualitative questions to elicit perceptions of numerous factors promoting or inhibiting PS. Using Peecher, Solomon and Trotman's (2013) accountability framework, we examine responses from 77 auditors of varying experience to gain insight into individual, firm, and regulatory sources of accountability and their perceived effects on auditor skepticism. We also conduct six interviews with respondents to explore the issues in depth. Results indicate that professionals believe PS is a necessary but not sufficient condition for being an effective auditor. Our data suggests that sources of accountability that can be traced to an *individual* more strongly promote auditor skepticism. Conversely, time budget pressure and excessive documentation may attenuate an auditor's PS. We present implications for research and practice.

Key Words: Professional skepticism, Accountability, Audit practice, PCAOB, Qualitative research

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INTRODUCTION

This study investigates how professional skepticism (PS) is operationalized and employed in practice, how multiple sources of accountability (Gibbins and Newton 1994; Bagley 2010) potentially influence auditor's PS and what are the factors that potentially promote and inhibit PS. The PCAOB has indicated that the profession does not exhibit adequate skepticism on many audit engagements (PCAOB 2012). For its part, the auditing profession recognizes the importance of PS and auditing firms (hereafter "firms") have developed tools to help promote PS (Hurtt, Brown-Liburd, Earley, and Krishnamoorthy 2013). For example, firms may promote PS through specific audit procedures, formal instruction, formalized work-papers and performance appraisals.

Although various mechanisms potentially enhance skeptical behavior, research suggests that some components of the audit environment, such as budget and client pressures, may impede appropriate use of PS (Nelson 2009; Hurtt et al. 2013). For example, an auditor may not want to uncover marginal problems if it causes extra, uncompensated or time intensive work (Gold, Gronewold, and Salterio 2014). Further, if firms primarily evaluate auditors (especially at lower levels) in terms of efficiency, an auditor may receive informal cues to be efficient even at the expense of exercising appropriate PS. From the perspectives of the firms and regulators, it is essential to understand which sources of accountability contribute to enhancing, as well as impeding, PS. Such knowledge could allow firms and regulators to place greater emphasis on specific mitigating policies and procedures to promote a higher level of skepticism that potentially could increase audit quality (Knechel, Krishnan, Pevzner, Shelchik and Velury 2013).[1]

In this study, we examine whether and how individual, team and firm sources of accountability[2] are perceived to affect PS. Specifically, we examine how these sources might either mitigate or accentuate the negative (positive) environmental effects of pressures on PS. Nelson (2009) and Hurtt et al. (2013) develop models to describe the relationship among personal, trait, and environmental characteristics and how those factors combine to produce professionally skeptical behavior (or the lack thereof). We integrate the research on skepticism, with literature on accountability (e.g., Peecher et al. 2013, Bagley 2010, Gibbins and Newton 1994) to examine the perceived impact of accountability on PS. We focus our examination on six sources of accountability noted by prior literature to potentially affect auditor behavior: threat of PCAOB inspection, litigation risk, client importance, work-paper review, formal evaluation, and time-budget pressure.

Prior studies on auditor's PS primarily employ experimental methods to examine a specific effect of an independent antecedent/outcome on a dependent skeptical judgment/action (see Hurtt et al. 2013, Appendix A for a review). Our goal is to extend this literature by providing a multi-faceted view of how accountabilities are perceived by practitioners to either promote or attenuate auditor skepticism. We derive our data from quantitative and qualitative

[1] We assume that higher levels of professional skepticism are preferred to lower levels in order to enhance the profession's stated commitment to act in the public interest (AICPA, ET Section 53). However, we recognize that there may be a difference between the form and the substance of PS that firms may actually desire (Cohen, Krishnamoorthy, and Wright 2008). For example, firms may publicly tout the importance of the highest levels of PS, yet in substance, they may reward much lower levels of PS if that results in greater practice development.

[2] Throughout the manuscript we use the terms *individual, team, firm* and *regulator*. *Individual* refers to an individual audit practitioner at any level (staff, senior, manager, partner) unless otherwise specified. *Team* refers to an audit client engagement team, which generally consists of multiple auditors at varying levels assigned for a period of time to perform an audit over internal controls and/or financial statements. *Firm* refers to a professional services firm that routinely performs the attest (audit) function for clients e.g., PwC, KPMG, BDO. *Regulator* refers to any professional body that has a stake in the integrated audit e.g., PCAOB, SEC.

responses from an in-depth survey conducted with 77 current and former audit practitioners of all levels i.e., staff through partner. We also perform follow-up interviews with six of the respondents. By gaining insights from auditors through this approach, we gain important insights on what factors create incentives (disincentives) for auditors to exhibit PS in practice.

Our results suggest current "penalty-based" accountabilities (e.g., PCAOB inspections) do promote more skeptical behavior. We also find that sources perceived to hold *individuals* accountable (as opposed to holding the audit team or the firm accountable) are perceived as the most effective for improving auditor skepticism across levels. Consistent with Peecher et al. (2013), we find that effective accountabilities are those that motivate shorter-term, compliance-focused behaviors, with auditors operating under a strategy of "penalty avoidance." On the other hand, client budget pressures and a team focus on audit documentation for the sake of documentation seem to inhibit PS. Finally, the responses from the interviews indicate that professional skepticism is a necessary but not sufficient condition for being an effective auditor.

Our paper makes the contribution of being the first study to directly elicit responses from audit practitioners about their perceptions on the effects of individual, team and firm accountabilities on auditor skepticism. Our data confirms views on threats to skepticism identified in the review papers of Nelson (2009) and Hurtt et al. (2013). Further, our data reveals insights on the rewards and penalties of accountability (Peecher et al. 2013) that currently may inhibit a higher level PS yet have the potential for enhancing skepticism.

In the next section we summarize the theoretical and practice foundations on which our research is based. This is followed by a description of the study's participants, development of our questionnaires and data analysis procedures. We then present our narrative with supporting quotations from the survey and interviews illustrating the rich insights provided by participants. The final section presents our conclusions and suggestions for future research.

BACKGROUND

Professional skepticism as a construct

The academic literature is inconsistent in defining PS. For example: the regulatory view (Hurtt et al. 2013) and some academic literature adopt a "presumptive doubt" perspective (e.g., Nelson 2009), while other studies take a "neutral" perspective (e.g., Hurtt 2010). A presumptive doubt view presumes some level of client dishonesty (Nelson 2009)[3] with an emphasis on the need to gather further evidence before accepting client-provided explanations (e.g., Peecher 1996, Turner 2001). In contrast, a neutral view of professional skepticism presumes an unbiased and objective mindset - neither assuming the client is honest or dishonest.[4] Thus, our first research question is aimed at identifying how audit practitioners view PS:

RQ 1: How do auditors perceive the construct of "professional skepticism"?

Professional Skepticism in Practice

External auditors are influenced by both institutionalized and social roles. For example, the profession has been charged by society with the institutional role of being the "public watchdog" that opines on corporate financial reports (U.S. Supreme Court 1984; Levitt 1998). In accomplishing this, the audit profession is expected to exhibit a particular set of professional

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[3] "I define PS as indicated by auditor judgments and decisions that reflect a heightened assessment of the risk that an assertion is incorrect, conditional on the information available to the auditor. Under this definition, an auditor who has high PS needs relatively more convincing (in the form of a more persuasive set of evidence) before concluding that an assertion is correct" (Nelson 2009, 4).

[4] We note that a definition of PS could be context specific. For example, Quadackers, Groot, and Wright (2014) suggest that presumptive doubt perspective is more predictive of skeptical behavior in higher risk settings.

attitudes and behaviors e.g., independence and objectivity (AICPA, 2013). Violations of these societal expectations have accentuated the expectation gap where the profession does not live up to society's expectations of reasonable performance (Porter 1993). This culminated in a rash of alleged audit failures during the late 1990's and early 2000's that led to the end of an era of self-regulation for the profession and the establishment of the PCAOB. The PCAOB has devoted considerable attention to PS, which is considered to be an essential attribute of the effective auditor mindset (PCAOB 2012). For example, the PCAOB released Staff Practice Alert No. 10, noting that "observations from the PCAOB's oversight activities continue to raise concerns about whether auditors consistently and diligently apply professional skepticism" (PCAOB 2012, p. 1).[5]

Firms acknowledge that there are substantive impediments to the application of skepticism (e.g., client relationships, budget and time pressures) and thus, have implemented standardized firm-wide rules and procedures meant to temper these threats (e.g., formal training, decision aids, work-paper review; see also Nelson 2009). Firms assume that their employees function according to the established blueprint (e.g., rules and procedures are followed, actual activities conform to the prescriptions), however organizational behavior research cast doubt on whether a firm's blueprint is actually effective (Meyer and Rowan 1977).

Two papers present models of PS that can be used both to understand and improve PS (Nelson 2009; Hurtt et al. 2013). Nelson (2009) models determinants of PS in auditor performance, suggesting that, despite the precautions firms take, there are personal (auditor

[5] The PCAOB (2012 1) states "when auditors do not appropriately apply professional skepticism, they may not obtain sufficient appropriate evidence to support their opinions." Observations from PCAOB (2010) inspections indicate that 15 percent of inspected audit engagements had failed to obtain sufficient appropriate audit evidence to support its audit opinion on the effectiveness of internal control (13 percent, financial statements). Additionally, between 1998 and 2011, the SEC documented 85 cases of fraud involving the auditor and in 69 percent of these cases; the auditor was cited for a lack of PS (Nickell 2014).

knowledge, traits and incentives) and task (audit evidence) characteristics that may influence auditor skepticism. Examples of personal characteristics include a lack of intelligence, self-confidence or specialization on the part of the auditor while task characteristics include pressure to stay within the engagement's time budget and a desire to avoid displeasing the client (e.g., Robertson 2010). Building on Nelson's (2009) model, Hurtt et al. (2013) suggest that additional characteristics (auditor, evidential, client, and the external environment) influence the auditor's ability to exercise skeptical judgment and skeptical action. For example, if firms only recognize and punish auditors when there are egregious failures in maintaining PS and fail to reward auditors when they excel at PS, then an audit culture may develop that promotes having sufficient PS to avoid getting punished. For example, firms may emphasize commercialism over professionalism (Gendron 2001; 2002) which could result in a potential impairment of auditor independence (Bazerman, Moore, Tetlock, and Tanlu 2006).

In reference to external environmental characteristics, Hurtt et al. (2013) allude to the importance of individual auditor, team and firm accountabilities as a means to influence skeptical behaviors. For example, they state "Although conceptually this should be a rich research area, we found only a limited number of recent papers dealing with these [accountability] issues" (Hurtt et al. 2013 61). While prior research has widely investigated the general importance of accountability in auditing (e.g., Gibbins and Newton 1994; DeZoort et al. 2006; Bagely 2010; Peecher et al. 2013), there has been minimal prior research that directly links how accountability pressures affect PS.

Accountability

Accountability refers to "the implicit or explicit expectation that one *may be* called to justify one's beliefs, feelings and actions to others" (Lerner and Tetlock 1999 255). Sources of accountability (e.g., work-paper review, regulatory inspection) represent powerful incentives to motivate auditor skepticism. However, as noted by Hurtt et al. (2013), research in this area is limited. Gibbins and Newton (1994) describe four components of an accountability relationship: (1) the source; (2) the accountable person; (3) the accountability relationship; and (4) the accountable person's response. In this study, we focus on the source of accountability and the issues that auditors encounter as they confront multiple sources of accountability i.e., sources may not agree in their preferences. More recently, Peecher et al. (2013) propose an accountability framework for financial statement auditors aligned on two dimensions: rewards versus penalties and process versus outcome triggered accountabilities. Peecher et al.'s (2013) framework suggests that accountability may affect PS dependent on whether a firm or a regulator rewards or penalizes it and whether PS is evaluated by the process a firm or an auditor employs or on the outcome that results in a particular case.

Defining Sources of Accountability

In practice, auditors are accountable to multiple parties including superiors within the firm, clients, and regulators (Gibbins and Newton 1994; Bagley 2010). In this section, we discuss sources of accountability that prior literature suggests may influence PS (Nelson 2009; Hurtt et al. 2013). Specifically, we examine three sources of firm-level accountability (threat of PCAOB inspection, risk of litigation, and client importance), and three sources of team-level (work-paper review, time/budget pressures) and individual-level accountability (formal evaluation).[6]

[6] We acknowledge that some of these sources may represent accountability at more than one level e.g., budget pressure represents both individual and team accountability.

Firm accountability generally occurs through the PCAOB inspection process, potential litigation exposure, and client oversight mechanisms. The first two of sources of accountability have a relatively direct and predictable effect on skepticism—they can enhance skepticism by increasing the cost of a lack of skepticism (Nelson 2009). For example, specific to the PCAOB inspection process, firms are held accountable for the quality of their audit with respect to Auditing Standards. For those audits selected for review and found to be deficient, firms are penalized by way of publicly available inspection comments.[7] Further, Daugherty, Dickens, and Tervo (2011) examined triennially inspected firms (i.e., registered audit firms with less than 100 SEC registrant clients) and report evidence linking Board-issued deficiency reports with subsequent dismissal by clients. Therefore, individual auditors, teams, or firms may potentially seek a strategy of achieving some minimum level of acceptable performance to avoid regulator-imposed penalties (i.e., the goal becomes providing the minimum level of quality that will result in a "clean" PCAOB inspection report).

However, other types of accountability may lead to more equivocal results. For example individual audit team members may be responsible for client oversight and maintaining healthy client relationships—this is especially the case for significant clients. This accountability can result in enhanced skepticism if, for example, the audit team views its role as 'keeping the client out of trouble with the SEC' (Wyatt 2004). However, it could also lead to reduced skepticism if maintaining a healthy auditor-client relationship is more focused on, for example, helping the client achieve its financial reporting objectives within the constraints and boundaries of GAAP

[7] In accordance with SOX Title I, Section 105(g), inspection reports publicly present the findings of the Board's investigation. The report is segmented into two parts, A and B, of which we refer to Part A. Part A provides findings with respect to specific engagements that are examined in the inspection and is published upon completion of the inspection.

(Hurtt et al. 2013) or if the firm has a more "commercialism" driven perspective (Gendron 2002, 2001).[8]

Moving from firm-level accountability, individual auditors are also held accountable for their own work within the boundaries of their assigned audit team; they are routinely assigned to multiple client engagements, and on each client engagement, an individual is accountable for his/her work to a superior by way of detailed work-paper review (Bagley 2010; Carpenter and Reimers 2013) and adherence to established time budgets (Asare, Trompeter and Wright 2000). An individual's performance is subsequently documented by the firm, serving as the basis of promotion and compensation adjustments determined in the annual evaluation process.

Following the discussion above, and given the limited evidence on the manner in which PS is viewed in practice, our primary investigation is informed by our second research question:

> RQ2: What role do firm, team, and individual accountability mechanisms play in promoting or inhibiting PS?

METHOD

To examine our research questions, we administer an on-line, in-depth quantitative and qualitative survey that is supplemented by six interviews to current and former auditors with varying degrees of experience.

Survey Participants

We gained access to individual auditors though personal contacts (Power and Gendron 2013) and through snowball procedures from those contacts (e.g., Tremblay and Gendron 2011, Trotman and Trotman 2014). Non-response to requests is unknown as all participants are

[8] Gendron (2001) found in a study of client acceptance decisions, that firms appear to focus more on profitability while others focus more on risk containment. Gendron (2001) referred to this as the trade-off between professionalism and commercialism.

anonymous and cannot be determined through demographic data acquired. As an incentive to take part in the study, participants were offered a $20 donation to one of five selected charities.

Our final sample of 77 survey respondents[9] comprise 65 current auditors, with a mean (median) of 9.52 (7.0) years of experience, and 12 former auditors, with a mean (median) of 6.71 (7.0) years of experience. Thirty-eight percent of our respondents have experience with Big 4 firms, 49 percent have experience with other multinational public accounting firms (e.g., Grant Thornton, BDO), and 13 percent have experience with regional/local firms. The participants represent a range of industry specializations (e.g., technology, manufacturing, financial services) having both public and private company audit experience. Seventy-two percent of our sample has recent public company audit experience.[10]

We solicit the perspectives of auditors across levels for three reasons. First, due to their position within the firm, partners/directors, have the most high-level perspective (i.e., performing the overall review of audit in order to issue and audit report), on factors affecting PS (Westermann, Bedard, and Earley 2014). Second, managers and seniors have the most detailed perspective on factors affecting PS as they are directly performing critical judgments and/or reviewing detailed audit procedures in the field (Westermann et al. 2014). Third, staff auditors play a different role on the team. Frequently, they are the individuals who directly observe

[9] Our total sample consisted of 83 responses. We removed four respondents who indicated less than 1 year of audit experience and two respondents did not complete the survey in full. Adding these six respondents back in does not substantively change the results of the survey.

[10] We asked participants "What percentage of your recent (last 5 years) audit experience relates to public company clients?" Twenty-three percent indicated they had no recent public company experience and 4 percent did not respond. Of the 72 percent who indicated they had recent experience working on public companies, the average percentage of time spent working on public companies is 48 percent (range 1 percent to 100 percent).

source documents, interact with client personnel and provide initial documentation of potential audit issues (Abdolmohammadi 1999).[11]

Interview Participants

As part of our survey questionnaire, we asked if respondents would be willing to participate in a one-hour follow-up interview related to professional skepticism.[12] We subsequently interview six participants with varying degrees of experience and firm affiliation.[13]

Survey Development

We derived our questions based on prior literature (Nelson 2009; Hurtt 2010; Hurtt et al. 2013; Peecher et al. 2013) as well as insights from one audit manager and one audit partner. We then pilot tested the instrument with eight accounting PhD students, all with professional public accounting audit experience. We refined the instrument for completeness and clarity based on the pilot test responses and feedback. The final version of the instrument consists of 15 scaled and open-ended questions (and sub-questions) about specific factors that are perceived to enhance or hinder professional skepticism in practice. Appendix A presents our survey instrument.

Survey Data Collection and Analysis

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[11] For each quote, we provide the affiliated firm type (Big 4, Other-Multi-National, Regional, Local), and rank (e.g., staff, senior, manager). All references denote current audit practitioners unless specifically denoted as a former audit practitioner. All references denote responses from the completed on-line survey, unless specifically denoted as an interview participant.

[12] Fourteen participants provided their contact information. Of those contacted, six responded affirmatively to be interviewed.

[13] Our interviewees consist of: (1) Big 4 retired national practice partner with 37 years public company experience; (2) other-multi-national office managing partner with 38 years public and private company experience; (3) regional practice partner with 30 years private company experience; (4) regional senior manager with 12 years private company experience; (5) Big 4 senior manager with 15 years public company experience; and (6) Big 4 practice partner with 38 years public company experience.

We administered the survey on-line. On average, participants took approximately 30 minutes to complete materials provided. For each scaled item, we calculated varying disaggregated descriptive statistics. To develop the coding scheme for our open-ended survey questions, two researchers independently developed categorizations of responses for each question. They subsequently compared and refined categories. After agreeing on categories, two researchers independently coded each question, with an 88 percent inter-coder agreement. The remaining disagreements were resolved by a third, independent researcher. To select the quotes included in the paper, each researcher identified quotations based on the representativeness and/or poignancy of the comment. The selected quotes were then reviewed and approved by the research team. We provide analysis below based on overall auditor perceptions. However, we also highlight where meaningful differences occur i.e., by level (rank within the firm), firm size/type (Big 4, other multinational, regional/local), and/or public client experience.

Interview Questionnaire Development

We developed our interview instrument based on the results of our survey responses. We designed our questions to inquire about inconsistencies in our findings as well as findings the authors deemed "interesting" and worthy of further inquiry. Our instrument consists of ten semi-structured interview questions (with some questions containing multiple parts) about professional skepticism in practice. Please see Appendix B for a copy of our interview instrument.

Interviews and Data Analysis

Interviews were conducted in 2014, taking between one and two hours in length. We conducted three interviews by phone and three interviews in person. All interviewees gave consent to be recorded by the interviewers. The interviewees provided client-specific and personal examples that were both positive and negative in nature, which strongly suggests that their responses were candid. Two research assistants converted the recordings into text. During the data consolidation process, we reviewed transcripts for accuracy, noting only minor errors in accounting/auditing terminology.

Each author independently reviewed each transcript for meaningful insights e.g., explanations of inconsistencies, firm nuances useful for explaining differences. To select the quotes included in the paper, each author identified comments that provide clarity and/or are particularly poignant. The selected quotes were then reviewed and approved by the other authors.

RESULTS

We present the results beginning with how participants perceive the construct of "professional skepticism" (RQ1). We then examine how firm, team, and individual sources of accountability are perceived to promote or inhibit skepticism (RQ2). The various sources of accountability we address may be recursive, rather than sequential, in the chronology of the audit process. For example, although the PCAOB inspection occurs subsequent to audit finalization, it may serve as an incentive during work performance.

Perceptions of "professional skepticism" as a construct

Our data suggests that, absent any contextual cues, much like academics, auditors have mixed views of the PS construct (view of either neutrality or presumptive doubt). Consistent with dimensions proposed by Hurtt (2010) (e.g., a questioning mind, a search for knowledge), approximately half of our respondents provided statements that reflect a more neutral view:

“Professional skepticism is the willingness to ask challenging questions and to be objective in coming to your own conclusions based on facts.” (Big 4 Partner)

“Looking at areas with a critical eye, not distrustful of management but professionally objective.” (Big 4 Sr. Manager)

“State of mind that auditor should have when reviewing evidence provided by client. Not to assume that the evidence is either right or wrong, rather gather evidence and make conclusion.” (Other-Multi National Manager)

In contrast, half of our respondents provided statements that reflect a presumptive doubt view: [14]

“Not assuming that management's assertions are correct without corroborating; maintaining your ‘eyes and ears’ open and think critically about the information presented” (Other Multi-National Senior).

“Professional skepticism is a questioning state of mind during the course of an audit. Clients' answers to inquiries should not be taken at face value but rather should be considered *in light of their motivations*.” (Former Big 4 Senior)

“I define [PS] as a culture within the audit process. Professional skepticism, to me, is a thread of consciousness that's developed in our audit group here - that starts with an approach of a ‘jaundice eye’ - that effectively no one is your friend, although they try to be. And with the understanding that every thread starts with “what could go wrong.” “What could go wrong” is a very powerful discussion thread that we bring from our SAS 99, planning meetings all the way through sign-off.” (Interview, Other Multi-National Partner)

One interviewee suggests that PS requires balance, as there may be a fine line between being reasonable (e.g., appropriately questioning the client) and being excessive (e.g., too critical of the client) stating, “You could have someone who is very skeptical and questions everything and just drives the client up the wall” (Interview, Big 4 Senior Manager).

Overall, our data suggests lack of a uniform conceptualization of skepticism. Such lack of uniformity may contribute to the gap, as noted in the PCAOB’s inspection reports, between the level of skepticism delivered by the firms and the PCAOB’s expectations. As such, it may be the

[14] Two participants provided responses that did not represent either a Presumptive Doubt or Neutral position, and one participant left the response blank. There are no significant differences between the number of auditors who view PS as Neutral or Presumptive Doubt by rank, status, gender, or firm-type.

case that PS may be better characterized as a *continuum* ranging from neutral (even handed evaluation of evidence) to presumptive doubt (assume that the client is lying). Under this characterization, it is possible that individual traits (e.g., personality traits leaning towards or away from heightened PS) or contextual factors (e.g., client risk or regulatory oversight risk) will dictate one's location on the continuum for a specific audit engagement or even a specific decision within an engagement.

Given that a respondent's conceptualization of professional skepticism may be colored by their current experiences, we probed respondent's to identify what "optimal" skepticism may look like. The interviewees had varying responses to this question, some reflecting a more rigid view of the skeptical auditor: "[optimal skepticism] would be that [the auditor] did not believe anything in the inquiry process" (Interview, Other Multi-National Office Managing Partner). Others holding a more pragmatic view of perfect skepticism: "optimally skeptical is knowing the right question to ask and how hard to push with your clients" (Interview, Big 4 Senior Manager).

Regardless of his/her opinion on optimal skepticism, interviewees unanimously agreed that auditors simply cannot attain "perfect" skepticism. One partner matter-of-factly states:

> "Optimum level of skepticism is a level that is never 100 percent because, if you say optimum is where you're skeptical of everything then never you do, [then] you would never finish an audit. You'd actually, literally, have to be there [to audit] every transaction, so to speak. So I think you have to accept in a system, god I hate to use the words 'cost justified', but there is a cost benefit that plays into this at some point in time. You cannot audit everything - every transaction of every company, every year, every day - the system has to accept some amount of error rate. You can argue [that] people have different views - it's whether or not the PCAOB is pushing for an error rate level that is unattainable… even in the best of circumstances" (Interview, Retired Big 4 Partner).

This quote illustrates the reality that there is a cost to doing more work that some auditors associate with optimal skepticism; either firms accept lower realization rates (profit margins) or clients pay more for audit services. How much error is the PCAOB willing to accept as reasonable? How far can the PCAOB push for requiring more audit procedures? How much are clients willing to pay for a more thorough audit? Ultimately someone has to pay the bill.

Even if auditors achieved some perfect level of skepticism, interviewees unanimously agreed that *financial statement misstatements would still occur*. However, the rationale supporting this sentiment varies: (1) audit procedures are based on a subjective sample within a fixed, contextually driven, period of time, "sometimes even if you are skeptical, you can only do what you can do with the information you have at the time… and in the environment (the context) in which that information exists" (Interview, Retired Big 4 Partner); (2) clients are more familiar with their own company relative to the auditor, "people that run companies are there 365 days a year 24/7. They are also totally aware of the limitations of their systems, how to record things. They have an enormous amount of time to sit and think about what they're trying to accomplish and how they are trying to accomplish it." (Interview, Regional Partner); and (3) while technology has made the audit process more efficient, technology generates so much sophisticated data, that it is often difficult to see the forest through the trees.

Sources of Accountability

In the following analyses, we combine a discussion of quantitative (survey) and qualitative (survey and interviews) findings for each source of accountability. For each scaled item, we calculated various disaggregated descriptive statistics. Table 1 shows overall descriptive statistics delineated by level (i.e., staff, senior, manager, partner). Table 2 shows descriptive statistics delineated by client experience (public/no public experience) and by level. Table 3 shows descriptive statistics delineated by firm type (i.e., Big 4, other-multi national, regional/local) and by level.

[Insert Table 1 about Here]

[Insert Table 2 about Here]

[Insert Table 3 about Here]

We first report results for three sources of firm-level accountability: threat of PCAOB inspection, risk of litigation and client importance. While these sources of accountability can affect various individual members of the team differently, each can be linked to a shared responsibility for the entire team. Subsequently, we discuss the relationship among individual and team sources of accountability and the interconnected effects on skepticism: time and budget constraints, work-paper review, and annual formal evaluations.

PCAOB Inspection Process

> "PCAOB inspection is as welcome as root canal and less satisfying."
> (Big 4 Partner)

> "You know when you look in your rearview mirror and you see the flashing police lights… that's the feeling. You are left waiting in anticipation, wondering what you're being pulled over for. The hardest part is that waiting for what is to come, and you know cops never pull you over just to thank you for going the speed limit."
> (Big 4 Partner)

In their discussion of the auditor's penalty (loss) – reward (gain) function, Peecher et al. (2013) indicate that, for audit clients that are SEC registrants, this function is asymmetric. Specifically, regulators may penalize auditors for negligent or reckless audits while they do not reward them for good audits. In cases where an auditor's work does not achieve some minimum threshold of audit performance/quality (e.g., exercise insufficient PS), the regulator may issue varying degrees of penalties (e.g., public inspection comment, monetary fine, loss of licensure). In contrast, for auditors who *do* meet some threshold of audit performance/quality, the regulator does *not* reward the behavior or publicize the good performance (e.g., there is a flat reward function shape). Thus, this creates incentives to be skeptical to the extent that one avoids penalties but perhaps little or no incentive to exhibit more PS than is necessary to achieve that objective.

Results reported in Table 2 (restricted to auditors with public client experience) suggest that regardless of one's position in the firm, the threat of a PCAOB inspection enhances skepticism.[15] Understandably, the threat of PCAOB inspection would enhance skepticism on the part of managers and partners, as interviewees indicate they are responsible for engaging directly with the inspection team. Partners are held accountable for poor inspection outcomes[16] in the form of tangible penalties (e.g., poor quality evaluation/rating, loss of existing partner units/shares, reputational damage; retired Big 4 partner), and managers (senior managers) may be affected by negative inspection findings, because such negative outcomes can delay or derail one's progress towards partner. Perhaps less obviously, staff and seniors are also likely to feel indirect penalties (e.g., reputational damage) of a poor PCAOB inspection related to his/her own work. It is noteworthy that among the firms—and across all ranks within the firms—there is a persistent, pervasive "buzz" about the possibility and importance of a PCAOB inspection:[17]

> "When I started my career in 2001, everyone talked about what something would look like if they were 'on the stand' in court. Now everyone talks about 'what they would say in a PCAOB inspection.'" (Big 4 Manager)

[15] Untabulated results indicate no significant difference based on rank.

[16] One partner describes the risk of a poor PCAOB inspection as "regulatory risk," which at least one firm now considers as part of their overall risk portfolio.

[17] A small minority of respondents indicate that external forces should have no effect on PS: "The procedures should be applied the same for every audit. PCAOB inspection is just a process to make sure the firm processes are in order and consistently applied" (Other Multi-National Senior).

> "Knowing the audit may be selected for review boosts the quality of all aspects of the audit. It encourages the team to ask questions and go the extra mile." (Other Multi-National Staff)

> "The team would be more alert and focused on identifying areas to audit to avoid any poor reporting by PCAOB." (Other Multi-National Manager)

The likelihood of PCAOB inspection generally leads teams to focus on ensuring defendable documentation i.e., crossing all t's and dotting all i's:

> "Once it is known that you are up for review, we apply a ton of skepticism to our own work to ensure nothing is missed. That said, I would say that many of the procedures remain the same, the documentation is just more robust." (Big 4 Manager)

> "Naturally, for those clients susceptible to inspection, an auditor may be more aware of what is written in the work-papers, as he/she may need to defend the documentation if ever questioned. Ideally, this should be true for all clients, but I think is prevalent for those susceptible to inspection." (Other Multi-National Staff)

> "[The PCAOB] just forces people to think more about what they are doing. By default it makes you more skeptical, but it's more that the PCAOB has driven the level of work and the detail you go into – it has just driven the audit to a higher quality now compared to 5 years ago." (Former Big 4 Senior Manager)

The focus on documentation-driven accountability may be viewed as beneficial to ensuring consistency as well as high audit quality. This impression is consistent with the evolution of the PCAOB and requirements of Auditing Standards (e.g., AS No. 3 Audit Documentation). However, others view documentation-driven accountability as hindering auditor skepticism. The following managers' quotes strongly support the contention that the PCAOB inspection process is, in large part, responsible for hampering auditors from practicing professional skepticism *because of* the focus on documentation:

> "The PCAOB's rules and inspection process are the reason firms have created a plethora of mind-numbing checklists and documentation requirements that quash critical thinking and incentivize auditors only to make it look like professional skepticism was practiced through fulfillment of these requirements. In actuality, completion of these procedures leaves no time or motivation to practice professional skepticism." (Former Big 4 Manager)

> "I think that when there is a threat of the PCAOB inspection, we tend to focus on 'what to do to make the inspectors happy.' We don't always focus on areas where we 'feel' there may be more risk. We focus more on work-paper documentation and less on auditing in a skeptical manner." (Other Multi-National Manager)

As suggested by one interviewee, the PCAOB inspection may have enhanced PS but does so in a costly manner: "It has enhanced it because it is such a ridiculous process" (Interview, Other Multi-National Partner). In essence, the PCAOB inspection process is essentially an "audit of the auditor"; firms are subject to the same scrutiny that is imposed upon clients (Interview, Big4 Partner) While audit firms may criticize formal oversight (as opposed to continued self-regulation), the perceptions of the majority of the respondents indicate that auditors, in general, reflect the view of standard setters, that accountability to a regulator encourages greater PS. As the above quotes suggest, there exists a renewed focus on audit firm documentation to meet guidelines set forth by the PCAOB; established to help ensure audit completeness and quality. However, there also exists an important concern that the documentation may fulfill the form rather than the substance of PS. In essence, constraining auditors within the "documentation box" may cause the auditor to lose crucial perspective necessary for effective skepticism:

> "less documentation equals more critical thinking." (Interview, Other Multi-National Partner)

> "[Big 4 Firm] has instituted so many documentation requirements / proscribed procedures / 'chief auditors' who dictate [Firm] audit policy and are completely removed from client relations / have little to no incentive to do anything but to advise you to follow the 'safest' a.k.a. most time consuming / laborious approaches - it has unfortunately taken a lot of professional judgment out of the practice, at least in my mind. So much of what I do as an auditor these days feels like 'check the box' exercises that have left me feeling stagnated, frustrated, and without the time in my day to focus on the aspects of my job I like i.e. client relations, coaching, performing thoughtful analytical procedures, etc." (Big 4 Senior)

In sum, when the threat of PCAOB inspection is likely, auditors have heightened awareness of regulatory authority and perceive a strong level of both individual and team accountability. However, it appears as though the PCAOB inspection process yields mixed results with respect to PS, and that this may have mixed effects on audit quality. On the one hand, PCAOB inspections serve to heighten PS and have improved audits – the firms just don't like the extra required work and scrutiny it takes to actually get there. On the other hand, the perception that inspectors focus on "documentation-as-proof-of-performance" appears to have a negative effect on audit quality because auditors become more focused on ensuring adequate documentation rather than on skeptical auditing.

To the extent that documentation results in higher audit quality, it should be a focus of the inspection. Regulators must avoid focusing on form as opposed to substance (Cohen et al. 2008). The PCAOB may consider inducing a positive accountability atmosphere by highlighting process accountability (i.e., based on the documentation provided in the work papers, did the auditor make an appropriate decision, given the information available?) and not just outcome accountability as is currently the case (Peecher et al. 2013). Thus, the PCAOB inspection could take the form of highlighting what firms are doing correctly and not just pointing out where firms are deficient. The data also suggests that, at least in some cases, for some auditors, it is the goal of documentation (form)—not providing a high quality audit (substance)—that has become the overriding target to shoot for. To combat this tendency, firms may consider placing greater emphasis on critical thinking both in training and on-the-job. Firms may then evaluate an individual's critical thinking via observation as part of the formal evaluation process e.g., observe and evaluate auditors on-the-job to discern what they are thinking about and why/how they are thinking about it which gives the reviewer greater (or lesser) confidence in an individual auditors work and conclusions.

Litigation Risk

Threat of litigation has been, is, and will remain a constant in the landscape of auditing (e.g., audit firms are perceived to have “deep pockets”; Lennox 1999, Khurana and Raman 2004). As such, we examine whether and to what extent litigation-induced accountability might lead to increased skepticism. The costs associated with litigation can be substantial--as summarized by one respondent, the costs of unfavorable litigation outcomes include: “[financial] losses from unfavorable verdict; loss of [CPA] license to practice; imprisonment; and/or operational losses (loss of clients due to negative effect on credibility)” (Big 4 Manager).

The quantitative results in Table 1 suggest that the majority of respondents perceive litigation risk to result in heightened skepticism. However, the qualitative responses suggest that respondent perceive that litigation provokes *less* awareness, relative to PCAOB inspection awareness:

> “The thought of litigation risk is not generally in the forefront of the minds of our engagement team unless it is a highly sensitive and risky client. In that case, I think [litigation risk] would greatly increase professional skepticism, but in general I do not think [litigation risk] would have much of an effect.” (Other Multi-National Senior)

> “I don't think most staff and senior-level auditors are affected much by the threat of potential future litigation. At least among my peers in the firm, litigation risk was something that the firm and the partners (and to some extent the managers) needed to worry about. The primary concern among the bottom ranks is simply doing enough work to get the work-paper past the next level of review.” (Former Big 4 Manager)

These responses suggest that individuals are not as motivated to the same degree by the threat of litigation as they are [motivated] by a likely PCAOB review. One former senior suggests that this distinction occurs because “the threat of litigation seems more remote, that its effects are not as wide reaching [as a PCAOB inspection]” (Former Big 4 Senior). Here, the senior is conveying the idea that (threat of) litigation against the auditor may lack salience, and thus may not necessarily produce a strong sense of individual accountability. In other words, the outcome(s) of litigation is generally attributed to failure of the firm as a whole, rather than attributed to failure of an individual. In contrast, our respondents imply that PCAOB inspections are viewed as more salient as evidenced by the following quote:

> "…litigation and being called into court happens pretty rarely. Just based on me being in public accounting for 15 years, I never got deposed or had an engagement called up for litigation, so you hear about it. But you never really experience it or its rare you experience it. And the folks who experience it are the manager and the partner but for PCAOB review - everybody has a chance of being picked and you hear about your friends being picked and they're sitting in the conference room for two to three weeks pawing through workpapers and the manager is calling the associate asking why did we do this and PCAOB is asking for this so we have to pull this. It's more tangible - the PCAOB review than the theoretical 'if something goes wrong we may end up in court.'" (Interview, Big 4 Senior Manager)

Auditors may perceive that if audit documentation passes a PCAOB inspection (trained accounting professionals), then it will likely pass the scrutiny of litigators. However, courts may take a more expansive view of audit quality than mere documentation and/or juries consisting of non-accounting trained individuals may lead to unpredictable outcomes. In sum, litigation risk is still a threat that, although not perceived as imminent, is still a factor that auditors must take in to consideration when conducting an audit.

Client Importance

Given that clients pay auditors' fees and that this could potentially impair their independence (Bazerman et al. 2006), we examine the potential influence of client importance as an accountability mechanism on PS. Overall, quantitative responses indicate that "client importance" is perceived to have no effect on PS. However when bifurcated by either public client experience (Table 2) or firm type (Table 3), the data suggests that auditors with no public company experience and those auditors at smaller firms do find client importance a threat to PS. Qualitative results also suggest that client importance affects PS. For example, some auditors may exhibit less skepticism on important clients because they are driven to "keep the client happy":[18]

> "Most cases where professional skepticism has been ignored are due to the importance of the client to the firm. It comes down to the structure of how this business is done. A client that accounts for 30% of your office's revenues is more likely to get by with questionable activities than one that is 1% of revenues." (Other Multi-National Manager)

> "Concern for 'keeping the client' may disincentivize exercising professional skepticism out of fear that making the client feel distrusted or judged may strain your relationship and potentially lead to losing the client." (Big 4 Senior)

In contrast to our quantitative findings, higher profile clients may represent higher engagement risk, thus, the need for enhanced scrutiny (e.g., exhibit *more* skepticism) as noted by several auditors:

> "My experience is the bigger the client is, the riskier and auditors tend to be more skeptical due to bigger risk." (Former Big 4 Senior)

> "Certain clients bring in more money, and are higher profile, these clients definitely have more resources available to audit various areas. The partners on these clients don't want a PCAOB review or an audit to go wrong, and are willing to allocate the time and resources to make sure every number and assumption checks out okay. Professional skepticism is more likely to not be considered as well on smaller teams due to limited resources." (Big 4 Staff)

The qualitative responses above highlight several reasons as to why client importance may actually *improve* auditor skepticism, particularly for larger audit firms: (1) larger firms have greater resources and may choose to allocate more or higher quality staff to noteworthy clients; (2) larger clients may be charged a higher audit fee, and in turn, the audit firm allocates higher budgeted hours; (3) certain types of these larger clients may have a higher likelihood of being

[18] In the following quotations, different participants used different language to denote the importance of a client to the firm. Taken in context, terms such as: important; high profile; high audit fees and noteworthy are all used by various respondents to indicate client importance.

selected for PCAOB review; and (4) no partner wants to risk problems with a prominent client because of negative comments from the PCAOB.

It is clear that the idea of client importance leads to many competing motivations (e.g., retaining fees and keeping the client happy versus effective auditing), some of which hinder skepticism and others that enhance auditor skepticism. This finding may be noted by researchers who are trying to better understand the effect of client importance on auditor judgment and decision making. The mixed effects of client importance suggest a more nuanced perspective than either "auditors will do whatever it takes to keep clients happy" or "risk is so important that auditors would never endanger their reputation by kowtowing to a client—no matter how important."

Time and Cost Budget

One of the most prominent factors documented by prior research that affects audit quality are time and cost pressures (e.g., McDaniel 1990; Knechel et al. 2013). Our data suggests that the more experienced the auditor, the less time pressure is perceived to negatively affect auditor skepticism. Data in Table 1 suggests that relative to more experienced auditors (i.e., partners and managers), seniors and staff more strongly believe that time pressure hinders skepticism as evidenced by the following quotes:[19]

> "Ultimately the more senior staff wants all the work done as fast as possible. As bad as it sounds, if you tell the senior 'I spent more 3 more hours being skeptical about [a specific audit area]' they're probably going to be unhappy. So if you are going to be skeptical and really examine something, you better have good reason." (Big 4 Staff)

> "If you don't have the time or the budget to gather more evidence then [follow-up] is disregarded." (Big 4 Staff)

[19] This difference in perceptions is also confirmed by comparing the sum of partner and manager responses to the sum of senior and staff responses, reveals a marginally significant difference in perceptions (p = .10 two-tailed).

One reason that staff and seniors, and to a lesser extent managers, believe that the budget "is king" is that the partner may, directly or indirectly, communicate that message.

> "…the message that they [the partners] are supposed to promote is that the most important thing is to get the job done right—and it is the most important thing. But if it isn't done right *and within budget* then the senior manager gets a lashing behind closed doors, and then the senior manager flows it down to the manager, and then there is pushing on the staff to meet the budget." (Emphasis added) (Former Big 4 Senior Manager)

Thus, the partner must be able to effectively deal with this tension. While realization rates (profitability) are heavily weighted in the partner evaluation process, partners bear the burden of work being done correctly—else factors such as litigation and PCAOB inspection could result in negative consequences. This nuanced conflict leads to an interesting juxtaposition. To the lower ranked members of the engagement team, the partner sets the tone for engagement profitability. Yet the partners themselves claim to perceive the budget as merely a *guideline*: "I used to have a thing on the audit that I would call 'a moment of silence' - everyone [on the team] would say, 'well what is that for?' 'Well, we just passed the budget but we are not finished. Let's pause, now let's get the job done.'" (Interview, Retired Big 4 Partner).

While time pressure is viewed as a key factor at all types of firms, it appears to be less concrete for private clients, perhaps because the deadline pressures can be more flexible:

> "in larger firms that have SEC deadlines that are brick wall, there are real ramifications if you run through an SEC deadline … if one of our clients runs through a bank deadline you can pick up the phone and call your bank and tell them that you're not going to deliver this [report] for another thirty days, and that's all there is to it" (Interview, Regional Partner).

Other comments suggest that taking the time for further investigation is only characterized as appropriate, if something is "found": "If you spend too much time on an area that you think could have an issue and then does not [have an issue] you can get reprimanded for blowing the budget." (Other Multi-National Manager). One former practitioner bluntly recollects his/her personal experience about the disincentives time budget pressure represents:

> "I clearly remember an instance where I was finishing up testing a sample late on a Friday night. The very last invoice I checked was missing a signature, which meant I was supposed to pull 30 additional items to test. The work had to be completed that night, and the additional work probably meant another several hours of work on what was already a very late night. Checking the box saying that the signature was there would have been incredibly easy and would have been virtually guaranteed not to be caught; and nearly every incentive was working against making the right choice of being professional skeptical by pulling the new sample. Here are just a few of those incentives: (1) I certainly didn't feel like doing the additional work; (2) doing the additional work would blow the budget in this area, which makes me look bad and often results in an upset manager and partner; (3) my engagement team is hoping for an award on this engagement, which is contingent on us meeting the budget, so they probably won't be very happy with me either; and (4) the client is getting billed by the hour, not to mention that the accounting clerk helping me can't go home either until I'm done, so they're not happy either. And what incentives were there for me to make the right choice? Basically just the warm, fuzzy feeling of doing what's right. With all of this working against you, how likely do you think auditors are to make the tough calls when they need to?" (Former Big 4 Manager)

One interviewee suggests that a viable way to combat the negative effects of time and budget pressure is to "kill the billable hour." "I think [something that] would change the accounting profession for the good is a death of a billable hour, kill it, dead…Forget your timesheet let's just get this thing done." This quote suggests that if auditors were evaluated more by effectiveness than by a focus on what could be charged out, then PS could potentially be enhanced.

Overall, the results on time and cost pressures suggest that at times PS can suffer because it could lead auditors to have incentives to get the job done perhaps at the expense of collecting evidence that may be needed. This is in line with Peecher et al. (2013, 6) who argue that, "once auditors meet the minimum threshold, their reward function shape is flat, giving them little incentive to substantially improve audit quality." These findings suggest several alternatives that firms may consider. First, firms may consider altering the reward system to better reward staff for spending more time on doing an audit when additional time is appropriate as opposed to the more traditional focus on rewarding efficiency. Second, it would seem advantageous for firms to continue efforts to spread out audits and do more continuous audits to avoid time crunches. This may allow time for reflection, greater PS and higher quality audits. Third, firms may consider restructuring the current system of required billable hours.

Work-paper Review (WPR)

The majority of participants believe that the detailed work-paper review (WPR) process strongly enhances skepticism through means of personal accountability to a supervisor. As expressed by one senior manager, “detail review keeps a preparer on ‘his toes’ and has a strong effect on professional skepticism. The fact that my work will be reviewed and questioned will make me question management’s assumptions” (Other Multi-National Sr. Manager). Specifically, participants believe that WPR is a valuable process that provides a “fresh perspective” from a more experienced auditor (i.e., supervisor) and typically results in necessary follow-up procedures for less experienced auditors: “Someone not involved in the direct discussion about the explanation is less likely to be swayed by fast talk of a client trying to get a staff out of his/her office” (Other Multi-National Senior).

Skepticism during WPR involves asking questions about what is expected and asking questions beyond what you see. One auditor notes the importance of thinking about what should have been seen: “To me, the reviewer has to take the next step and say, yes [the account balances are similar to last year], but *should* it have been similar to last year? *Should* it look this way? Why should it have been close? or Why should it have been different? Were the circumstances the same? How do you know it's reasonable?" (Interview, Retired Big4 Partner)

Some respondents indicate that skepticism applied during WPR will differ by level, indicating that partners and managers will be more focused on subjective areas of the audit, while staff and seniors will pay more attention to detail and process rather than the big picture:

> “Audit professionals with varying levels of experience will have a different vantage point and may be able to apply professional skepticism in different ways…one's frame of reference can dictate how they apply professional skepticism.” (Big 4 Senior Manager)

Our results reinforce the argument by Hurtt et al. (2013) that reviewers can act as a powerful force to promote PS. One former audit senior summarizes the benefits of detailed WPR:

> “Timely and effective review of work papers by experienced members of an audit team: (1) ensures all issues were identified and adequately addressed; (2) provides development of team members technically and professionally; (3) audit risk (i.e., risk that an audit opinion is wrong) is minimized; and (4) the audit engagement is carried out efficiently.” (Former Big 4 Senior)

A statement by one former Big 4 senior, suggests that WPR may have been the only quality mechanism for which he/she was concerned:

> “I've thought a lot about this over the years, and my own personal opinion is that this is one of the key areas influencing how a staff perceives professional skepticism. As a staff, and later as a senior, my primary goal in completing a work paper for a specific area was to make sure it could get past the manager and/or partner review process. I'd like to say I was motivated more by some deep-seeded professional skepticism and fiduciary duty, but the impending review process was usually the only hurdle we were concerned with. *If it could get past the manager, it was good enough.* At the staff and senior level, you simply don't feel nearly the same kind of responsibility for the financial statements that partner and managers must. I think at least at some subconscious level, staff know that they won't be the ones left holding the bag if something goes wrong on the audit.” (Former Big 4 Senior)

“Theoretically, [WPR] is what the most important thing should be, but that doesn’t always work out that way in public accounting” (Interview, Big 4 Sr. Manager) due to, for example, the pressure to sell client business and enhance practice development (Asare, Cohen and Trompeter 2005). Respondents acknowledge that there are many activities that may compete with good WPR, but if WPR is performed correctly, learning on [the current] engagement will make an auditor more skeptical on future audit engagements:

> “Reviewers take a fresh look at the area being reviewed and can ask the right questions, whereas the person doing the work might have been more focused on detailed work. Reviewers look at the big picture more often than the person doing the work. This is no excuse for the person doing the work to not identify issues, however, reviewers, through on-the-job training can ‘transmit’ some of their skepticism to the person being reviewed for [use in a] similar situation in the future.” (Other Multi-National Senior)

Collectively, these findings indicate that WPR is an essential mechanism in developing PS and enhancing audit quality. As such, firms may consider explicitly training and rewarding good WPR practices. For example, firms can pay more attention to the quality of the review process of auditors at different levels when making compensation and promotion decisions. This could result in the review process being even more effective at promoting PS within the firm. As Carpenter and Reimers (2013) findings suggest knowing that you will be accountable to a superior who will review your workpapers for proper PS, may induce all levels of the firms to pay more attention to appropriate PS.

Annual Evaluation Process

Participant responses indicate that partners, managers and staff perceive that the annual evaluation process promotes skepticism while seniors perceive the evaluation process to have no effect (Table 1). Qualitative responses indicate that PS is not directly measured on evaluation forms and is considered a necessary but not sufficient condition for promotion; yet, PS is considered and documented *only when deficient*.

> “We're not evaluated greatly on our professional skepticism unless we clearly do not apply it.” (Other Multi-National Senior)

> “Only, if a large matter on an audit was missed, [then an auditor] should be dinged with respect to compensation.” (Other Multi-National Partner)

In a similar light, interview responses imply that professional skepticism is a necessary but not sufficient condition for being a good auditor:

> "if you are not professionally skeptical and don't think about what the client tells you, I think by definition you are a bad auditor. But on the flip side if you skeptical and you flag everything [you are not a good auditor] – there is more that needs to go into being a good auditor than just being skeptical." (Interview Big 4 Senior Manager)

Other participants believe that the annual evaluation process discourages skepticism because firms measure performance indicators that are seemingly at odds with skeptical behavior:

> "Formal evaluation usually measures you against certain predefined performance indicators where you give examples of how you've met those indicators. I don't like how they kind of put you in a little box and you are evaluated within the box. People tend to stay within the box to be safe, therefore hindering professional skepticism." (Former Big 4 Senior)

> "The formal evaluation process, promotion practices and compensation practices are all linked. If you want to get a good review, get a good raise and get promoted, then you need to have good relationships with your clients. If you come across as distrustful or badger clients with difficult / repetitive questions, then they will not speak well of you to your superiors. In general, exercising professional skepticism requires you to ask the difficult question, investigate items that do not make sense, etc. These types of conversations can be uncomfortable and do not strengthen [client] relationships. Thus, staff are only likely to engage in such conversations when absolutely necessary (for example, when a potential error is material) and will typically avoid them otherwise." (Retired Big 4 Partner)

> "I would not say that professional skepticism is a major component of promotions/formal/compensation evaluations. The main consideration is how much work you got done, how quickly, you got it done, and what was the quality of it when it came to review." (Big 4 Staff)

Thus, although PS may be acknowledged during the formal process, it appears to be downplayed unless there is a negative event. Interviewees suggest two reasons why this may be the case. One explanation is that firms view (appropriate) skeptical behavior *as expected*, and thus not worthy of a "reward". A second explanation is that PS is not a defined and measured criterion “it is hard sometimes to separate skepticism from good performance in itself.” (Interview, Retired Big4 Partner)

The lack of PS as a reward, but merely as a penalty, may inadvertently reduce the effectiveness of PS which is similar to the critique that Peecher et al. (2013) state is the potential problem with the current approach used by regulators. Thus, the way in which PS is currently incorporated within a firm’s evaluation process may actually create disincentives to expend too much effort on PS. This sentiment is reinforced by the following quotes:

> “I saw a lot of bonuses and cash performance awards given out (and received several myself), but I'm not personally aware of a single instance where such a reward was given for anything related to professional skepticism. Almost without exception, these awards were given out as a very public form of congratulations for meeting or beating a budget, and/or finishing ahead of schedule. In most instances, being professionally skeptical by maintaining a questioning mind means MORE work and MORE time, which are tough pills to swallow in an environment obsessed with budgets and efficiency. The importance of professional skepticism is frequently touted during training meetings, but the unfortunate reality is that auditors are much more likely to perceive the behaviors that are recognized and awarded by the firm and act accordingly.” (Former Big 4 Manager)

> “If you are doing something right, a mere pat in the back is not enough (especially in this day and in this industry). Auditing is a profession that makes it difficult on some days to believe you are doing ‘good’ for others, especially because of how much [the client] hates auditors. [But] there are also good days where you have the satisfaction of feeling you are doing something ‘good’. If you are getting promoted, it helps you with that satisfaction. It does not mean you will lose your professional skepticism if you don't get promoted, but if you are a good employee and feel like you deserve [promotion] you will be out of the door [by choice].” (Other Multi-National, Senior)

These findings have potential implications for audit firms and for PCAOB inspectors. First, the PCAOB has highlighted PS as a point of emphasis, and this in turn has influenced the firms to attend to PS. However, this focus on PS by the firms has not resulted in firms rewarding individuals or audit teams for enhanced PS. In part, this lack of reward for “good” PS may be because it is inherently difficult to unambiguously measure PS and thus it is difficult to base rewards on ambiguous criteria. However, it may also be, in part, because, as our data suggests, audit firms presume skepticism is embedded in in performance—it's just part of what auditors are expected to do.

Moving forward, firms, may consider modifying their evaluation and reward system to (a) develop measurable attributes of skepticism that are explicitly acknowledged in the annual review process (b) better reward good PS rather than maintaining a more exclusive focus on penalizing bad PS. With respect to the PCAOB, when evaluating an auditing firm's quality control, inspection teams may consider how the firm's evaluation process incorporates PS both for positive and negative PS exhibited. Without such changes, it is difficult to see how the profession can move away from exerting just enough effort to achieve the minimum level of skepticism to avoid penalty as opposed to striving for heightened levels of PS and audit quality.

DISCUSSION

Prior research suggests that PS is a function of multiple accountabilities (Peecher et al. 2013) and that individual and situational factors can promote or inhibit PS (Nelson 2009; Hurtt et al. 2013). To investigate the influences upon PS, we employed an in-depth survey that elicited both quantitative and qualitative responses from auditors at various levels and from various firm types. Further, we followed up the survey with in-depth interviews with six of the participants.

Overall, our results indicate that skepticism is a necessary but not sufficient condition for being a good auditor and that varying degrees of skepticism are contextual i.e., there is a time and a place to be more skeptical. Collectively, our results indicate that personal accountability is what drives most of the PS; thus an accountability source that can be traced to an *individual* will potentially have the most influence on PS. Specifically, supervisory review can act as a powerful force to promote PS, as an individual is held accountable for the quality of work during both the audit engagement and annual evaluation process. It also appears that participants perceived that the loss of PS (e.g., insufficient skepticism exercised) is taken much more seriously rather than "better" PS because exhibiting a modicum of PS is expected and is thus a necessary but insufficient condition for rewards. In turn, the profession appears to emphasize the penalties associated with PS rather than rewarding positive behavior. With respect to regulation, our results suggest that when the threat of PCAOB inspection and litigation risk is likely, auditors have heightened awareness of regulatory authority. This awareness leads to a more critical focus on ensuring defendable documentation, which may, in fact, be detrimental to skepticism. Client importance appears overall to negatively affect PS but the qualitative responses suggest a more complex and layered effect of client importance. For some auditors, client importance reduces PS but for others the heightened importance of large clients may increase PS as auditors perceive that these clients may be more prone to generate negative publicity if there is an audit failure.

As with all research, there are limitations that represent opportunities for further research. First, our data was collected through personal and professional contacts, thus, the responses of our participants may not represent the experiences of all auditors. A future study can enlist the assistance of the leadership of firms to ensure a wider sample. Second, we study perspectives of individuals who share personal experiences. Those responses may be subject to a recall bias (Plous 1993). A future study can take these results and test for recall and search patterns on PS-related tasks. Third, qualitative analysis necessarily involves researcher interpretation. We independently coded the survey responses and provide direct quotes so that our interpretations can be distinguished from thoughts provided by participants. A future study can use alternative paradigms such as institutional theory (Cohen et al. 2008) to evaluate survey and interview responses. Finally, our study suggests a number of improvements developed by both the authors and interviewees that could be considered by firms to improve PS practices. For example, firms should consider exploring rewarding exceptional PS as opposed to only highlighting PS when it has been insufficient.

Despite these limitations, this study represents the first attempt to uncover the black box of what constitutes PS in an auditor's mind. By enhancing PS, firms may reduce their business risk and ultimately enhance audit quality (Knechel et al. 2013). Only time will tell if we see a positive effect on audit quality as the PCAOB emphasizes PS and enhanced PS permeates throughout the auditing profession's culture (PCAOB 2012; Knechel et al. 2013).

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TABLE 1

Scaled Responses for Sources of Accountability by Level

			Perceived Impact on Professional Skepticism [a] ***Mean (Standard Deviation) Response by Level***					
Firm Level	n	Yrs	PCAOB Inspection	Litigation Risk	Client Importance	Work-paper Review	Formal Evaluation	Time Budget Pressure
Partner/Director	11	24.2	5.00 (1.18)***	5.82 (1.25)***	3.45 (1.13)*	6.18 (0.98)***	5.36 (1.57)***	3.45 (0.52)***
Sr. Manager/Manager	31	9.8	5.19 (1.47)***	5.29 (1.13)***	3.71 (1.42)	6.90 (1.01)***	4.87 (1.02)***	3.26 (1.53)***
Senior	22	4.4	5.36 (1.62)***	6.00 (1.11)***	3.73 (1.75)	6.00 (1.07)***	4.36 (1.68)	2.86 (1.67)***
Staff	13	1.5	5.77 (1.09)***	6.00 (0.91)***	3.77 (1.69)	6.08 (0.86)***	5.00 (1.15)***	2.92 (1.26)***
Overall Mean (SD)	***77***	***9.1***	***5.31 (1.42) ******	***5.69 (1.14) ******	***3.61 (1.51)***	***6.00(0.99) ******	***4.82(1.35) ******	***3.12(1.42) ******

[a] "What effect, if any, does [*accountability incentive*] have on professional skepticism?" 1= Hinders Professional Skepticism; 4 = No Effect; 7 = Helps Professional Skepticism

******* Items are significantly different from "no effect" at the <.01 level, ****** Items are significantly different from "no effect" at the <.05 level, ***** Items are significantly different from "no effect" at the <.10 level.

TABLE 2

Scaled Responses for Sources of Accountability by Client Experience (Public/Non-Public)[a] and by Level

			Perceived Impact on Professional Skepticism [b] ***Mean (Standard Deviation) Response by Level***					
	n	Yrs.	PCAOB Inspection	Litigation Risk	Client Importance	Work-paper Review	Formal Evaluation	Time Budget Pressure
Prior Public Client Experience	*55*	*8.7*	*5.33 (1.47) ****	*5.62 (1.18) ****	*3.84 (1.52)*	*6.06 (0.98)****	*4.73 (1.38)****	*3.22 (1.55)****
Partner/Director	6	23.2	4.83 (1.17)*	5.67 (1.21)***	3.50 (1.38)	6.00 (0.63)***	4.83 (1.60)	3.67 (0.52)*
Sr. Manager/Manager	26	9.6	5.35 (1.52)***	5.38 (1.20)***	3.73 (1.54)	6.88 (0.99)***	5.00 (1.06)***	3.27 (1.61)**
Senior	17	4.5	5.24 (1.64)***	5.88 (1.17)***	3.88 (1.65)	6.00 (1.17)***	4.24 (1.79)	2.94 (1.82)*
Staff	6	1.8	6.00 (0.89)***	5.83 (1.17)***	4.50 (1.38)	6.50 (0.55)***	4.83 (0.98)**	3.33 (1.21)
No Prior Public Client Experience	*22*	*10.2*	*5.27 (1.32)****	*5.86 (1.04) ****	*3.32 (1.43) ****	*6.00 (1.02)****	*5.05 (1.29)****	*2.86 (1.04)****
Partner/Director	5	25.4	5.20 (1.30)*	6.00 (1.41)***	3.40 (0.89)	6.40 (1.34)***	6.0 (1.41)**	3.20 (0.45)***
Sr. Manager/Manager	5	10.5	4.40 (0.89)	4.80 (0.45)***	3.60 (0.55)*	6.00 (1.22)**	4.20 (0.45)	3.20 (1.10)*
Senior	5	4.0	5.80 (1.64)**	6.40 (0.89)***	3.20 (2.17)	6.00 (0.71)***	4.80 (1.30)	2.60 (1.14)**
Staff	7	1.3	5.57 (1.27)***	6.14 (0.69)***	3.14 (1.77)	5.71 (0.95)***	5.14 (1.35)**	2.57 (1.27)**

[a] There were three respondents who did not indicate whether they had/did not have public company experience whom we designate as having no public client experience.

[b] "What effect, if any, does [*accountability incentive*] have on professional skepticism?" 1= Hinders Professional Skepticism; 4 = No Effect; 7 = Helps Professional Skepticism

******* Items are significantly different from "no effect" at the <.01 level, ****** Items are significantly different from "no effect" at the <.05 level, ***** Items are significantly different from "no effect" at the <.10 level.

TABLE 3

Scaled Responses for Sources of Accountability by Firm Type and by Level

			Perceived Impact on Professional Skepticism [a] ***Mean (Standard Deviation) Response by Level***					
Firm Type/Level	n	Yrs.	PCAOB Inspection	Litigation Risk	Client Importance	Work-paper Review	Formal Evaluation	Time Budget Pressure
Big 4	***29***	***10.6***	***4.66 (1.32)****	***5.00 (1.07)****	***3.76 (1.68)***	***5.52(1.06)****	***5.07 (1.56)****	***3.10 (1.78)****
Partner/Director	5	23.8	4.40 (0.55)*	4.80 (0.84)**	3.20 (1.64)	5.60 (1.14)**	6.40 (0.55)***	3.60 (0.55)*
Sr. Manager/Manager	15	9.7	5.07(1.39)***	5.00 (1.13)***	3.67 (1.59)	5.53 (0.99)***	5.20(1.21)***	3.13 (1.85)**
Senior	7	5.5	3.71 (1.25)	5.14 (1.21)**	4.14 (2.04)	5.29 (1.38)**	3.71 (1.98)	3.00 (2.38)
Staff	2	1.8	5.50 (0.71)	5.00 (1.41)	4.50 (2.12)	6.00 (0.00)	5.50 (0.71)	2.00 (1.41)
Other Multi-National	***38***	***7.2***	***5.89 (1.31)****	***6.18 (0.93)****	***3.71 (1.51)***	***6.26 (0.86)****	***4.74 (1.27)****	***3.18 (1.23)****
Partner/Director	3	22.7	5.00 (1.73)	7.00 (0.00)	4.67 (0.58)	6.67 (0.58)***	4.67 (2.52)	3.67 (0.58)
Sr. Manager/Manager	13	9.8	5.62 (1.61)***	5.77 (1.09)***	3.77 (1.42)	6.15 (0.99)***	4.69 (0.75)***	3.54 (1.20)*
Senior	15	3.9	6.13 (1.13)***	6.40 (0.83)***	3.53 (1.64)	6.33 (0.72)***	4.67 (1.50)*	2.80 (1.32)***
Staff	7	1.7	6.29 (0.76)***	6.14 (0.69)***	4.00 (1.83)	6.14 (1.07)***	5.00 (1.15)**	3.14 (1.21)*
Regional/Local	***10***	***11.4***	***5.00 (1.25)***	***5.80 (1.14)****	***3.40(0.97)***	***6.40 (0.70)****	***4.40 (0.97)***	***2.90 (0.99)****
Partner/Director	3	26.3	6.00 (1.00)**	6.33 (1.15)**	3.67 (0.58)	6.67 (0.58)***	4.33 (0.58)	3.00 (0.00)
Sr. Manager/Manager	3	10.2	4.00 (0.00)	4.67 (0.58)*	3.67 (0.58)	6.67 (0.58)***	4.00 (0.00)	2.67 (1.15)*
Staff	4	1.1	5.00 (1.41)	6.25 (0.96)***	3.00 (1.41)	6.00 (0.82)***	4.75 (1.50)	3.00 (1.41)

[a] "What effect, if any, does [*accountability incentive*] have on professional skepticism?" 1= Hinders Professional Skepticism; 4 = No Effect; 7 = Helps Professional Skepticism

******* Items are significantly different from "no effect" at the <.01 level, ****** Items are significantly different from "no effect" at the <.05 level, ***** Items are significantly different from "no effect" at the <.10 level.

APPENDIX A:
Survey Instrument[20]

For the following question, think of professional skepticism in general.
1. In your own words, how do you define (describe) professional skepticism?

For the following question, think of professional skepticism, in general, at your specific firm.
2. What effect, if any, does the work-paper review process have on professional skepticism? [a]

For the following questions, think of the client where you spend a majority of your time:
3. What effect, if any, does the potential for your client to be selected for the PCAOB inspection process have on professional skepticism? [a]
4. What effect, if any, does litigation risk have on professional skepticism? [a]
5. What effect, if any, does engagement "economics" or "politics" have on professional skepticism?
    5a. Time/budget pressure [a]
    5b. Importance of the client to a particular office (e.g., reputation, revenue) [a]

Scales Used:
[a] Hinders PS = -3; Helps PS +3; Specific Comments/Examples (list up to 3 points).

[20] Our complete instrument contains 15 questions (sub-questions), however not all questions are relevant to the current manuscript. Thus, we provide in this appendix only questions relevant to our analysis. A copy of the full instrument is available upon request.

APPENDIX B:
Interview Instrument

1. How do you define professional skepticism?

2. How would a “good” work-paper reviewer promote or hinder PS?
    a. How do you trade off the time to do a good work-paper review and the expectation of getting everything else done?

3. How much of a role does “being skeptical” in the work-paper review process play in compensation/promotion decisions?
    a. Should it play a greater role or a lesser role? Please elaborate.

4. How can audit firms do a better job of rewarding effectiveness as opposed to merely rewarding efficiency?

5. Has threat of PCAOB inspections enhanced or diminished the importance of conducting a good work-paper review?

6. Many of the respondents to the survey consider that the increased focus on documentation actually takes away professional judgment.
    a. What is your response to this?
    b. What could the PCAOB do differently?
    c. What could the audit firm do differently?

7. Is the extent of documentation required for the PCAOB appropriate? If not, do you think there is “too much” documentation?
    a. Are there problems with documentation becoming the overriding focus of the audit?

8. Which has more of an effect on PS: PCAOB Inspections or litigation?
    a. Why do you think this is the case?
    b. Do you think this varies by level?

9. What is the firm response/preparation for when the PCAOB selects a client for inspection?
    a. Who (at the firm) is primarily held responsible for any deficiencies identified (the partner, individual audit team members, the team, all of the above)?
    b. Is the process of assigning responsibility similar for when the firm is confronting litigation over a client matter?

10. If auditors were “optimally” skeptical, what would that look like? Would misstatements still occur?