The Practice of Professional Scepticism in Auditing

A thesis submitted to the University of Manchester for the degree of Doctor of Philosophy (PhD) In the Faculty of Humanities

2019

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<tr>
<th>Abbreviation</th>
<th>Full Form</th>
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<tbody>
<tr>
<td>AICPA</td>
<td>American Institute of Certified Public Accountants</td>
</tr>
<tr>
<td>AIU</td>
<td>Audit Inspection Unit</td>
</tr>
<tr>
<td>APB</td>
<td>Auditing Practice Board</td>
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<tr>
<td>AQR</td>
<td>Audit Quality Review</td>
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<td>AQST</td>
<td>Audit Quality Support Team</td>
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<tr>
<td>BEIS</td>
<td>Business Energy Industrial Strategy</td>
</tr>
<tr>
<td>CMA</td>
<td>Competition and Markets Authority</td>
</tr>
<tr>
<td>FCA</td>
<td>Financial Conduct Authority</td>
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<tr>
<td>FRC</td>
<td>Financial Reports Council</td>
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<tr>
<td>FS</td>
<td>Financial Statements</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>GF</td>
<td>Gut Feeling</td>
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<tr>
<td>GFD</td>
<td>Gut Feeling of Discomfort</td>
</tr>
<tr>
<td>IAASB</td>
<td>International Auditing and Assurance Standards Board</td>
</tr>
<tr>
<td>ICAEW</td>
<td>Institute of Charted Accountants in England and Wales</td>
</tr>
<tr>
<td>IESBA</td>
<td>International Ethics Standards Boards for Accountants</td>
</tr>
<tr>
<td>ISA</td>
<td>International Standard of Auditing</td>
</tr>
<tr>
<td>JDM</td>
<td>Judgment and Decision Making</td>
</tr>
<tr>
<td>PCAOB</td>
<td>Public Company Accounting Oversight Board</td>
</tr>
<tr>
<td>PS</td>
<td>Professional Scepticism</td>
</tr>
<tr>
<td>REM</td>
<td>Real Earnings Management</td>
</tr>
<tr>
<td>SAS</td>
<td>Statement of Auditing Standards</td>
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<tr>
<td>SIM</td>
<td>Social Intuitionist Model</td>
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<tr>
<td>UK</td>
<td>United Kingdom</td>
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<td>United States</td>
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ABSTRACT
The Practice of Professional Scepticism in Auditing  
Yasser A. Alnafisah  
The University of Manchester, Doctor of Philosophy

During the last decade, auditors’ exercise of Professional Scepticism (PS) has been increasingly criticised by accounting regulators worldwide, such as by Financial Reporting Council (FRC) in the United Kingdom (UK). Existing studies in auditing literature have indicated that exercising the appropriate level of scepticism is made difficult due to the lacking understanding of PS. Despite attempts being made in the extant literature to problematize PS as a concept, what PS actually means in practice remains unclear. This study aims to explore and understand how practicing professional auditors internalise and operationalise the concept of PS in practice.

This study employs a qualitative research approach to investigate the meaning of PS in auditing in the context of the practical experience of external financial statements auditors. The primary data collection method has involved semi-structured interviews with 44 research participants, namely; professional auditors working in the Big Four audit firms in the UK. The Social Intuitionist Model (SIM) is used to provide explanations of PS practical meaning that appreciate the role of gut feeling (emotion) in shaping auditors’ PS practice whilst being mindful of the reasoning process. Using such a theoretical framework helps to provide a holistic interpretation of PS which can uncover its nature and constructs, the interaction between its cognitive aspects, and the process upon which auditors make their everyday professional judgment.

Drawing on the review of the relevant literature, the use of SIM and the analysis of interview evidence, the PS Process Model (PSPM) has been developed to summarise this study’s findings. The PSPM indicates that PS should not be confined to certain personal traits that can only be possessed by some people, nor an indefinite cognitive state in which the nature of PS is absent. Rather, it provides a more holistic and practical understanding of PS as an ongoing process. It shows that this process is initiated, constructed and refined by an emotional state (Gut Feeling of Discomfort [GFD]) that auditors experience. This emotional state is sourced by certain negative consequences relevant to reviewers’ expectations, and triggered, shaped and channelled through auditors’ accumulated knowledge and the fact-pattern available (i.e. triggers of GFD). It emphasises that the tension between the feelings of comfort and discomfort that auditors can experience shapes the PS process. The PSPM specifically illustrates how social interaction with others (client personnel and audit team members) can influence auditors’ GFD and be used to act upon their sceptical judgment (including pursuing certain efforts to influence others to accept their judgment).

This study provides methodological and empirical contributions by providing evidence on the practical meaning of PS drawn from interviews with practicing professional auditors from different positions in the audit team organisational hierarchy. Furthermore, by using a theoretical perspective (SIM) from the field of psychology, this study provides a new perspective in interpreting PS as an ongoing process initiated and developed as an emotional state, emphasising the role of gut feeling in the auditing JDM process and providing empirical evidence that demonstrates how professionals’ feelings of comfort/discomfort can be more related to their own well-being than those people they are acting on behalf of.
DECLARATION

No portion of the work referred to in the thesis has been submitted in support of an application for another degree or qualification of this or any other university or other institute of learning.

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ACKNOWLEDGMENTS

My sincere thanks and gratitude goes to God. Without his help and guidance, I would not have the opportunity to pursue and complete this project.

I would also like to express my sincere gratitude to both supervisors, Dr Anna Samsonova-Taddei and Prof Stuart Turley, who have provided me with their genuine guidance and support. I am deeply indebted to them for their kindness and continuous assistance and support, constructive comments, and appreciation of my circumstances throughout my PhD journey. My thanks also go to Prof Brendan O'Dwyer and all faculties and academics who provided advice and constructive comments in the annual review sessions and during my PhD study. Additionally, I would like to acknowledge comments given by academics and PhD colleagues at the AMBS Doctoral Conference 2017, and the BAFA Doctoral Colloquium, 2017 and 2018.

I would like to thank my colleagues in the Alliance Manchester Business School as well as friends in the city of Manchester and Saudi Arabia for their help and encouragement, which helped me to manage my stress and stay cheerful.

My gratitude and thankfulness is also truly expressed to the research participants for their time, information and references which significantly contributed to the completion of this research project. Accordingly, I should also thank Imam Mohammad Ibn Saud University in Saudi Arabia, for providing me with the scholarship to fulfil this research project and the staff of the Saudi Arabian Cultural Bureau in London for their assistance.

No words can truly express my appreciation, gratitude and love to the most beloved persons in my life; my father and mother. Nevertheless, I owe much to my parents who have greatly invested and believed in me from the beginning of my life until this stage. Their honest and heartfelt prayers and wise words have kept me safe and hopeful, and helped me to survive during this journey. I should also thank my brothers and sisters who provided me with their support and cheerful insights, which kept me hopeful and ambitious throughout my PhD.

Last, but not least, I owe much to my wife, Sarah, who has sacrificed a lot to provide me with the help, patience, love and support, all of which have helped make this difficult journey a lot easier for me.

Finally, my thanks and deepest gratitude to all those who have assisted me in the completion of this project.
DEDICATION

To my beloved Father, Mother and Wife who kept me inspired all the way during my PhD journey.
Chapter 1: Introduction and Background
1. Subject of the Thesis
This thesis investigates the way in which practicing professional auditors internalise and operationalise the concept of Professional Scepticism (PS) in practice. Enhancing the understanding of PS and the exercise of PS in practice is important given that accounting oversight boards (such as Financial Reporting Council (FRC) and Public Company Accounting Oversight Board (PCAOB)) continue to highlight this as an area of deficiency (e.g. FRC, 2018; PCAOB, 2013). Both academic and regulatory studies have provided varied explanations of the nature and constructs of PS practice, and this may have contributed to the blurred understanding of PS, and deficiencies in practice (e.g. Olsen & Gold, 2018; Carpenter & Reimers, 2013). For instance, PS has been conceptualised as a personal trait (e.g. Hurtt, 2010), as a state (e.g. Glover & Prawitt, 2014), or both (e.g. Hurtt, Brown-Liburd, Earley & Krishnamoorthy, 2013). The majority of prior studies have focused on examining the relationship between PS (hypothesised, for instance, as a sceptical trait, disposition to distrust or level of risk) and certain characteristics (such as auditors characteristics, audit firms characteristics and client characteristics) indirectly in experimental settings (e.g. Carpenter & Reimers, 2013; Koch & Salterio, 2017; Noviyanti & Winata, 2015). Consequently, less is known about how practicing auditors conceptualise and operationalise the PS concept in their everyday audit practice. This study uses a qualitative research approach to contribute to research on this subject.

This chapter is organised as follows: Section 1.1 summarises the research background. Section 1.2 briefly discusses the current state of PS in audit practice in the United Kingdom (UK) based a review of the FRC’s Audit Quality Review (AQR) reports. Section 1.3 explains the motivations behind the study, leading to the research questions which are introduced in Section 1.4. The contribution of this study is summarised in Section 1.5. Finally, Section 1.6 shows the structure of the thesis.

1.1 Research Background
PS has been the focus of attention in a number of academic research projects. This interest has grown recently after many global accounting regulatory bodies have repeatedly expressed their criticism of auditors’ practice of PS. Many of these studies have offered insights on the complexity associated with PS and its relationship with
multiple antecedents (such as auditor characteristics, client characteristics, audit evidence properties and firm and external environment characteristics). This complexity and the multifaceted nature of PS has contributed to the blurred understanding of the concept and provides a motivation for further investigation of this concept (see e.g. Hurtt et al., 2013; Nelson, 2009; Nolder & Kadous, 2018; Olsen & Gold, 2018; Toba, 2011).

The nature and constructs of PS have been considered in a variety of ways in the auditing literature. The varied understandings of PS include two key areas: (1) whether the PS practice should be based on a neutral perspective or a presumptive doubt perspective, and (2) whether PS should be defined as a state, as a personal trait or both (see e.g. Hurtt, 2010; Hurtt et al., 2013; Toba, 2011) (explained further in Chapter 2). Nelson (2009) has also contributed to the understanding of PS by separating PS in two integral components: sceptical judgment and sceptical action. Many subsequent studies have relied on this understanding and attempted to examine the cognitive aspect (sceptical judgment) of PS which is the element highlighted most in the definition of PS in practice regulations.

As will be explained in Chapter 3, in the psychology and Judgment and Decision Making (JDM) process literature, there are two types of thinking systems that people use to form their judgment. According to dual process theories, people have two types of thinking systems: Type 1 which is more affective, emotional, unconscious and associative, and Type 2 thinking system that is more rational, deliberate, conscious and systematic. These two thinking systems interact with each other whether in a sequential or parallel manner to shape judgment (see e.g. Evans, 2008; Smith & DeCoster, 2000). The majority of prior auditing studies which have investigated PS have broadly theorised the cognitive aspect of PS as being merely rational and deliberate (Type 2 thinking process) (see e.g. Bucaro, 2019; Griffith, Hammersley, Kadous & Young, 2015; Humphrey & Moizer, 1990; Nolder & Kadous, 2018; Olsen & Gold, 2018; Plumlee, Rixom & Rosman, 2015; Rasso, 2015). Although some studies have acknowledged the role that emotions can play in auditing practices (specifically PS practice) (see e.g. Guenin-Paracini, Malsch & Paille, 2014; Rowe, 2019), the recognition of a Type 1 thinking process, which captures the role of emotion in the JDM process, has been limited. Those studies that have examined the role of emotion (which is a form of
cognition (e.g. Lazarus, 1991)) in auditing practices have linked it to explanations of auditing practice as a ritual (see e.g. Pentland, 1993) or process of comfort production (Carrington & Catasus, 2007). These and similar studies emphasise the important role that emotion can play in influencing PS in the context of auditing practice (see e.g. Bhattacharjee & Moreno, 2013; Guenin-Paracini et al., 2014; Rowe, 2019).

This study uses the Social Intuitionist Model (SIM) to help interpret and explain the practice of PS. SIM which is based on the dual process idea stresses the role of gut feeling (Type 1 thinking system), but it does not disregard the role of reasoning (Type 2 thinking system). It also stresses the social construction of people’s judgment as resulting from their social interactions with others. SIM can uniquely contribute to the understanding of PS and the JDM process in auditing because it not only provides a holistic view which recognises the role of gut feeling and gives a role for reasoning, but it can also assist in providing an explanation of how auditors process these two systems to form and communicate their judgment in practice. Through this holistic view which specifically emphasises and captures the role of emotion in auditors’ construction of PS practice, this study can complement and extend prior studies which have highlighted the important role of auditors’ feelings in forming their auditing practices (see e.g. Carrington & Catasus, 2007; Commerford, Hermanson, Houston & Peters, 2016; Guenin-Paracini et al., 2014; Rowe, 2019). Thus far a limited number of studies within the auditing literature have attempted to recognise the role of the affective aspect of the PS concept, and their investigation has been limited to the use of experimental design and has considered emotion as being a construct of different nature from cognition (see e.g. Nolder & Kadous, 2018).

Most prior studies in the PS literature primarily follow an experimental research design. Experiments based on a set of controlled hypothetical scenarios limit examination to only a few variables and consequently do not provide the full picture of the practice environment (Kachelmeier, 2018; Westermann, Bedard & Earley, 2015). Such studies, which treat PS as a black box, do not fully recognise the complexity associated with PS and this may have contributed to the mixed findings that these prior studies have reported with regard to the relationship between certain factors and PS. The dominant use of experimental research approach in auditing studies has been criticised for limiting
the understanding of how audit is constructed in practice because this approach could not capture the complexity in the working environment (Humphrey, 2008; Sikka, Filling & Liew, 2009). Qualitative research methods which focus on studying auditing concepts in their natural settings and from the auditors’ experiences and interpretations have been considered the best way to study multifaceted concepts of such as PS (Brazel & Schaefer, 2015; Humphery, 2008; Power & Gendron, 2015). This study employs an interpretive qualitative research approach to provide an in-depth understanding of PS, and in so doing aims to contribute to the literature by studying PS from the point of view of professional auditors who make sense of and operationalise PS in practice. The interpretive research approach is employed to describe auditors’ perspective on their understanding and processing of the PS concept which has been described as a multifaceted and multidimensional concept.

While the qualitative investigation of PS involves analysing aspects emerging out of the empirical data that are related to cognition and emotions, certain epistemological challenges should be acknowledged. According to the literature on cognition and emotion, the observer (researcher) can infer such cognitive and affective states based on the agents’ (participants’) behaviour and self-reporting of their experience. However, there is a danger that the experience that study participants self-report may be misread by the researcher or mistakenly reported by the participants. The implicit nature of cognitive and affective processes, the ambiguity associated with understanding the nature of emotion and the conceptual overlap that can exist between different emotional states (e.g. anxiety, worry, fear, disgust) can contribute to this possibility where the cognitive and affective experience may be misinterpreted (e.g. Akinci, 2014; Cornelius, 1996; Greenwood, 1987; Guenin-Paracini et al., 2014). The primary way to address such epistemological difficulties associated with the qualitative investigation of cognition and emotion is by clarity in the methods by which participants’ experiences are interrogated and collected. Therefore, when affective and cognitive aspects were included in the analysis process of this study, the researcher sought to clarify the understanding of the nature of the emotion (see Chapter 4) and the specific emotional experiences that participants highlighted in relation to their understanding and application of PS (see Chapter 3).
1.2 The Status of PS in the UK Based on the FRC’s AQR Reports

An initial stage of this research involved a detailed review of the FRC’s AQR reports to develop an understanding of the status of PS in audit practice in the UK. The PS literature in auditing has previously shown how in the United States (US) regulatory inspections by the PCAOB have criticised auditors’ with reference to the exercise of PS, and it was important to establish the equivalent position from the UK as evidenced in the FRC’s inspection reports. A qualitative content analysis of the reports found that the AQR inspectors’ concern about auditors’ insufficient exercise of PS has grown during the last decade. Although audit firms have attempted to respond to the inspectors’ criticisms by establishing certain initiatives and programs (including training and having effective control policies and procedures) which are focused on enhancing the practice of PS, insufficient exercise of PS has been mentioned to a growing extent by the AQR inspectors. (A detailed discussion of this review of the FRC’s AQR reports is provided in Appendix 1.)

The analysis produced a long list of issues (about 37 issues for the Big Four firms and 36 for the non-Big Four firms) that have been linked to the insufficient exercise of PS. The identified issues cover the different stages and procedures of an auditing engagement from the planning stage to the formation and finalisation of the audit report. These issues also cover the interactions that audit personnel engage in whether they are internal (e.g. staff and partners’ review appraisal processes) or external (such as obtaining external confirmations). The issues can be categorised into three main general themes: auditing areas of judgement, the sufficiency and appropriateness of audit evidence and audit procedures, and firms’ internal cultures.

The findings of this qualitative analysis of the AQR reports support the relevance of exploring the practical meaning of PS as they have shown a growing concern about auditors’ insufficient exercise of PS and the vagueness associated with the PS concept. Since most of prior auditing studies, in particular those concerned with PS, have been conducted in the US context, this review sheds light on the current state of PS in the UK audit practice, and highlights regulators’ (FRC specifically) perception of PS as expressed in AQR reports.
1.3 Research Motivations

The motivation for exploring the practical meaning of PS is to understand how professional auditors internalise this concept and how they process PS while making their everyday professional judgments. PS has been regarded as at the core of high-quality auditing work (International Auditing & Assurance Standards Board [IAASB], 2015; FRC, 2012a). Specifically, the IAASB’s (2014) “Audit Quality Framework”, for instance, indicates that exhibiting the PS qualities as an individual auditor, engagement team, or accounting firm is an important construct of high audit quality. This claimed positive relationship between audit quality and PS identifies that a higher exercised PS increases auditors’ ability to detect material misstatements. Although PS is seen as of core importance for audit quality, regulators (such as FRC) continue to point to deficiencies in auditors’ practice of PS. This has motivated different regulatory bodies as well as academicians to show extensive interest in investigating PS. Studies continue to reflect the diversity and ambiguity associated with the understanding of PS and have attributed this to its complexity and multifaceted nature (e.g. Brazel, Jackson, Schaefer & Stewart, 2016; Hurtt et al., 2013; Olsen & Gold, 2018). This research aims to provide an in depth understanding of PS by employing a qualitative research approach to capture the complexity associated with PS practice (see e.g. Brazel & Schaefer, 2015).

The interest in PS arises for various reasons, including the repeated occurrence of accounting scandals, the growing complexity of business operations and the regulators’ identification of insufficient exercise of PS as a common audit deficiency (see Fei Gong, Kim & Harding, 2014; Glover & Prawitt, 2014; Nach, 2014; Penning, 2014). Different global regulatory bodies have shown significant interests in PS in their professional standards and inspection reports. For instance, American Institute of Certified Public Accountants [AICPA] Statement on Auditing Standards [SAS] No. 1 and No. 99, and IAASB International Standard on Auditing [ISA] 200, require auditors to exercise PS during the whole process of the audit engagement. In various reports, regulators (e.g. FRC, PCAOB and Centre for Audit Quality [CAQ]) have emphasised the importance of exercising PS appropriately (CAQ, 2010; FRC, 2012a; PCAOB Staff Audit Practice Alert [SAPA] No. 10, 2012). High emphasis has been placed on auditors exercising the appropriate level of PS, but regulators continue to highlight auditors’ failure to exercise the appropriate level of PS as a frequent audit deficiency (Business, Energy & Industrial
This study attempts to explore and understand the PS nature and its constructs from the perspective of auditors because they are the ones who make sense of this concept in practice. It focuses on exploring and understanding the factors by which auditors give meaning to PS and how they process PS while they engage in everyday audit engagements. Different factors have been linked to auditors’ practice of PS in the existing literature, such as the underlying perspective from which PS is exercised (neutrality or presumptive doubt), auditors’ characteristics (e.g. knowledge and critical thinking (reasoning process)), accounting firm characteristics (e.g. tone at the top), client characteristics (e.g. complexity of client operations) or the external environment (e.g. international issues) (see e.g. Hurtt et al., 2013; Nelson, 2009; Olsen & Gold, 2018). Prior studies’ using experimental research designs are limited in the extent to which they can capture how these different factors which can collectively occur in the real auditing environment may influence auditors’ practice of PS. Limited studies have been developed to explore how professional auditors’ perceptions, which could reflect all these different factors, influence the way PS practice is defined and conducted. Studies that explore PS by obtaining insights from professional auditors are therefore able to make a particular contribution to research findings on PS (see e.g. Brazel & Schaefer, 2015). This study aims to contribute to the literature on how professional auditors give meaning to PS and how they operationalise PS to conduct an audit engagement. This study seeks to explain the nature of PS and the constructs which provide the basis on which professional auditors process PS in their everyday practice.

1.4 Research Questions
Since the primary objective of this study is to understand the practical meaning of PS from the point of view of professional auditors, it is important to understand how these audit practitioners perceive and interpret their internalisation of this concept. Their
perceptions of this concept as audit professionals can influence how they operationalise and conduct PS in practice. A limited number of studies has engaged with audit professionals to explore how they make sense of PS in their everyday audit practice. Therefore, in order to fulfil the main objective of this study, the following first research question is investigated:

**Research question 1:** How do auditors’ internalise the PS concept in practice?

The existing literature on PS provides a variety of understandings about the nature of PS, its constructs and the way in which it is constructed. Prior studies have linked different factors to PS and focused on examining PS as a personal trait that some people are gifted with or a cognitive state that is influenced by different sets of factors. However, less is known about how these different factors contribute to the construction of PS in practice (see e.g. Hurtt et al., 2013; Olsen & Gold, 2018). Therefore, as this study also seeks to explore the way by which auditors construct and communicate their day-to-day PS practice, the second research question of this study is set out as follows:

**Research questions 2:** How do auditors process PS in the context of their everyday professional judgment?

Two sub-questions that are more specific were formed to support the investigation into auditors’ construction and communication of PS while making their everyday professional judgment. These sub-questions are formed as follows:

**Sub-question 1:** How does an auditor’s exposure to different potential negative consequences shape their day-to-day PS practice?

**Sub-question 2:** How does an auditor’s social interaction with others (specifically client personnel and other audit team members) shape their day-to-day PS practice?

The research questions are addressed by an interpretive qualitative research approach which it is felt can be of value given the complexity of this ill-defined area of practice (PS). An analytical framework based on the SIM is employed for the abductive analysis of the study findings. The framework facilitates the development of an understanding of
the practical meaning of PS including its conceptualisation and operationalisation in everyday practice. Semi-structured interviews are used as the main research method because this method particularly allows for in-depth and contextualised exploration of the issues underlying the study’s research questions. These interviews are supplemented by a review of the FRC’s AQR reports and the relevant literature.

1.5 Research Contribution

The significance of this study can be summarised as follows:

1) It contributes to the existing PS literature as it provides evidence drawn from individuals who undertake audit practice in the UK and uses the interpretive approach. This approach helps to provide an in-depth explanation of PS practice which can illuminate the complexity associated with PS. This is important because it complements the approach followed in most prior studies, which have used a positivist approach, employed experimental design and focused on the US context.

2) It specifically explains PS as a process that is initiated and shaped as an emotional state (gut feeling of discomfort). This adds another dimension to the discussion and debates in the auditing literature about the nature of PS and the factors that can influence the practice of PS.

3) It contributes to the JDM literature, in auditing and more generally, by providing empirical evidence that can help explaining the role that emotions can play in making professional auditing judgments.

4) It enhances understanding of the nature and different constructs of PS, which can help regulators, practitioners, audit firms and academicians in their efforts to promote auditors’ practice of PS in order to enhance audit quality.

1.6 Structure of Thesis

This thesis consists of 8 chapters (including this chapter) and is structured as follows:

Chapter 2 provides a review of the extant literature that is relevant to the notion of PS. The aim is to situate the status of PS in the current PS and auditing literature and identify
the relevant research gaps, given that limited studies have investigated the PS concept in its practical and contextual setting.

Chapter 3 introduces the theoretical framework employed in this study. It provides an overview and explanation of the SIM (including its basis in the dual process framework and cognitive theory of emotion) and demonstrates how this framework can help analyse and make sense of the empirical findings. This framework offers a basis to recognise the complex factors and relations that can influence the meaning of PS in practice.

Chapter 4 describes the research methodology design. It explains the choice of an interpretive research paradigm underpinning the qualitative research methodology that this study employs, the data collection method, the research sample and the approach used to analyse the empirical evidence.

The subsequent three chapters (5, 6 and 7) discuss the empirical findings regarding how auditors process PS while making their everyday professional judgments. Chapter 5 addresses research question 1 through showing empirical evidence on how auditors conceptualise and internalise PS in practice. Chapters 6 and 7 address the two sub-questions of research question 2: Chapter 6 provides evidence explaining how auditors’ exposure to different negative consequences shapes their day-to-day PS practice; and Chapter 7 reports empirical findings on how auditors’ social interaction with the client management personnel and audit team members shape their day-to-day PS practice.

Finally, Chapter 8 provides a summary and discussion of the main findings of the study. It positions those findings in the broader context of auditing literature and discusses the study’s contribution and implications. It concludes by discussing the limitations of the study and offering some suggestions for future research.
Chapter 2: Literature Review
2. Introduction

PS has been regarded as fundamental to high-quality audit work (IAASB, 2015; FRC, 2012a). Under the “trust, but verify\(^1\)” approach, auditors should seek more persuasive evidence before being satisfied with client management representations (Peytcheva, 2014; Toba, 2011). Auditors are expected to act as an independent third party with the technical competency to challenge the management’s assertions and to assure their fairness and freeness of material misstatements. The importance of PS in ensuring high audit quality is reflected in the concerns raised by audit oversight boards about the failure of auditors to exercise a sufficient level of PS (FRC, 2017a; IAASB, 2015; PCAOB, 2013). The positive relationship between audit quality and exercised PS means that PS increases the auditors’ ability to detect material misstatements. It has been suggested that major efforts should be made to understand the causes of insufficient PS as highlighted in the regulators’ inspections of audit firms (e.g. Brazel et al., 2016).

This chapter provides a review of the previous auditing studies focused on exploring and/or explaining the PS concept and identifies certain research gaps that this study aims to help fill. This chapter covers the following topics: the importance of PS, PS definitions and conceptual frameworks, factors influencing auditors’ practice of PS, barriers of practicing PS and the research gaps.

2.1 The Importance of PS

The concept of PS has been frequently emphasised by regulators and researchers for various reasons, such as the repeated occurrence of accounting scandals, the growing sophistication of business operations, the regulators’ consideration towards the lack of PS as a common audit deficiency and the inconsistent understanding of the PS concept (Fei Gong et al., 2014; Glover & Prawitt, 2014; Hardies & Janssen, 2017; Nach, 2014). The exercise of PS is of particular importance when dealing with certain complex audit issues, such as accounting estimates, arm length transactions and client compliance with regulations (Penning, 2014).

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\(^1\) According to Grumet (2003), this phrase can be traced back to the Russian President Ronald Reagan who used these wordings in the negotiations of Soviet Union nuclear arms treaties during 1980s.
Over the years, the actual exercise of PS in the conduct of audit engagements has been one of the key areas of concern for audit regulators. In a recent statement issues in relation to its quality inspections, the FRC indicated that “across the Big 4, the fall in quality is due to a number of factors, including a failure to challenge management and show appropriate scepticism across their audits” (FRC, 2018). This statement echoes similar assessments by FRC as well as other audit regulators with regards to PS made in previous years (FRC, 2010a, 2013a, 2017a; PCAOB, 2013). For instance, the qualitative review conducted on the FRC’s AQR reports provides evidence showing that since 2008, the AQR inspectors have increasingly expressed their criticism of auditors’ exercise of PS (explained further in Appendix 1). Likewise, a number of studies which reviewed quality inspection reports issued by audit regulators around the world have shown that most common audit deficiencies are related to the lack of practised PS (e.g. Beasley et al., 2013; CMA, 2019; Messier et al., 2010). Furthermore, increasing business complexity has been commonly highlighted by academics (Law & Yuen, 2016; Penning, 2014) and regulators (FRC, 2015, 2017a; PCAOB, 2009, 2013, 2014) as placing an additional pressure on auditors’ ability to exercise PS. This complexity encompasses, among other things, the rise of complex financial instruments, digitised transactions, accounting estimates, fair value accounting and the increased complexity of accounting standards. Despite these business complexities (risks), auditors are expected to practice the appropriate level of PS in order to be able to properly respond to such risks (Curtis, 2014; Toba, 2011).

In addition, audit firms’ growing emphasis on commercialistic values and identities has been said to contribute significantly to the increased importance of PS (Barrainkua & Espinosa-Pike, 2017; Carter & Spence, 2014; Malsch & Gendron, 2013; Suddaby, Gendron & Lam, 2009; Sweeney & McGarry, 2011). The image of accountants (auditors) has changed from being “boring and reliable” to being more concerned with meeting the client’s needs (Carnegie & Napier, 2010; Picard, Durocher & Gendron, 2014). The responsiveness of auditors to the clients’ needs has been seen as a major impediment to the auditors’ exercise of independence and PS (Hellman, 2006).
2.2 PS Definition
PS is a broad concept that crosses multiple disciplines, encompassing auditing, corporate governance, human psychology; and ethics, among others (PCAOB, 2013). In the audit field, PS gains its significance due to the nature of the relationship between an auditor and the client, which requires the auditor to maintain an independent mindset while evaluating management assertions.

2.2.1 Philosophical Underpinnings of PS
Early references to scepticism may be traced back to the ancient Greek philosopher Pyrrho who was considered so sceptical that he could have lost his life because of his distrust of everything. There was no truth or lie according to Pyrrho because things are indifferentiable, immeasurable and indeterminable. It is debatable whether Pyrrho would have endorsed the current notion of scepticism, but subsequent writers have used the term “Pyrrhonism” to describe sceptical ideas nonetheless (Bett, 2010; Landesman & Meeks, 2003; Penning, 2014). In the contemporary English language, scepticism refers to as a “…disposition to doubt or incredulity in general; mistrustfulness” (Oxford English Dictionary [OED], 2017a). Thus, the word “sceptic” refers to those who suspect that certainty, knowledge or even warranted belief is possibly attainable (Landesman & Meeks, 2003). Those on the extreme spectrum who see knowledge as unattainable adopt the notion of “systematic scepticism”, which must be differentiated from “methodological scepticism”. Methodological sceptics do not deny the possibility of obtaining knowledge (truth), or naively accept things without verification, yet they obtain evidence before accepting things (Bunge, 1991). In the context of auditing, Mautz and Sharaf (1961) emphasised that “auditors should be hard to convince, but not impossible” (p.117), which implies that auditors should not easily accept management’s assertions without obtaining persuasive evidence. In a similar vein, audit regulators require that auditors “not be satisfied with less than persuasive evidence” (AU Section 316. 13; FRC, 2010a, p. 29; ISA 200.15(a22)).

2.2.2 Neutral versus Presumptive Doubt Perspectives
As the word “scepticism” refers to the “disposition to doubt” (OED, 2017a), the regulators and researchers in the auditing literature have debated the kind of doubt upon which auditors should exercise their PS. Some believe that auditors should presume the
possible presence of material misstatements, while others argue that auditors should objectively question the management’s assertions. For instance, Cohen, Dalton, and Harp (2017) studied the impact of auditors’ sceptical trait (holding neutral versus presumptive doubt) on their turnover intentions and organisational citizenship behaviour. They found auditors with the sceptical trait of presumptive doubt were more likely to leave the audit profession and exhibit lower levels of organisational citizenship behaviour because they perceive their managers (partners) as being unsupportive of PS behaviour. On the other hand, they found a neutral perspective to have positive influence on auditors’ perception of their superiors and accordingly they would exhibit higher levels of organisational citizenship behaviour and a lower tendency to leave the profession.

**Neutrality**

Some academic studies and auditing standards have promoted the neutral view, which requires auditors to exercise PS with an unbiased mindset. According to SAS No. 1, auditors should maintain an objective position while performing the audit and, “diligently perform, in good faith and with integrity, the gathering and objective evaluation of evidence” (AU Section 230.07). Same audit standard indicates that sceptical auditors are those who presume that the management is neither honest nor dishonest (AU Section 230.09). The PCAOB embrace a similar standpoint of PS, which supports the neutral perspective (PCAOB SAPA No. 10, 2012). One of the previous studies that explicitly relies on the neutral perspective to define PS is the study by Cushing (2000) which views sceptical belief as an “unbiased belief”. Likewise, Hurtt (2010) who developed a seminal PS trait scale, which has been widely utilised in the PS literature, assumes the neutral perspective in defining the PS concept as “a multidimensional construct”. Thus, it has been stressed that PS does not imply completely distrusting management or being cynical or insulting, rather it means accepting the management’s assertions only when supporting evidence is available (CAQ, 2010; Noviyanti & Winata, 2015). Although the neutral perspective has been increasingly encouraged in the auditing literature, there is a noticeable shift from the neutral view to what is referred to as “presumptive doubt perspective” (Bell, Peecher & Solomon, 2005)
Presumptive Doubt

Noticeably, the auditing standards that embrace auditors’ role in fraud detection have argued that auditors should assume the potential existence of material misstatements when performing the audit (Nelson, 2009). According to international audit standard ISA 200 and US audit standard SAS No.99, auditors should exercise PS taking into account the potential existence of material misstatements, whether due to fraud or error. Both standards emphasise that auditors should practice PS “regardless of any past experience with the entity and regardless of the auditor’s belief about the management’s honesty and integrity” (AU Section 316.13; ISA 200.15). The wording of these standards explicitly highlights that the presumed existence of fraud is important for performing effective PS. In the UK, FRC (2012a) emphasised that auditors should actively look for risks of material misstatements when critically assessing the management’s assertions. Similarly, the Centre for Audit Quality [CAQ] (2010) adopts the presumptive doubt view in defining PS as an enemy of fraud which prompts the importance of recognising the potential presence of fraud.

Numerous studies have demonstrated that sceptics tend to be more sensitive to negative evidence than positive evidence (Hogarth & Einhorn, 1992; McMillan & White, 1993). Shaub and Lawrence (1996) and Shaub (1996) equate PS with suspicion which has been defined as the opposite of trust. Nelson (2009) strongly advocates the presumptive doubt approach supporting his argument with a list of references to the auditing standards and previous studies that highlight the significance of assuming the potential existence of material misstatements while exercising PS. He proposed that highly sceptic auditors are those who do not accept an assertion without gathering more (in terms of quality and quantity) persuasive evidence. In a study focused on the neutral and presumptive doubt perspectives in audit, Quadackers, Groot and Wright (2014) found that sceptical characteristics are more related to the presumptive doubt perspective.

After a historical review of the previous studies of the PS concept, Toba (2011) developed a model which describes the different positions of approaching PS. This model encompasses two dimensions, ways of knowing and questioning state of mind. The first dimension explains “the ways of knowing” by which auditors seek to verify the management’s assertions. Accordingly, two ways of knowing are identified, which are
distinguished based on whether the auditors concentrate on positive evidence (affirmative approach) or negative evidence (falsification). The second dimension reflects the basis upon which auditors raise questions about the management’s assertions. Two stances are defined, which include: the neutral stance and the presumptive stance (biased toward negative evidence). Through this model, Toba proposed that the increased bias toward negative evidence and propositions would increase the auditors’ interest in exercising PS. He argues that the auditing standards’ existing shift to a presumptive doubt perspective should be accompanied with an emphasis on negating the management’s assertions, instead of confirming them. He emphasised that the audit risk approach, which becomes the common basis of conducting the audit procedures, fits more with the presumptive doubt view.

2.2.3 Definitions of PS in the Auditing Field
PS has been defined in the US auditing standards as, “an attitude that includes a questioning mind and a critical assessment of the audit evidence” (AU Section 230.07). This definition assumes that auditors should gather objective evidence and not be satisfied with less than persuasive evidence. This definition explicitly embraces the neutral perspective. However, the US auditing standards related to fraud detection responsibility (e.g. SAS No. 99) are more consistent with the presumptive doubt view reflected in the definition of PS in ISA as “an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence” (ISA 200.13(l)). This latter standard requires that auditors not only gather evidence but also assume the possible presence of material misstatements, whether due to fraud or error. In academic literature, we can witness a similar inconsistency in defining PS in terms of the neutral and presumptive doubt perspectives. For example, Nelson (2009) defines 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” (p.4); whereas Hurtt (2010) emphasises a neutral basis of PS as, “a multi-dimensional construct that characterizes the propensity of an individual to defer concluding until the evidence provides sufficient support for one alternative/explanation over others” (p.151).
Further, extant definitions of PS appear to link it to the questioning mind, hence presenting PS as part of the judgement process. For instance, auditing standards stress the “questioning mind and critical assessment” (AU Section 230.07; ISA 200. 13(l)). These wordings present PS as a state of cognitive substance enabling auditors to evaluate audit evidence and perform the audit procedures. Similarly, academic literature has also underlined the cognitive substance of PS. Nelson’s (2009) definition, for instance, categorises PS behaviour into two integral constructs: sceptical judgement and sceptical actions. Furthermore, the concept of exercising PS has been broadened to encompass auditors questioning their own judgements and those made by their peers in the firm (inward scepticism) as well as questioning client management’s representations (outward scepticism) (Bell et al., 2005; Peecher, Solomon & Trotman, 2013). Inward scepticism is defined as “being pre-emptively self-critical in anticipation of various arguments that others could bring against their beliefs or the evidential base they have or have not relied upon to form such beliefs” (Bell et al., 2005, p.34). When auditors are being sceptical of their own judgements, they tend to identify more alternative fraud explanations of the management’s assertions, and become more alerted to a possibility of unidentified or undetected misstatements (Brasel, Hatfield, Nickell & Parsons, 2019; Grenier, 2017).

2.2.4 PS as a Trait versus State
There has been a lack of consensus in the literature also as to whether PS should be conceptualised as a trait, a state or both. For instance, Hurtt (2010) views PS as a personal trait similar to other personality traits, such as curiosity, consciousness, and extroversion. Conversely, others see PS as a response to the audit circumstances with respect to the auditor-client relationship (Glover & Prawitt, 2014; Robinson, Curtis, & Robertson, 2018). The auditing standards and other regulators’ reports which embrace the risk assessment approach appear to view PS as a state that is triggered by the risks associated with the context where audit is taking place. For instance, in ISA 200, the exercise of PS includes paying careful attention to high-risk situations, such as contradictory audit evidence, conditions that may imply possible fraud, situations requiring the performance of additional audit procedures and information which may reduce the reliability of audit evidence. In contrast, Hurtt et al. (2013) and Nelson (2009) depict PS as both a trait and a state.
Ajzen (2005) defines a trait as, “a characteristic of an individual that exerts pervasive influence on a broad range of trait-relevant responses” (p.2). The importance of these individual differences emerges from their impacts on individuals’ attitudes and behaviours. For instance, some studies have found a significant impact of certain types of personalities on the auditors’ job stress, job performance, the acceptance of new audit technology, quality of accounting judgement, and level of PS judgement and action (Bonner, 1999; Choo, 1986; Cohen et al, 2017; Curtis & Payne, 2008; Hurtt, 2010; Quadackers et al., 2014; Toba, 2011). One of the popular definitions of PS is as the opposite of trust or the disposition toward distrust (Rennie, Kopp & Lemon, 2010; Rose, 2007; Shaub & Lawrence, 1996). Shaub (1996) presumes that auditors become sceptic when they possess a lower level of interpersonal trust. Trust is defined as a personal trait, which is reflected by individual differences in fear, cynicism, wariness, vigilance and scepticism (Lewicki, McAllister & Bies, 1998). Some people inherently have a disposition to trust or distrust others regardless of the situations that they are in (Harding, Azim, Jidin & Muir, 2016). Accordingly, Hurtt et al. (2013) define traits as the individual characteristics by which auditors are able to employ sceptical judgment.

In her other work, Hurtt (2010) developed a scale to measure the PS trait. Fundamentally, she based her scale on two assumptions: the neutral view of PS and defining PS as a personal trait (which is stable over time). Based on an intensive review of the PS literature, Hurtt defined the PS trait as a multidimensional concept that consists of six personal characteristics. These six characteristics encompass a questioning mindset (sense of doubt or disbelief), withholding judgement until evidence is obtained, curiosity, understanding the motivations and available opportunities for client management to provide misleading evidence, self-motivation in critically questioning the evidence obtained and the self-confidence to challenge the client management and resist their persuasions involving such evidence. In accordance with these characteristics, Hurtt developed her PS trait scale which consists of 30 items. A number of studies in the PS literature have used Hurtt’s scale to test the scale or to measure the auditors’ PS trait and explore the different factors (variables) that can influence it. For instance, Hussin and Iskandar (2015) tested Hurtt’s scale in the Milesian auditing context and found that the suspension of the judgement trait is irrelevant to maintaining
the PS attitude in Malaysia, which suggests that PS traits may differ in different environments. Thus, it was suggested that Hurtt’s scale needs to consider the cultural differences between US and other contexts (e.g. China) (Kwocka, Ho & James, 2016).

An alternative view is that people’s behaviours are not only influenced by personal traits but also by situational factors (state) and the interaction between the two (Steyer, Schmitt & Eid, 1999). For instance, dispositions of trust or distrust reflected in behaviours have also been seen as the outcomes of interaction between situational factors, dispositional factors, and previous experience (Bonner, 1999; Curtis & Payne, 2008; Harding et al., 2016; Kee & Knox, 1970). Nelson (2009) and Hurtt et al. (2013) depicted this in their models which they developed based on their extensive review of the PS literature to help understanding PS. According to Nelson’s (2009) model, PS is a cognitive state (judgement) that is not to be displayed through actions unless it reaches a threshold. Thus, the sceptical action can be prevented from being exercised because of different factors, such as the audit efficiency and the firms’ culture. He exhibited personal traits as an important factor influencing auditors’ cognitive state of mind. Likewise, Hurtt et al. (2013) used Nelson’s (2009) classification of PS behaviour into sceptical judgement and sceptical actions and Hurtt’s (2010) six PS traits and accordingly warranted the importance of both personal traits and situational factors. They argued that auditors can have sceptical traits, yet they might not act sceptically because of situational factors. Conversely, the situational factors may necessitate the exercise of PS; however, the auditors might not exercise PS sufficiently because they do not possess the sceptical traits. Likewise, Robinson et al. (2018) perceived PS as both state and trait, but they strongly emphasised on PS state to the extent that they developed, based on Hurtt’s (2010) scale, a new scale that focuses on disentangling and measuring PS state.

Defining PS mainly as a state is supported by the auditing standards, which require auditors to be alerted to high-risk situations (FRC, 2012a). For instance, auditors are expected to respond differently toward high risk issues. This expectation appears to support Glover and Prawitt’s (2014) continuum linking the level of scepticism with the risk. Similarly, Toba (2011) stressed the complexity and multifaceted nature of the PS concept, defining PS as a hybrid concept consisting of philosophical substance (way of
knowing) and psychological substance (cognitive state). Furthermore, Nolder and Kadous (2018) emphasised that PS should be conceptualised as being contextual and situational, arguing that both trait and state are both important in predicting people’s behaviour.

2.3 Developments in Conceptualising PS

In an attempt to clarify the PS concept, Nelson (2009) conducted a detailed review of the PS literature in auditing as well as other disciplines and built a model that noticeably contributed to the literature. Consistently, he defined PS as an attitude that is “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” (Nelson, 2009. p.4). In this definition, Nelson shows that the PS behaviour starts as sceptical judgement and is then reflected through sceptical actions. He then explained that auditors’ sceptical behaviour (judgement and actions) is influenced by a set of factors, including evidential inputs (e.g. client characteristics), knowledge of client management incentives to misstate the Financial Statements (FS), auditors’ motivations, and auditors’ competency (knowledge and non-knowledge attributes (traits)).

In addition to Hurtt’s (2010) PS trait scale which she contributed to the PS literature to help explaining PS as a personal trait as well as measuring auditors’ PS, Hurtt and her co-authors extensively synthesised the PS literature and developed a holistic model to explain PS (Hurtt et al., 2013). In their model, they list different factors that can influence auditors’ sceptical judgement and actions, including the auditor’s personal characteristics, client’s characteristics, evidential characteristics and external environment characteristics. Although their work captures the complexity of the PS concept as being multifaceted, they emphasised that multiple questions about the PS concept request further research in order to expand the understanding of the PS concept and its relationships with these different factors in practice.

In a recent study, Nolder and Kadous (2018) reviewed the PS literature and mindset and attitude theories literature with the aim of providing clearer conceptualisation of the PS concept, which can offer certain proxies that can help future researchers, firms and regulators to better examine and gauge auditors’ exercise of PS. Relying on the mindset
and attitude theories from psychology, they tried to conceptualise the PS concept as both a mindset and an attitude which dually manifest auditors’ PS behaviour and are influenced by certain factors (e.g. auditors’ personalities, knowledge, firm culture, client pressures, etc). Nolder and Kadous use the argument that PS is contextual and situational more than being a personal trait, but they consider personal traits a part of the situational factors influencing auditors’ exercise of PS. Importantly, they emphasised the important role of feelings (emotions) in the construct of PS practice which they described as being widely neglected in the regulators’ publications and previous academic studies. Their study is an attempt to combine the conceptualisation efforts of practice (regulators’ standards and reports) and academic research by the exploitation of mindset and attitude theories. They argue that auditors access a certain deliberate mindset to engage in certain activities (understand the issue, gather the facts, consider the alternatives and perform the analysis) which influence (or be influenced by) their feelings and beliefs (attitude), which then influence their intentions and sceptical actions.

2.4 Factors Affecting Auditors’ Exercise of PS
As shown earlier in the chapter, extant definitions of PS acknowledge the influence of various factors on the auditors’ practice of PS. These factors vary but include elements such as auditor characteristics, client characteristics, evidential characteristics and environment characteristics. In the following sections, we will provide a detailed discussion of literature exploring the effects of those factors.

2.4.1 Auditor Characteristics
Auditors’ personal characteristics refer to their personal differences (traits), knowledge (experience), ethical attitude, accountability, personal incentives, and emotions (affect, feelings or mood). The following sub-sections are developed to provide a discussion of research evidence about the relationship between these personal characteristics and auditors’ PS.

Personal Traits
Auditors’ personal traits have an influence on the exercise of PS (Nelson, 2009). Similarly, based on a review of the audit standards, psychology, philosophy, and consumer behaviour research, Hurtt (2010) defines the auditors’ sceptical trait on the
basis of six personalities: a questioning mind, suspension of judgment, search for knowledge, self-confidence, autonomy, and interpersonal trust. These personal traits are supposed to be inherently possessed by auditors, and so it is possible to classify auditors into two groups: sceptic auditors and non-sceptic auditors.

Sceptic auditors have been seen as those who suspend making a decision until fully examining a sufficient amount of evidence, consider the client management incentives to misstate FS and have the self-courage and ability to act in accordance with the evidence acquired. Auditing standards require auditors to suspend judgement until obtaining persuasive evidence (ISA 240; SAS No. 99). The disposition to trust others is associated with the expectation that their words or actions can be relied upon (Rotter, 1980). Understanding others’ motives and competence has been found to influence the subjective assessment of others’ trustworthiness (Kee & Knox, 1970). The auditors’ understanding of client management’s incentives and integrity has an impact on the auditors’ sceptical judgement. Therefore, it was found that auditors who are less trusting and understand the management’s motivations are more able to infer the likelihood of fraud and challenge the management’s assumptions (Brown-Liburd, Cohen & Trompeter, 2013; Rose, 2007; Quadackers, Groot & Wright, 2009; Shaub, 1996; Shaub & Lawrence, 1996).

Quadackers et al. (2014) suggest that a lower level of interpersonal trust encourages auditors to be more sceptical. Auditors with dispositional distrust tend to be more sensitive to situations that signal high risks or issues of distrust (Harding et al., 2016). Several studies in the PS literature have used Hurtt’s (2010) scale to measure the level of PS traits (Agarwalla, Desai & Tripathy, 2017; Aschauer, Fink, Moro, van Bakel-Auer & Warming-Rasmussen, 2017; Law & Yuen, 2016; Mcallister, Blay & Kadous, 2016; Noviyanti & Winata, 2015; Peytcheva, 2014; Quadackers et al., 2014). Farag and Elias (2016), for example, analysed the Big Five personality characteristics (extraversion, agreeableness, conscientiousness, neuroticism, and openness to experience) based on a sample of accounting students. They found students who score highly on Hurtt’s scale and possess the Big Five traits are more likely to be successful auditors as highly sceptic students were found to socialise with others better than non-sceptics. Whilst most previous studies appear to link PS to higher quality professional judgement, some
nonetheless found that the PS trait to be “a double-edged sword” (Hurley, 2019, p.24) increasing ego depletion, which may in turn lead auditors to accept management’s view more readily.

**Experience**

The knowledge developed over time to detect errors and the patterns of evidence that signal high probability of misstatement represent the type of experience that can influence auditors’ PS (Nelson, 2009; Shaub, 1996; Shaub & Lawrence, 1996). Different studies have explored the association between the exercise of PS and auditors’ specific or general experience. Grenier (2017), for example, studied how industry specialisation may prompt auditors to make quicker decisions without further questioning. He found that auditors’ industry specialisation may inhibit their practice of PS when error prompts are absent but also that specialised auditors may be better at exercising PS when such prompts are available.

Further, Popova (2013) proposed that auditors’ client-specific experience can have both a negative and a positive effect on PS, based on the type of experience that auditors have. Auditors’ experience may also influence their response to situational primes which signal serious audit risks. For instance, Peytcheva (2014) found that the situational primes have a greater influence on the sceptical judgement of less experienced auditors (e.g. trainees) compared to experienced auditors. Rodgers, Mubako and Hall (2017) emphasised the significant role of knowledge transfer from expert auditors to novices in improving auditors’ exercise of PS. Professional participants in Curtis’s (2014) study viewed experience and training as the most important influences on the auditors’ level of PS. Penning (2014) showed that a long client-specific audit experience that does not lead to the detection of significant misstatements may create a subconscious “confirmation bias” which may reduce the exercise of PS. Similarly, a large number of studies have found audit tenure (which is linked to the length of audit experience with a given client) to have a negative effect on the practice of PS (Enofe, Ukpebor & Ogbomo, 2015; Kerler & Killough, 2009; Nelson, 2009).
**Ethics**

According to the auditing ethics codes, auditors are held ethically accountable for maintaining independence and objectivity when performing an audit (International Ethics Standards Boards for Accountants [IESBA], 2006). It is considered generally unethical for auditors to readily accept management’s assertions without exhibiting appropriate levels of PS (Brown-Liburd et al., 2013). The way auditors make sense of and interpret what constitutes ethical behaviours is important. Eutsler (2017) found in this regard that auditors exercise low levels of PS when they perceive public interest in a narrow sense – i.e. as protecting the interests of particular individuals (who auditors may be familiar with), as opposed to the interests of capital markets participants as a whole. It has been argued that auditors who are more ethics conscious are also expected to exercise higher levels of PS (Shaub & Lawrence, 1996). Enofe et al. (2015), for example, found a positive relationship between ethics and PS, suggesting that a greater emphasis on the importance of ethics encourages auditors to practice auditing with due diligence. However, other studies (Kerler and Killough, 2009), did not find evidence to suggest that higher moral reasoning necessarily leads auditors to feel lower trust toward client management. Similarly, Agarwalla et al. (2017) argued that although the PS trait increases individuals’ perceptions of morality in the context of earnings management, this influence is minimised in case of professional accountants who may have greater exposure to ethics requirement and information. They also suggest that the PS trait has lesser effects on accountants’ morality ratings of earnings management issues.

**Accountability**

Auditors’ accountability toward reviewers, regulators, and superiors (partners) has been shown as one of the key motivations that inspires them to practise the appropriate level of PS (Fei Gong et al., 2014; Hurtt et al., 2013; Kim & Trotman, 2015; Nelson, 2009). This influence of accountability on auditors’ practice of PS has been claimed to be greater when auditors’ accountability is linked to the judgment process that they follow rather than their final judgment (outcome) (Kim & Trotman, 2015). Likewise, Turner (2001) found that reviewers with preference for scepticism, as opposed to meeting client needs, can motivate reviewees (auditors) to collect more evidence. He also found that auditors exercise greater scepticism when the reviewer’s preference is unclear. Auditors whose superiors exhibit preference for effectiveness (scepticism) over efficiency were
found to demonstrate more sceptical judgements in relation to fraud risk assessment (Carpenter & Reimers, 2013) (explained further in “tone at the top” section below).

Furthermore, some studies demonstrated that regulators prompt auditors to practise higher levels of PS when evaluating management’s fair value assumptions (Earley, Hoffman & Joe, 2012). However, others (Cannon & Bedard, 2017) argued that the most significant difficulty facing auditors during audits of fair value estimates is the risk assessment rather than PS. This is because auditors were found to assess fair value issues of high complexity and uncertainty as only low to moderate risk. Furthermore, regulators’ requirement (such as those set out by PCAOB) for auditors to document and interpret their fraud risk assessments was found to produce unintended outcomes by reducing auditors’ practice of PS due to difficulty of supporting such assessments (Hammersley, Bamber & Carpenter, 2010; Piercey, 2011). As regulators usually penalise auditors for not meeting certain thresholds of performance, such as an insufficient exercise of PS, auditors choose to adjust their judgements in order to meet the preference of those reviewing their work (Peecher et al., 2013). Participants of Westermann, Cohen and Trompeter’s study (2014) also indicate that applying a higher level of PS would not get rewarded or even noticed as much as the lack of exercising PS. This led some to suggest that reviewers (including regulatory inspectors) should concentrate on providing constructive feedback on not only sub-standard but also good performance and practice of PS in order to encourage auditors to achieve more than simply standard expectations (Nach, 2014). Indeed, the compliance mindset attributed to modern-day auditors was shown to impair their ability to uncover complex fraud and practise PS appropriately (Carpenter & Reimers, 2013; Nolder & Kadous, 2018; Peecher et al., 2013).

**Emotions**

Hurtt et al. (2013) classified emotions (affect, feeling or mood) that auditors may experience as a factor influencing auditors’ exercise of PS. Some studies have demonstrated that negative feelings and moods (e.g. disliking, being angry, sad, stressed, anxious) that auditors experience as professionals can make them more conservative when interacting with the client management and making professional judgments (Bhattacharjee & Moreno, 2002; Bhattacharjee & Moreno, 2013; Chung, Cohen &
Monroe & 2008; Garcia-Falieres & Herrbach, 2015; Schafer & Schafer, 2018). For instance, Guenin-Paracini et al., (2014) conceptualised audit work in terms of management of fear and how emotions related to this feeling profoundly influence and shape different practices (including PS) that constitute audit practice. Cianci and Bierstaker (2009) found auditors with negative mood were more able to generate correct explanations for fluctuations in financial ratios, while more positively predisposed auditors were also more ethically conscious.

Other studies provided an alternative view by interpreting auditing practice as comfort production rituals (Pentland, 1993; Power, 1997) and processes (Carrington & Catasus, 2007). They showed how auditors develop certain practices, such as further challenging the client management and more evidence collection, in order to that the feelings of comfort and discomfort emerging in the course of an audit can be reconciled and managed (Carrington & Catasus, 2007). Relying on this perspective, Commerford et al. (2016) who conducted a study to investigate the influence of Real Earnings Management (REM) on auditors’ comfort found that the presence of REM can make auditors feel uncomfortable. They indicated that auditors tend to respond to such discomfort and maintain feeling of comfort through engaging in certain activities including discussion with clients management, exercising higher level of scepticism and modifying audit procedures and risk assessment. However, Rowe (2019) demonstrated in this regard that gathering more audit evidence to challenge the client management does not always lead to increased levels of comfort, especially when an auditor has already reached confidence required to defend his/her judgement.

At this point, it is worth noting that auditing studies have only started recognising the role of emotions in auditing practices. While prior studies tend to investigate emotion as a factor influencing auditing practices (including PS), this study aims to contribute to this emerging body of literature by interpreting emotion (affect) as a part of cognitive system and a construct of PS (explained further in Chapter 3). Likewise, since emotions represent a part of the cognitive system, acknowledging their role in auditors’ practice of PS can contribute to a better understanding of how it is practiced. Thus, considering emotions (which can be captured by the Type 1 thinking process as further explained in Chapter 3) can expand one’s understanding of the nature and constructs of PS which
may have been broadly limited to the deliberate adoption of a certain mindset (e.g. Nolder & Kadous, 2018). For example, although, Nolder and Kadous (2018) attempted to capture the relationship between auditors’ emotional response to risks and PS through their endorsement of the attitude dimension, they presented affective reaction as a component of different nature than cognition, which contradicts the proposition that emotion is part of the cognitive process, which this study’s key theoretical framework (SIM, see Chapter 3) is fundamentally built upon.

2.4.2 The Context of Audit Work
Audit firms’ environment and culture (such as quality control, workloads, proper engagement planning, and performance appraisal) represent another significant influence on the exercise of PS by auditors (Harding & Trotman, 2016; Penning, 2014; Sommerfeldt, Zimbelman & Zimbelman, 2018; Stevens, Moroney & Webster, 2019; Svanberg & Ohman, 2016; Westermann et al., 2014). In this section, we consider the influence of the audit firms’ tone at the top, rewards and promotion policies as well as relationship with client management on auditors’ PS.

Tone at the Top
As previously discussed, auditors are motivated by the expectations of those to whom they are held accountable (Cohen et al, 2017; Hurtt et al., 2013). More specifically, Peecher et al. (2013) indicated that auditors tend to align their professional judgment with their supervisors’ preference. Accounting regulators suggest the significant influence of the tone at the top on encouraging auditors to apply the appropriate level of PS (AICPA SAS No. 99; IAASB 2014a). Relatively, Carpenter and Reimers (2013) found that the partners’ emphasis on PS has a significant influence on fraud risk assessment (sceptical judgment) and the choice of fraud risk factors and procedures. They found that auditors become more effective and efficient in terms of identifying a higher number of fraud risk factors, and relevant fraud procedures, especially when the fraud indicators are strong. However, it has been claimed that the influence of partners’ preference of PS tends to be greater on auditors who possess a low level of PS traits (Noviyanti & Winata, 2015). Audit partners’ communication of their own views about the lower probability of fraud existence have a different effect on auditors’ PS than their communication of client’s management views. Harding and Trotman (2016) found that
when partners communicate their own views about the lower likelihood of fraud existence, they have a greater impact on decreasing their subordinates’ PS judgement, but did not seem to decrease their PS actions. This contradictory influence of partners’ communicated views might be caused by the study’s controlled experiments, which focus on providing partners’ view in a fraud brainstorming session.

**Rewards and Promotion Policy**

Audit firms seek, by their control policies, to avoid the potential risk of litigation, loss of reputation or regulatory sanctions because such avoidance may increase their opportunity to satisfy their profitability objectives (which can be perceived as rewards) (Nelson, 2009; Westermann et al., 2014). The rewards and promotion policies reflect the audit firms’ tools to motivate auditors to apply high levels of PS (Curtis, 2014; Nelson, 2009). Rewarding auditors, whether through promotion or monetary compensation, with the purpose of enhancing audit quality has been introduced by audit firms as one of the strategies to elevate PS (Kadous & Zhou, 2019; Nach, 2014; Pecher et al., 2013). Knechel, Sofla and Svanstrom (2018) found that there is a positive association between the exercise of PS and auditor compensations. In a similar fashion, Brazel, Leiby and Schaefer (2018) found that rewarding PS can encourage further exercise of PS only if auditors expect their superiors to place priority of scepticism as a desirable audit behaviour. In terms of promotion practices, studies showed that partners’ exposure to higher risks (litigation, regulators’ sanctions, and loss of reputation) encourages them to maintain higher PS when they review practices performed by audit teams (Westermann et al., 2014). However, research evidence on the link between seniority and the exercise of PS has been mixed. Some studies assumed more experienced auditors exercise higher levels of PS (Hurtt et al., 2013; Nelson, 2009), while others found new entrants to apply more sensitively and care in their practice of PS (Curtis, 2014; Peytcheva, 2014).

**Relationship with Client Management**

The nature of auditors’ relationship with client management is one of the contextual factors which can influence the auditors’ exercise of PS. Examples of client characteristics discussed in the literature include the client’s internal control quality, business complexity, and the management’s negotiating stance (Bennett & Hatfield, 2013; Hurtt et al., 2013; Shaub & Lawrence 1996; Westermann et al., 2014;
Zimmerman, 2016). Studies have found that auditors may accept the management’s assertions more readily when they perceive management to possess high integrity, exhibit expressions of confidence, display attractive office environment, share similar values and norms (identity), have a previous auditing experience or have a close personal relationship with the audit team (Aghazadeh & Joe, 2015; Bauer, 2015; Favere-Marchesi & Emby, 2017; Khan & Harding, 2019; Shaub & Lawrence, 1996; Rennie et al., 2010). There is also research evidence suggesting that client management’s pressure (e.g. “ingratiation”\(^2\) or using diversion strategy\(^3\)) can impact auditors’ judgement, including the practice of PS (Koch & Salterio, 2017; Luippold, Kida, Piercey & Smith, 2015; Robertson, 2010). Eutsler, Norris and Trompeter (2018) find that auditors are less likely to pose questions (exhibit PS behaviour) to the client management in cases when management personnel appear more friendly and responsive in their dealings with the auditor. Moreover, client size may also influence auditors’ desire to practice higher levels of PS. Rather than pleasing prominent clients, Westermann et al.’s study (2014) found that auditors may practice higher PS in audits of larger client because of the fear of greater regulatory scrutiny and litigation concerns.

Furthermore, the auditor-client method of communication and the client’s subjective accounting estimates can have an impact on the auditors’ PS. In general, studies demonstrated that auditors are more likely to exhibit higher level of PS (challenge more) when they interact with the client management personnel in person (Bennett & Hatfield, 2018; Saiewitz, 2018). However, research also shows that the client’s experience and status may also be an important influence here. In this respect, Bennett and Hatfield (2013) found that a significant difference in age and experience between audit staff and client managers may lead to auditors’ reluctance to pursue further information requests.

### 2.5 Barriers to Practicing PS

The efficiency objective and the nature of the relationship with the client have been most commonly identified in the literature as factors that inhibit the practice of PS in auditing. Efficiency objective places auditors under strong time pressure which is usually

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\(^2\)Robertson defines ingratiation as “an attempt to induce positive affect to facilitate persuasion” (Robertson, 2010, p.69)

\(^3\) According to Luippold et al. (2015), client management may strategically attempt to divert auditors’ attention to certain FS accounts to conceal earnings management.
reflected in the audit budget. Thus, auditors may choose not to act in accordance with their PS judgement to meet the audit budget, favouring efficiency over effectiveness (Boyle & Carpenter, 2015; Cohen et al, 2017; Nelson, 2009; Westermann et al., 2014). For instance, Eutsler (2017) found that auditors exhibit insufficient exercise of PS when they experience time pressure which leads them to engage in a moral justification process. In addition, auditors are also faced with heavy workloads and responsibilities, which might impair their practice of PS (Coppage & Shastri, 2014). Knechel et al. (2018) demonstrated how such pressures result in auditors’ perceptions that high levels of PS may have unwanted consequences, such as time “lost” on collecting additional audit evidence which may be deemed unnecessary at the end. A concern that higher levels of PS require additional time and cost but don’t necessarily lead to better decisions and judgements represents the kind of efficiency objective barrier that restricts further practice of PS (Brazel et al., 2016; Knechel et al., 2018; Peytcheva, 2014). In order to minimise the risk of inefficient audit work or clients’ dissatisfaction, audit firms may choose to focus on efficiency and client satisfaction in their evaluation (review) processes. The evaluators (reviewers) may thus focus on auditors’ compliance with budget and client feedback instead of explicitly focusing on the practice of PS (Westermann et al., 2014). Brazel et al. (2016), for example, examined the influence of the outcomes of quality reviews on audit firms’ and their client’s evaluations of auditors’ work and found that reviewers deem auditors’ performance to be lower in the absence of detected misstatements. They also found that client managers consider it as a waste of time when auditors practice higher levels of PS (such as by asking for more evidence) which do not lead to the detection of material misstatements. Therefore, there is a risk that auditors may choose not to act sceptically for fear it may negatively affect their performance evaluations as well as their working relationship with the client.

2.6 Research Gaps
This chapter has provided an overarching view of PS’s importance to higher audit quality, the PS concept’s multi-faceted nature and the existing academic studies that have explored the PS concept in audit. Even though there has been a growing interest in PS, understandings of the concept remain ambiguous (Brazel & Schaefer, 2015; Hussin & Iskandarb, 2015; Olsen & Gold, 2018). Researchers have realized that the PS concept is multi-faceted and has several aspects linked to it (Hurt et al, 2013; Nelson, 2009;
Toba, 2011). These related aspects include auditor characteristics, client characteristics, the nature of audit evidence and firm and external environment characteristics (Hurtt et al, 2013). Many of the relationships between the PS concept and these different aspects have not been explored and involve different research questions that require further research efforts. For instance, numerous studies have called for additional studies to explore issues around the determinants of PS (Brael et al., 2016; Knechel et al., 2018; Olsen & Gold, 2018; Ying, 2015), PS traits (Curtis, 2014; Hussin & Iskandarab, 2015), balancing the exercise of PS with the objectives of audit efficiency (Mcallister et al., 2016), the application of PS in the audit process (Glover & Prawitt, 2014; Knechel, Krishnan, Pevzner, Shefchik & Velury, 2013) and the role of the client’s audit committee and audit firms’ culture on the exercise of PS (Glover & Prawitt, 2014; Penning, 2014).

Although many of the previous studies have utilized Hurtt’s (2010) PS trait scale to gauge the practices levels of PS in order to test the influence of different antecedents on sceptic or non-sceptic auditors, this scale has some limitations in terms of its development, assumption of a neutral view of PS and constrained definition of the PS concept as a personal trait. Hurtt (2010) predominantly developed her scale based on her review of the literature in different disciplines, as opposed to exploring first-hand how audit professionals make sense of the PS concept in practical settings. She also assumed a neutral view of the PS concept which has been criticised for not being able to encourage higher practice of PS (Toba, 2011). Therefore, Hurtt’s PS trait scale focuses only on measuring auditors’ PS trait without sufficient consideration being given to the situational factors which may have greater influence on auditors’ practice of PS (Harding & Trotman, 2016; Curtis, 2014; Westermann et al., 2014).

Nelson (2009) has made a major contribution to the PS literature as he divides PS behaviour into two related components, which are PS judgment and PS actions. However, many of the subsequent studies have concentrated more on studying PS judgement. It has been argued that PS behaviour is reflected in the relevant actions on which regulators based their finding that the auditors’ exercise of PS is lacking. Thus, sceptical judgement does not necessarily lead to the exhibition of sceptical action because some situational factors (such as client’s performance or audit budget) might
motivate auditors to not act sceptically (Brown-Liburd et al., 2013). There is a clear need for understanding how the PS concept is demonstrated and documented by professionals in practice (Brael & Schaefer, 2015; Glover & Prawitt, 2014; Toba, 2011; Ying, 2015). For instance, when Hurtt (2010) surveyed auditors’ opinions about the PS concept in the construction process of her model, she indicated that auditors had provided her with varied definitions of the concept. These varied views support the call for further understanding of the practical meaning of PS.

Therefore, based on the literature review in this study, which shows a limited understanding of this multifaceted concept, this thesis sets an objective to explore and explain the practical meaning of the PS concept from the point of view of professional external auditors who are practising audit in the UK context using archive documents (FRC’s AQR reports) and in-depth interviews. This is important because auditors are required and expected to manifest this concept in their everyday practice. This study therefore aims to contribute to the literature through obtaining an in-depth understanding of the PS concept which explains the meaning of the PS concept that professional external auditors internalise and act upon in practice.

Additionally, previous studies of the PS topic have been rather one-dimensional in terms of their focus on the PS judgement as a rational process. Most previous studies have implicitly assumed that the cognitive state which is associated with the practice of PS represents an analytical and systematic type of thinking process (this is referred to as Type 2 thinking process; see Chapter 3 for detailed discussion) where auditors are expected to follow certain rules and analytical tools. In other words, PS has been commonly conceived of as a deliberate and rational state of mind (Bucaro, 2019; Griffith et al, 2015; Griffith, Kadous & Young, 2019; Humphrey & Moizer, 1990; Nolder & Kadous, 2018; Plumlee et al., 2015; Rasso, 2015). For instance, Urboniene, Endrawes and Matawie (2013), who conducted a study examining the relationship between PS and the business students’ thinking styles, argued that PS can be more linked to the Type 2 thinking process. However, as we showed earlier in this chapter, emotions and feelings have been documented to play important roles in the practice of auditing, and as a consequence, the exercise of PS (Carrington & Catasus, 2007; Commerford et al., 2016; Pentland, 1993; Power, 1997; Rowe, 2019). Carrington and Catasus (2007), for example,
explained that auditors need to build up their comfort in order to make their judgement before producing comfort to the society. Similarly, Guenin-Paracini et al. (2014) who found feeling of fear associates auditing as a work activity emphasised the significant role of emotion in shaping auditing practices. This interpretation highlights the important role that intuition and feelings (Type 1 thinking process; see Chapter 3) may play in the JDM process in auditing.

Psychological studies, as we will explain in Chapter 3, have stressed the role of intuition, gut feeling, and emotion to the extent that it is considered to be the key process dictating and determining moral judgement. Although a limited number of studies within the auditing literature have devoted certain efforts to acknowledge the affective aspects of the PS concept, they did not explore those through in-depth empirical work. For instance, Nolder and Kadous (2018) sought to develop proxies (measures) for future experimental research to gauge PS, acknowledging the role of feelings (emotions) and beliefs through the inclusion of attitude constructs as possible proxies, and hence differentiating between the cognitive processes and their affective evaluations.

Therefore, this thesis responds to the previous calls to explore and explain the role that affective thinking processes and emotions play in the practice of PS (Commerford et al., 2016; Griffith, Kadous & Young, 2016; Nolder & Kadous, 2018; Olsen & Gold, 2018). More specifically, this thesis aims to contribute to the extant literature by providing an overarching interpretation (a theoretical model) of the PS practice which can explain the nature of PS as a cognitive state, the role of emotion in it, and the manner in which both affective and rational thinking processes interact as auditors practice PS.

Furthermore, one of the major limitations of most of the previous studies in the PS literature is their primary utilisation of the experimental research design. Experimental research design does not provide the full picture of the practice environment because it is based on a set of controlled hypothetical scenarios which limit examination to merely a few variables (Kachelmeier, 2018; Westermann et al., 2015). Humphrey (2008) criticised the consistent use of experiments in audit research, stating that most audit research focused on “constructing experiments that cannot ever really be expected to replicate either the real pressures and career challenging or threatening scenarios that
some auditors can encounter in their actual working environment” (p.193). The quantitative experimental research design is accused of limiting the knowledge of the method by which audit is produced and manufactured in practice (Sikka et al., 2009). For instance, as the previous sections show mixed findings and a blurred understanding of the effects of different factors on auditors’ PS, this can be related to the excessive use of experimental design which simplifies the complicated PS behaviour into a few isolated variables which collectively occur in reality, used different proxies to represent similar variables, disregard the social aspect which is difficult to quantify, and sometimes used students to surrogate practitioners.

Likewise, the qualitative research method has been argued to be the best to expand our understanding of audit practices since it requires studying auditing concepts in their natural settings and from the auditors’ experiences and interpretations (Humphery, 2008; Power & Gendron, 2015). In this regard, a previous study involved a limited number of interviews, but the researcher has found that the insights obtained in the interviews very beneficial and important (Westermann et al., 2014). Relatively, Brazel and Schaefer (2015), who conducted an updated review of the audit PS literature have called for utilising a qualitative research approach to expand our understanding of PS. Thus, this thesis responds to previous studies’ calls as it employs a qualitative research design to provide an in-depth understanding of PS. The qualitative design is employed to help this study satisfy its aims of explaining the practical meaning of the PS concept, which acknowledges the different factors (e.g. knowledge, review process and efficiency objective) shaping auditors’ practice of PS, including their social interaction with the client management personnel and audit team members.

2.7 Summary
This review of the PS-relevant literature indicates that although there is a growing body of research, the PS concept still remains ill-defined, warranting the need for further exploration. Relatively, few studies have used qualitative research methods, been conducted outside the US context, acknowledged the affective process in auditing JDM or focused on the practical meaning of the PS concept. This study aims to contribute to the literature through offering an in-depth understanding of the practical meaning of PS which appreciates and explains its emotional origins, the cognitive process by which PS
is shaped, the interaction between the two thinking process types by which sceptical judgement is arrived at and the social element and the other different factors which influence the construction of PS in practice. The study employs an interpretive qualitative research design to study PS from the auditors’ perspective by using semi-structured interviews with a purposeful sample of professional auditors working in the Big Four audit firms in the UK. The following chapter will explain the theoretical framework that will be utilised to help satisfy the objectives of this study.
Chapter 3: Theoretical Framework
3. Introduction

The exercise of PS is inextricably linked to professional judgement. This study has utilised concepts and ideas from the Social Intuitionist Model (SIM) as an interpretive tool to provide plausible theoretical explanations of auditors’ understanding and processing of PS. The SIM is developed in the field of social psychology to explain individuals’ moral judgment. The dual process framework which explains that people use two types of thinking systems (Type 1 and Type 2) to form their judgment represents the basis of SIM. Hence, SIM places a particular focus on the role of intuition⁴, or what is hereby referred to as Gut Feeling (GF), in individuals’ JDM process as they make moral judgments.

According to Haidt (2013), who is the founder of SIM, people, “engage in moral reasoning not to figure out what is really true, but to prepare for social interactions in which […] [they] might be called upon to justify […] [their] judgments to others” (p. 287). Hence, once people have a feeling that something is wrong, they play the lawyer’s role trying to build a case, rather than playing the judge’s role by searching for the truth (Haidt, 2001). SIM, which can also be considered as an anti-rationalist model, stresses the pre-eminence of GF in one’s moral judgment, whilst also not discounting the role of analytical reasoning. This model supposes that moral judgment is socially constructed and warranted in an interaction between two people. In SIM, judgment is conceptualised as an ongoing process and this differs from other psychological or JDM models utilising the dual process framework in that it recognises the role of reasoning but also appreciates the social construction of judgement, explains the interaction between the two cognitive processes (GF and reasoning), and views GF as an innate enculturated process.

This chapter starts by providing an overview of the association between PS and professional judgement in auditing. This is followed by a brief explanation of the dual process framework on which SIM is based. SIM is then articulated and the role of GF, which is part of SIM, is explained in detail together with how it relates to the exercise of PS.

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⁴ In this study, we will use the “gut feeling” term which is one of the terms used to describe Type 1 thinking system in dual process framework to describe intuition.
3.1 PS and Professional Judgement

As explained in the previous chapter, auditing standards and other relevant regulations require that auditors apply professional judgement (PS) throughout the entire audit process (ISA 200; ISA 240). For instance, the UK’s FRC (2010a) indicated that, “a sceptical attitude of mind is essential if an audit is to be rigorous and performed with due professional care” (p. 5). Auditors are morally obligated to practise auditing with professional due care (IESBA, 2006). Thus, while performing an audit service, auditors have to make a sound professional judgement when they are faced with certain situations, such as assessing the sufficiency and appropriateness of audit evidence and procedures, or reviewing their peers’ performance (Mala & Chand, 2015; Trotman, 2006). Particular areas of judgement may include decisions about whether to rely on client managements’ assertions or explanations, to conduct additional audit procedures, to maintain additional audit evidence or to encourage teammates to go beyond the audit budget (plan). While auditors are required to collect sufficient and appropriate audit evidence and to apply an appropriate level of PS, the particular extent to which PS should be applied is also subject to judgement (Nelson, 2009).

The perceived importance of making decent professional judgements has inspired researchers to explore auditors’ JDM process (Boritz, 1986). A majority of JDM studies in the auditing and accounting literature have concentrated on measuring auditors’ performance when making professional judgements and examining the determinants of auditors’ professional judgement quality (Bonner, 1999). Studies of JDM in the audit context can be classified into three groups exploring the effects of particular attributes, including auditors’ personal attributes (e.g. auditors’ interpersonal interaction with others, auditors’ knowledge and experience), the nature of the audit task (e.g. accounting issue complexity and level of risk), and the audit environment (e.g. time pressure and corporate governance process) (Bonner, 1999; Nelson & Tan, 2005).

In particular, some studies have documented the significant positive influence that experience and knowledge have on auditors’ ability to make sound judgements (Choo & Trotman, 1991; Frederick, Heiman-Hoffman & Libby, 1994; Nelson & Tan, 2005; Rose, 2007). Others have demonstrated that the type of experience and knowledge required to
make high-quality judgement is greatly associated with the characteristics of the audit task itself (e.g. the type of accounting issue being considered, the level of complexity, and the client’s industry, among others) (Abdolmohammadi & Wright 1987; Bedard & Biggs, 1991; Bedard & Graham, 2002; Earley, 2002; Lehmann & Norman, 2006). Although the majority of the JDM studies have demonstrated the positive effect of auditors’ knowledge and experience on their judgements, some research has found that auditors’ experience may negatively influence their judgements (Grenier, 2017; Haynes, Jenkins & Nutt, 1998). Auditors may, for instance, accumulate knowledge of non-misstatement explanations for certain unfamiliar accounting issues, which may constrain their practice of PS (Grenier, 2017).

Furthermore, characteristics of the audit environment can also contribute to shaping auditors’ professional judgements. Examples of such environmental factors may include corporate governance processes (e.g. the role of an audit committee and effective internal controls), risks (e.g. litigation and losing client threats), and audit firms’ internal culture (e.g. accountability, tone at the top and time-budget pressure). More specifically, effective audit committees and strong internal controls in both clients and audit firms themselves have been found to enhance auditors’ judgements by mitigating client risk and pressures (e.g. time-budget pressure and client preference pressure) (Alderman & Deitrick, 1982; Cohen, Krishnamoorthy & Wright, 2002; Kelley & Margheim, 1990; Moreno & Bhattacharjee, 2003; Sharma, Boo & Sharma, 2008; Wright & Wright, 1996). Also, audit risks (e.g. litigation risk and a risk of client loss) have been found to influence auditors’ judgements with regard to issues such as client acceptance, audit planning, and audit pricing. The outcomes of risk assessment have been reported to lead auditors to pay closer attention to high risk issues and exhibit more conservative behaviours (Ayers & Kaplan, 1998; Barron, Pratt & Stice, 2001; Goodwin & Trotman, 1995; Johnstone, 2000; Phillips, 1999; Pratt & Stice, 1994; Venkataraman, Weber & Willenborg, 2008).

Significant pressures on audit work (such as budget constraints or superior’s appraisal), extensive audit risks and task-related information interpreted as having negative effects may all, individually or simultaneously, trigger auditors’ affective reaction and, consequently, shape their judgements (Bhattacharjee & Moreno, 2013; Frank &
Hoffman, 2015; Garcia-Falieres & Herrbach, 2015; Moreno, Kida & Smith, 2002). However, research evidence provides a mixed picture as to the exact effects of such influences. Some studies, for example, found that negative information clues and predispositions (including negative mood) can have a positive influence on the quality of auditors’ judgements by encouraging more conservative behaviours (Bhattacharjee & Moreno, 2002; Chung et al., 2008; Cianci & Bierstaker, 2009).

Further, the audit context has been argued to stimulate certain cognitive biases which can impact auditors’ JDM processes or even result in judgement errors. For example, cognitive biases, such as the recency effect (Ashton & Ashton, 1988; Kennedy, 1993; Libby, 1985; Messier & Tubbs, 1994), confirmation bias (Butt & Campbell, 1989; Kadous, Magro & Spilker, 2008; Kida, 1984; Trotman & Sng, 1989; Waller & Felix, 1984), information choice bias (Smith, Tayler & Prawitt, 2016) and anchoring bias (Butler, 1986; Holt, 1987; Joyce & Biddle, 1981a; Joyce & Biddle, 1981b; Kinney & Uecker, 1982) have been argued to exist within auditors’ JDM process. However, it should be noted that previous studies provide mixed findings regarding the association of some of these cognitive biases in the auditors’ JDM process.

From the discussion above, it can be seen that auditors’ personal attributes, audit task and audit environment characteristics can all influence auditors’ JDM process. It is important to note that, although studied separately and largely in experiment settings, these three attributes can simultaneously influence auditor judgement. Therefore, enhancing the effectiveness of audit firms’ governance processes may not always produce a desired effect on the quality of auditor judgement unless such measures are also supplemented by changes in the firms’ recruitment, client selection and other policies.

### 3.2 The Dual Thinking Process

Psychology scholars have long argued that humans use two types of thinking process (Type 1 and 2) to form their judgements (Evans, 2008). The Type 1 process refers to intuition or GF, and Type 2 relates to the exercise of reasoning or reflection (Evans, 2010). Research that has elaborated this dual process framework has also laid out different attributes by which the two types of thinking processes can be distinguished.
For instance, Type 1 (GF) is commonly discussed as unconscious, automatic, low effort, fast, implicit and as an affective (emotional) process. In contrast, Type 2 process (reasoning) is characterised as conscious, controlled, high effort, slow, explicit and rational (Evans, 2008; Evans, 2010; Petty, Brinol, Loersch & McCaslin, 2009; Sloman, 1996). In this regard, Epstein (1994) explained that Type 1 thinking is predominantly associated with emotion and experience, whilst Type 2 is more associated with intellect.

Additionally, these two types of thinking process have been claimed to have access to two memory systems. These two separate memory systems are not only differentiated by the type of information they can store, but they also have different principles and rules of operation. The slow-learning memory system deals with regularities which can be learned after multiple trials over time and records what is typical or expected. In contrast, the fast-learning memory system records matters that are novel and interesting and attends more to unpredicted events. When humans experience a new event, it will be stored in the fast-learning memory system, but after repeated trials over time, these experiences with this type of stimuli (event) are consolidated and transmitted into the slow-learning memory system. Although these two memory systems are independent, they operate interactively. Over many trials, the slow-learning memory establishes stable and general illustrations of the distinctive properties of the environment, which are going to be used pre-consciously to process and interpret new information by comparing and categorising it. After the single occurrence of an event, the fast-learning memory constructs (through a conscious process) new representations that link together information about the different aspects of such an event (Sherry & Schacter, 1987; Smith & DeCoster, 2000). Likewise, Lapsley and Hill (2008) demonstrated that while the Type 1 thinking process (GF), “draws (often reflexive) inferences on the basis of similarity, typicality and contiguity among concrete images, stereotypes and feature sets that arise from personal experience”, the Type 2 process (reasoning), “attempts to describe the world by encoding different kinds of logical, causal and hierarchical structure among abstracted features of language and culture” (p. 316).

Previous research has not provided a consistent view as to whether these two types of thinking process operate interactively in a sequential or parallel manner (Evans, 2008). Some scholars have argued that the two processes operate interactively in a parallel
manner (Epstein, 1994; Epstein, Lipson, Holstein & Huh, 1992; Lapsley & Hill, 2008; Sloman, 1996; Smith & DeCoster, 2000; Stanovich & West, 2000). Other studies, however, insisted that the Type 1 thinking process, which is quick, unconscious and effortless, occurs first and then analytic reasoning (Type 2 process) happens next as a way to consciously evaluate the available evidence and make the decision. These latter studies, therefore, argue that the two types of thinking process are independent, but they interact with each other through sequential operation (Evans, 2006; Evans, 2008; Haidt, 2001).

Mautz and Sharaf (1961) provide an example that can be used to explain the Type 1 thinking process (GF) in auditing. They quote an editorial which was published in the Accounting Review in 1934 as follows:

“There are accountants who can barely glance at a balance sheet and come away with a good many significant facts in their minds. They are not geniuses. They are exceptionally well-trained scanners. Their peculiar capacity is the fruit of long experience of many scannings… A good scanner is a person who sees many things quickly-in their relationship to other things” (p. 113).

As illustrated in the above excerpt, once the long-term experiences of “scanning” FS have been accumulated in the slow-learning memory, these experiences are then used by the fast-learning memory to swiftly and effortlessly process information about similar characteristics and analogous situations in the future (Smith & DeCoster, 2000). Alternatively, auditors may also rely on rule-based processing when, based on certain control procedures, they ascertain whether misstatements are likely to occur or when, by reference to the outcome of recalculation procedures, they determine whether an account balance is fairly presented (Mautz & Sharaf, 1961). In this regard, it has been argued that people tend to think intensively about the tasks they encounter when they have sufficient motivation, time and freedom (Smith & DeCoster, 2000).

As auditors are expected to make high-quality professional judgements free from bias and based on robust procedures, they are required to utilise critical thinking when collecting and evaluating audit evidence. In order to form judgements in relation to, for instance, inventory account balances, auditors are expected to conduct procedures such as analytical and substantive tests (e.g. recalculation and physical observation). This
emphasis on prescribed methods and procedures as pivotal pre-conditions enabling auditors to form opinions and make judgements exemplifies Type 2 thinking process (reasoning), which has been characterized as slow, conscious, high effort, deliberate, and rational (Evans, 2008; ISA 200; Mautz & Sharaf, 1961).

Furthermore, auditors are expected to rely on their knowledge and experience to reach professional judgements. These experiences and knowledge, which after a while turn out to be habits or routines, are stored in the slow-learning memory system and work interactively with the Type 1 thinking process (GF) which has been characterised as fast, unconscious, automatic, low effort and emotional (Epstein, 1994; Evans, 2008; Kahneman & Klein, 2009; Logan, 1988; Simon, 1987; Sloman, 1996; Smith & DeCoster, 2000; Sun & Mathews, 2012; Vila-Henninger, 2014). In this regard, Simon (1987) used an interesting analogy with the chess grandmaster to explain the relationship between Type 1 thinking (GF) and accumulated expert knowledge/experience. He argued that if a grandmaster was asked about how they decide on their next move in the existing circumstances (e.g. time pressure and game complexity), they would answer that “it is done by ‘intuition’, or by applying one’s ‘professional judgement’ to the situation” (Simon, 1987, p. 59). Likewise, Dane, Rockmann and Pratt (2012) emphasised that the quality of judgement made through GF can be impaired if the decision-maker lacks experience or relevant expertise.

**Gut Feeling (GF)**

GF is part of the cognitive system that PS has been linked to and as argued above, constitutes the Type 1 thinking process. In prior studies developing the dual process framework, GF has also been referred to as the experiential process, associative process, unconscious process, automaticity (automatic process), and implicit process. For the purpose of this study, we concentrate on GF as an associative and experiential process where emotions play a significant role (Epstein, 1994; Sloman, 1996). For instance, Epstein (1994) maintained that, “people, when they are highly emotional, characteristically think in a manner that is categorical, personal, concretive, unreflective, and action-oriented, and the stronger the emotion, the more they think that way and the more their thinking appears to them to be self-evidently valid” (p. 710). Thus, for Epstein (1994) and others (e.g. Arnold, 1970; Lazarus, 1991), emotion is a way of
thinking and interpreting as people, for instance, get angry or upset only when they perceive a given circumstance as upsetting.

The literature linked to psychology and JDM has provided different definitions of GF (Type 1 thinking process) which specifically employ affect expressions (e.g. feeling) to highlight the emotional reaction as the key element of GF (Hogarth, 2010). For example, Shirley and Langan-Fox (1996) define GF as a “feeling of knowing with certitude on the basis of inadequate information and without conscious awareness of rational thinking” (p. 564). Similarly, Shapiro and Spence (1997) explain the GF process as a “nonconscious, holistic processing mode in which judgements are made with no awareness of the rules of knowledge used for inference and which can feel right, despite one's inability to articulate the reason” (p. 64). GF has also been defined as, “a cognitive conclusion based on a decision-maker's previous experiences and emotional inputs” (Burke & Miller, 1999, p. 92). Therefore, the GF term (a synonym of intuition) and other different terms, which emphasise the affective meaning of the Type 1 thinking process have been widely used to describe this type of thinking process, such as gut instinct, insight, hunch, sixth sense, evaluative affect (Burke & Miller, 1999; Dane & Pratt, 2007; Shapiro & Spence, 1997; Shirley & Langan-Fox, 1996).

Multiple studies of different professions (e.g. nursing, management, law, and firefight commanders) have empirically evidenced the major role that GF plays in shaping professionals’ judgements (Benner & Tanner, 1987; Dane & Pratt, 2007; Hyppanen, 2014; Okoli, Weller & Watt, 2016; Sadler-Smith & Shefy, 2004; Wistrich, Rachlinski & Guthrie, 2014). For instance, in nursing, studies have found that GF exerts a significant effect on nurses’ clinical judgements (see e.g. Benner & Tanner, 1987; Hams, 2000; Lyneham, Parkinson & Denholm, 2008; Olsson & Adolfsson, 2011; Rosciano, Lindell, Bryer & DiMarco, 2016; Ruth-Sahd & Tisdell, 2007). Interestingly, one of the nurses who participated in Ruth-Sahd and Tisdell’s (2007) study demonstrated her definition of GF (intuition) as, “a feeling or thought that I get, telling me that something is not right. I sit and listen, take it all in and run it through my head… Intuition allows me to tune in to verbal and nonverbal cues from my patients and their environment, see into the future, and make meaning out of them in a way that informs my nursing practice” (p. 125). One can draw some parallels between nurses and auditors as the latter group also assesses
symptoms and clues to form a conclusion about the financial health of a client (Lehmann & Norman, 2006).

The nature of audit practice and audit environment may be interpreted as warranting a range of emotions such as fear, anxiety, stress and negative mood (Bagley, 2010; Gaertner & Ruhe, 1981; Gibbins & Newton, 1994; Hermanson, Houston, Stefaniak & Wilkins, 2016; Kelley, 1990; McDaniel, 1990; Lupu & Empson, 2015). A participant in Windsor and Kavanagh’s (2012) study, for example, stated when discussing client pressure that “it does become very frustrating. [...] in some cases it can be very stressful” (p. 15). These different emotions that auditors experience can be related to their GF. For instance, commercialistic pressures imposed by the top management may lead to the accumulation of a plethora of feelings and emotions, such as the fear of losing a client, a promotion opportunity, or of violating professional practice rules. In an ethnographic study of a Big Four firm, Guenin-Paracini et al. (2014) found that risks associated with audit practice (such as litigation risk, reputation risk, or risk of a loss of client) drive auditors’ feelings of fear and anxiety. They also showed how auditors’ efforts to avoid or cope with such feelings may have significant (both positive and negative) consequences for various aspects of the audit process, such as auditors’ use of standards, and interactions with clients and colleagues. They emphasised that fear can be positive in the sense that it could drive auditors to embrace practical intelligence as they learn to tackle the fear of failure. Interestingly, the authors used the term “intuition” to refer to such a fear by explaining that since auditors “are afraid of making a mistake, they regularly return to what they have done in order to verify that nothing has been forgotten and that everything is as it should be. At this stage, they often use official guidance to confirm, revise and legitimize their intuition” (Guenin-Paracini et al., 2014, p. 271). This excerpt may be interpreted as another illustration of how GF (intuition), which is defined as an affective process, may shape auditors’ professional judgement and, consequently, the exercise of PS.

3.3 Gut Feeling (GF) and PS

GF can be linked to PS from different perspectives. First, GF has been seen as a method used for discovery and problem solving (Cappon, 1994; Rew, 1988; Ruth-Sahd & Tisdell, 2007) insofar as it is a means of generating hypotheses which require further
examination before they are accepted as valid (Bowers, Regehr & Balthazard, 1990). If we take the above perspective alongside a view of GF as an affective process, it then becomes possible to better relate GF to the exercise of PS. More specifically, as Nelson (2009) and Hurt et al. (2013) noted, practising PS leads auditors to apply more audit procedures or to obtain further evidence (to know more about the accounting issues subject to audit). This behaviour of conducting extensive procedures and searching for persuasive evidence is confirmed when auditing high-risk situations (Glover & Prawitt, 2014) which are linked to, for instance, the experience of feeling fear (Guenin-Paracini et al., 2014).

Second, GF or associative processing, which operates with the slow-learning memory demonstrates that people, based on their accumulated knowledge, can recall in a comprehensive detail a previously experienced event when they are faced with a similar event. Similarly, in the PS literature, some researchers have linked auditors’ scepticism to their experience and knowledge of, for instance, patterns that signal a high risk of material misstatement. When auditors are exposed to error (non-error) explanations, they can relate and spot the patterns pointing to high risk and need for further assurance procedures based on their stored experience of similar misstatements (Schaub, 1996; Schaub & Lawrence, 1996).

Thirdly, previous studies in psychology and JDM have demonstrated that GF is used more commonly at times when resources are restricted (Akinci & Sadler-Smith, 2012; Burke & Miller, 1999; Glockner & Betsch, 2008). Similarly, under time pressure, GF may be particularly useful to auditors as their stored experience and knowledge enables them to obtain necessary cues quickly in order to ascertain the likelihood of material misstatements. If the risk of material misstatement is high, auditors’ GF can lead them to act in a certain way, such as extending new audit procedures to corroborate existing evidence or collecting further evidence.

Furthermore, as illustrated in Chapter 2, some studies in the auditing literature have tried to define auditing practice as rituals (Pentland, 1993; Power, 1997) or process (Carrington & Catasus, 2007) of comfort production. These and other (Commerford et al., 2016; Guenin-Paracini et al., 2014; Rowe, 2019) studies, have linked auditors’ GF
(or practical intelligence) to feelings of comfort and discomfort (fear). Carrington and Catasus (2007) explained the attainment of comfort in the courses of an audit as an outcome of certain actions performed by an auditor that turn a non-acceptable state of comfort (discomfort) into an acceptable state. In this study, the term “gut feeling” is used to emphasise the role of emotion in shaping auditors’ practice of PS which may induce the feelings of both comfort and discomfort. Here, comfort is understood as an emotional state where auditors experience stable intellectual wellbeing (also characterized as happiness, pleasure, tranquillity, quietude, and safety) where scenarios of certain threats to their wellbeing are limited or absent (Pezeu-Massabuau, 2012; Power & Dalgleish, 1997). When experiencing such an emotional status, auditors’ memory may produce images that reinforce a sense of approval by others, such as audit team members, superiors, external reviewers, and client management. Discomfort, on the other hand, has been associated with the unsettling feelings of uncertainty, worry and anxiety (Pezeu-Massabuau, 2012). In the audit context, the feelings of discomfort can be interpreted as an emotional state where auditors experience degrees of uncertainty and worry as a result of certain images flashing in their minds as potential threats to their personal goals and aspirations and/or their future as professionals. Since approval of auditors’ judgements by others (e.g. meeting the internal and external reviewers’ expectations) represents a source of comfort, auditors experience feelings of discomfort when they face practice scenarios in which their ability to meet reviewers’ expectations is seen as negatively affected. Auditors may experience different, and often conflicting, feelings of (dis)comfort as a result of the reviewers’ different expectations, such as sufficiently challenging the client management, satisfying the efficiency objective or keeping the client happy. This clarification of the understanding of the GFD is important in order to prevent the researcher from excessively inferring the relevance of GFD while analysing the empirical data and overcome the epistemological difficulties resulting from the possible conceptual overlap that may exist between different emotional states (e.g. fear, worry, discomfort) that participants report during interviews (e.g. Cornelius, 1996; Greenwood, 1987; Guenin-Paracini et al., 2014).

5 Unless otherwise is stated, when we refer to memory in this study, we indicate to the memory system associated with Type 1 thinking process (GF) which is slow learning memory system (Smith & DeCoster, 2000).
3.4 The Social Intuitionist Model (SIM)

“Reason is, and ought only to be, the slave of the passions, and can never pretend to any other office than to serve and obey them” (Hume, 1739-1740/1969, p. 462 cited in Haidt, 2001, p. 816).

The SIM is an anti-rationalist model of moral judgement which is based on the premise that the pervasiveness of reasoning (rational thinking) is often overstated. Haidt (2001) who developed the model demonstrated that GF is the main driver of people’s moral judgement. In other words, the SIM does not deny the role of reasoning in shaping people’s moral judgement, but stresses instead that GF is the primary process and reasoning is only a subordinate to that process. According to Haidt (2001), moral intuition (GF) leads to moral judgement, and moral reasoning constitutes the post hoc process to justify the moral judgement that had already been made. For instance, by using reasoning, we may judge an action that results in the death of innocent people as being immoral, but we would not make that judgement unless we care about those people and we have emotions that appreciate human life. Therefore, judgement cannot be made by reasoning alone. The SIM is based on the argument that GF is a cognitive process (Epstein, 1994; Lazarus, 1991), and is built on the dual process framework (explained above) which argues that the human cognitive process consists of two independent systems, intuition and reasoning.

In Figure 3.1, the SIM is depicted by reference to an interaction initially between two persons (A and B) which is an ongoing social process that spreads out over time to involve other people. The SIM consists of four main and two additional links which represent aspects of the reasoning process. Link 1 represents the intuitive moral judgement which effortlessly appears in one’s consciousness as a result of moral intuition. Link 2 describes the post-hoc reasoning where a person makes a conscious effort to look for reasons to justify the moral judgement which has already been made. After making and justifying (e.g. verbally expressing) the moral judgement to others, such justifications may influence others’ intuition as a result of the maker’s reasoned persuasion (link 3, reasoned persuasion).

The SIM suggests in link 4 (social persuasion link) that a moral judgement can have a direct influence on others even without reasoned persuasion. This can occur when a
moral judgement has been made by a friend or a peer one is close to because people are usually highly attuned to group norms. The reasoned judgement link (link 5) represents a situation where people’s reasoning overrides their initial intuition, but this situation is theorised to be very rare and occurs only when the initial intuition is weak and the processing capacity (e.g. time) is high. Alternatively, situations where reasoned judgement conflicts with strong intuition can lead to what is called “dual attitude”, when reasoned judgement is enacted in verbal expression while the intuition is still operating behind the scene. Additionally, link 6 (private reflection) occurs when a new intuition, which is contradictory to the initial one, emerges while a person is still cognitively processing a situation. For instance, a person may assess a situation from multiple perspectives, resulting in the emergence of several competing intuitions. In order to devise a plausible course of action, a person would then need to side with one intuition, either one (s)he feels strongest about or one which complies with accepted norms or rules of behaviour. Thus, the six links above display the relationships between an initial intuition, a conscious moral judgement and conscious moral reasoning (Haidt & Bjorklund, 2008).

Figure 3.1 The Social Intuitionist Model (SIM) (Haidt, 2001)

In the audit context, auditors need to make professional judgements about different aspects of the auditing process, such as engagement with a client, recruitment of an external specialist, selection of the audit procedure, or determination of the sufficiency
of the audit evidence. Auditors form their judgements frequently through social interaction, most often with their colleagues or client’s management (Antle & Nalebuff, 1991). For example, with regard to a specific accounting issue, auditors (person A) and the client management (person B) interact with each other in order to ensure the fairness of the accounting issue representation in the FS. Auditors who are qualified and experienced then form their initial GF as to whether more testing would be required (the intuitive judgement link).

This initial GF is “both innate and encultured” (Haidt, 2001, p. 826) in the sense that it is the product of auditors’ experience, strongly held beliefs and cultural norms they are subject to (most notably, firms’ culture). The accounting issue’s related cues which can trigger auditors’ GF can pertain to the importance of the client, prior experience with the client or similar clients, client management’s personal characteristics, accounting issues (tasks), and firms’ internal culture. For example, when an auditor is to audit a material accounting issue (e.g. intangible asset impairment), (s)he may make an initial judgement (GF) that a material misstatement (e.g. a failure to recognize material impairment) is very likely to exist.

The key premise developed in this study is that it is on the basis of the initial judgement (GF) that auditors make further decisions as to whether to continue to investigate a particular accounting issue as well as looking for justifications (evidence) for their initial judgement (post hoc reasoning). They develop justifications to persuade the client’s management to cooperate with them and their superiors to support their positions. While auditors are trying to justify their initial judgement, they would have discussions with client management and their superiors. For instance, auditors may trigger client’s management intuitive system by emphasising the materiality of such an issue and/or describing the adverse consequences of ignoring it. When seeking to justify their initial

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6 Haidt argues that humans evolutionarily have a set of emotional backs (innate intuitions) that prepare them for social interactions. Thus, Haidt and his colleague Graham (2007) studied humans’ innate intuitions (emotional backs) and found five sets of innate intuitions (or what they call Moral Foundations Theory (MFT)) that prepare people to emotional react to such issues that relate to these five foundations. These five sets of innate intuitions include: harm/care, fairness/ reciprocity/ justice, in-group/ loyalty, authority/respect, and purity and sanctity. However, Haidt emphasises that local culture can develop and shape humans intuitions and these intuitions can include the situations to which people might respond intuitively since they have long experience in dealing with them (not specifically moral issues) (Haidt, 2001; Haidt, 2004).
judgement (GF), auditors may obtain new information which may, in turn, trigger a new intuition. For instance, after considering the assumptions and explanations provided by the client’s management, the auditor may develop a new GF, such as a feeling of comfort if (s)he is satisfied that such explanations are trustworthy. Conversely, auditors may encounter new information that renders their initial GF less compelling (links 5 and 6), leading them to revisit it, which sometimes may occur multiple times.

Since, ontologically, the SIM is based on an assumption that moral judgement is socially constructed, this framework justifies the use of interviews to study auditors’ PS practice. Prior studies have commonly used interviews, where researchers (external observers) can infer participants’ cognitive and affective experience based on their self-report, to investigate gut feeling (emotion) and moral judgment (e.g. Cornelius, 1996; Keltner & Haidt, 1999). For instance, Haidt used interviews to study moral judgements, making an empirical observation that people tend to rely more on their GF while making such judgements (Haidt, Bjorklund & Murphy, 2000; Haidt & Hersh, 2001; Haidt, 2001). Further, in a cross-cultural study, Haidt, Koller and Dias (1993) interviewed circa 360 people and observed that most participants were very quick to deliver their initial judgement when presented with the research materials, although some appeared to struggle to find reasons to support this (dumbfounding) (see also Haidt et al. (2000) for a similar approach).

Since the SIM is built on the premise that GF is “both innate and enculturated” (Haidt, 2001, p. 826), it may help provide a holistic view of the PS concept as being both a personal trait and a state (Hurtt et al., 2013; Nelson, 2009). More specifically, it may help counterbalance dominant argumentation provided in the audit literature that implicitly links better audit quality to the use by auditors of a reasoning process and hence limits the exercise of PS to the deliberate adoption of a certain mindset (e.g. Griffith et al., 2015; Nolder & Kadous, 2018; Plumlee et al., 2015; Rasso, 2015). In contrast, the SIM can serve to comprehensively explain how auditors may make use of the two thinking systems (GF and reasoning) to practice PS. In this regards, psychology literature (McMackin & Slovic, 2000; Wilson & Schooler, 1991; Zhong, 2011) has shown, for example, that excessive reasoning may in fact impair the quality of people’s judgement. Likewise, in the audit context, Wolfe, Christensen and Vandervelde (2014)
found that auditors’ heavy reliance on the analytical thinking process (reasoning) may crowd out and weaken their GF and, as a consequence, impair their PS behaviour.

3.5 Summary

This chapter displayed how PS and professional judgement is interconnected and illustrated the ethical perspective of PS. Additionally, SIM, which is recruited in this thesis to help explain participants’ interpretations of PS practical meaning was discussed in details. The SIM and its constructs have also been articulated to the auditing context. This chapter illustrated how the SIM is distinguished from other psychological or JDM models, which rely on the dual process framework as it values GF more than reasoning, gives reasoning some space to influence the moral JDM process, proposes that GF is innate and socially enculturated and explains the interaction between both thinking processes (GF and reasoning). Correspondingly, based on the fundamentals and function of the SIM framework that has been described, we believe that the SIM can assist interpreting auditors’ internalisation of the PS concept and understanding the process through which PS is warranted and shaped.

The SIM framework and multiple studies that have used interviews to study professionals’ utilisation of GF to make professional judgements warrant the research methodology of this thesis which uses semi-structured interviews to qualitatively study the auditors’ PS (Benner & Tanner, 1987; Hams, 2000; Okoli et al., 2016; Sadler-Smith & Shefy, 2004; Wistrich et al., 2014). Haidt, who is a social psychological scientist, has utilised interviews to help him build and evidence his SIM (Haidt, 2001). For instance, Haidt (2004) explicitly indicates that his utilisation of interviews had helped him to understand the dumbfounding phenomenon that people fall into when they do not have reasons to support their positions, as he states, “when I interview Americans about such acts, I often get strong and clear condemnation, followed by a struggle to provide reasons […] [and] I interpret it as a case in which the intuitive judgement link has created a strong judgement that the act is wrong, but the post hoc reasoning link is having trouble doing its job.” (p. 289). This quote shows Haidt’s interpretation of his participants’ responses to his interview questions, which clearly reference the ontological perspective of social psychologists who believe that reality is socially constructed (Greenwood, 1992; Keltner & Haidt, 1999; Strongman, 2003).
Accordingly, Haidt believes that the best approach to understand moral judgement is to conceptualise it as a social process rather than a private act of cognition (Haidt & Bjorklund, 2008). Social scientists use interviews to provide a deep understanding of the social reality through obtaining people’s broad views of the world as well as experiencing the natural setting within which the phenomenon occurs (Brinkmann, 2008; Cook, 2008; Creswell, 2014; Marvasti, 2003). Interviews are the best methods to gather data about such phenomena, specifically when that phenomenon (e.g. feeling, intention, or thoughts) is unobservable. As further demonstrated in the next chapter, this study interviews individual auditors in order to understand their internalisation of the PS concept and perceptions of the process by which PS is shaped in their everyday practice (Patton, 2002).
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Chapter 4: Research Methodology
4. Introduction
As outlined in the previous chapters, different studies in the auditing field as well as regulators’ reports have highlighted a need for further understanding of the PS concept in practice. Multiple efforts have been made to explain the PS concept, but these have provided limited understanding of auditors’ everyday practices because of their focus on quantitative or experiment-based research designs. There is a limited understanding of how auditors internalise PS while conducting everyday auditing procedures, how they go about processing PS in their everyday practice, and how their social interaction with others shapes their practice of PS. Since this study aims to provide a deeper understanding of the PS concept in practice, its methodological approach, which involves an interpretive qualitative research design, has been developed to reflect this. This chapter aims to provide a detailed explanation of the chosen research methodology.

The chapter is organised into 4 sections. Section 4.1 briefly illustrates common research philosophy perspectives and methodologies. A detailed explanation of the research methods and data collection approaches used to address this study’s objectives is provided in section 4.2. Section 4.3 provides a detailed illustration of the data analysis process applied to make sense of the data and generate research findings. Section 4.4 provides a discussion of the ethical considerations relevant to the research design adopted in this study. Finally, Section 4.5 provides a summary of the chapter.

4.1 Research Philosophy and Methodology
According to Guba and Lincoln (1994), a research paradigm is fundamentally related to ontology, epistemology and methodology concepts. Burrell and Morgan (1979) identified four research paradigms that reflect the different ontological (how to see reality) and epistemological (how to gain knowledge) assumptions underpinning the study of social phenomena. They include Functionalism (Positivism), Interpretivism, Radical Humanism, and Radical Structuralism. Subsequently, Chua (1986) grouped the two radical paradigms into one: the critical paradigm. Below, this chapter discusses the three paradigms with an emphasis on the research paradigm underpinning this study.
4.1.1 Positivism

Positivism has been described as the mainstream research paradigm in accounting and auditing research (Chua, 1986). According to Burrell and Morgan (1979), positivism views the social world as consisting of tangible empirical artefacts and relationships that can be objectively recognised, examined and measured using methods that are derived from natural science. Positivists attempt to objectively test and measure reality, which is a concrete structure independent from the researcher (Burrell & Morgan, 1979; Chua, 1986; Morgan & Smircich, 1980). Importantly, as positivists view reality as being autonomous, they use quantitative research methods, such as experimental manipulative settings and surveys, to gather data (Guba & Lincoln, 1994). Furthermore, they employ a deductive research approach to form scientific hypotheses which are going to be statistically examined (Bryman, 1988; Chen & Hirschheim, 2004; Saunders, Lewis, & Thornhill, 2007). Even though positivism has been deemed the mainstream research paradigm in accounting research, there has been some growing criticism surrounding it. For instance, Chen and Hirschheim (2004) argued that positivism’s proposed benefits and appropriateness to social sciences should be seriously questioned, as positivists are remote from the problem under study. Additionally, it has been argued that positivism does not capture social factors and other factors associated with the phenomenon under study (Fox, 2008; Kaplan & Duchon, 1988).

4.1.2 Critical Realism

Burrell and Morgan’s (1979) model divided this paradigm into Radical Humanism and Radical Structuralism. However, Chua (1986) has combined the two paradigms into one, namely Critical Theory (or Critical Realism). Critical realists see reality as independent and objective, but they appreciate the role of human beings in constructing it. They believe that human beings have the ability to interpret everyday life, but their ability is restricted by dominating systems that separate human beings from self-realisation. Critical realists argue that studying things in isolation is incomplete, since things exist within different relationships (Chua, 1986). Critical realists believe that both agency (human actions) and structural factors influence behaviour. Thus, this philosophical research paradigm can be used in qualitative and/or quantitative research approaches (Clark, 2008).
4.1.3 Interpretivism

Unlike positivists, interpretivists assume that reality is socially constructed, which means that reality is not completely separated from the social element (Chua, 1986). Interpretivists aim to study social realities and the ways in which they are socially constructed and negotiated. Interpretivists attempt to provide a deep understanding of social reality from the point of view of the people who are being studied. Importantly, it has been clarified that the interpretive paradigm is concerned primarily with understanding the essence of everyday world practices (Burrell & Morgan, 1979; Hopper & Powell, 1985). The interpretive paradigm broadly embraces the use of a research approach where the empirical data leads the analysis process and, accordingly, qualitative research methods, such as in-depth interviews and direct observations, are used to make sense of the social phenomenon being studied. Research participants’ experiences and interpretations are inferred, observed and interpreted by the researcher (Bhattacharya, 2008; Fox, 2008; Guba & Lincoln, 1994). An interpretive research approach can be identified through three characteristics: non-deterministic evidence, involvement of the researcher in the social settings being investigated, and focus on capturing participants’ perspectives (Chen & Hirschheim, 2004; Kaplan & Duchon, 1988).

Qualitative research methodologies are most commonly used by interpretivist scholars (Bhattacharya, 2008; Bryman, 1988; Flick, 2009). A qualitative research approach can be defined as a method of exploring and making sense of individuals’ perceptions or experiences of social concerns. A qualitative researcher should allow significant flexibility in research procedures, collect data in participants’ settings to enrich his/her interpretation of participants’ experiences, allow the data to guide the analysis process, building from specific particulars to broad themes, and interpret the data collected. The researcher induces the theory from participants’ interpretations and observed experiences (Johnson, 2004). In this research approach, the researcher becomes a significant part of the research process as they holistically observe the phenomenon and reflect on the research process. Qualitative researchers often rely on social science theories as a guide in formulating research questions as well as data collection and analysis (Creswell, 2014; Marshall & Rossman, 2006).
Silverman (2010) considers a qualitative research approach to be the most appropriate method in exploring people’s everyday life practices and perceptions. Unlike quantitative research, the qualitative methodology pays particular attention to context, words and observation of participants’ experiences that can give away their perceptions of a particular subject matter (Chen & Hirschheim, 2004; Creswell, 2014; Patton, 2002). Furthermore, in the context of audit research, Humphrey (2008) noted that quantitative experimental methods commonly used by audit scholars failed to enrich the understanding of audit practices (see also Sikka et al., 2009). Similarly, Power and Gendron (2015) strongly advocated for greater reliance on qualitative methods in audit research as a way to uncover the “black box” of audit practice. Thus, the aim of this study (providing an in-depth understanding of how auditors practice PS), warrants the use of an interpretive qualitative research methodology as a tool to make sense of auditors’ everyday experiences with exercising PS (Silverman, 2010). Furthermore, since prior studies have conceptualised PS as a multi-faceted and multi-dimensional concept (Brazel & Schaefer, 2015; Hurtt, 2010; Hurtt et al., 2013; Nelson, 2009; Toba, 2011), an interpretive approach seems most appropriate in the context of this study (Burrell & Morgan, 1979; Chua, 1986; Creswell, 2014).

As illustrated above, this study employs a qualitative research approach which is deemed inseparable from interpretive approach to help providing an in-depth understanding of how auditors give meaning and operationalise the PS concept in their everyday audit practice (Daymon & Holloway, 2002). Although the qualitative research approach has been criticised for being subjective, unstructured and having limited generalisability, these challenges can be mitigated effectively through a thoughtful and careful research design (Creswell, 2014; Flick, 2009; Lukka & Kasanen, 1995; Silverman, 2010). This study has considered different strategies, which were suggested to help mitigate the challenges associated with a qualitative research approach and therefore ensuring credibility, reliability and transferability of a qualitative study. These strategies include, among others, utilising data triangulation, theoretical and purposive sampling, acknowledging deviant cases in analysis, documenting the research process (interview transcripts), recognising potential theoretical replication (transferability), presenting research evidence and arguments in a plausible and clear way and locating research findings to relevant literature (Creswell, 2014; Daymon & Holloway, 2002; Flick, 2009;
Hartley, 2004; Kumar, 2011; Lukka & Kasanen, 1995; Malsch & Salterio, 2016; Miller, 2008a; Miller, 2008b; Saunders et al, 2007; Silverman, 2010; Tracy, 2010).

4.2 Research Design and Data Collection Methods
The qualitative research design of this study is based on semi-structured interviews with practising auditors in the UK as a primary research method (Blatter, 2008; Brinkmann, 2008; Bryman, 1988; Cook, 2008; Creswell, 2014; Marshall & Rossman, 2006; Tope, Chamberlain, Crowley, & Hodson, 2005; Patton, 2002). The use of semi-structured interviews is warranted due to the multifaceted nature of the PS concept (Kumar, 2011; Mason, 2002; Saunders et al, 2007). Semi-structured interviews were favoured in this study for some additional reasons. First, this method serves the aim of this study, which is to provide an in-depth understanding of the constructs which interviewees use as a basis for their perceptions and beliefs about PS (Daymon & Holloway, 2002). Second, it gives the researcher the flexibility to explore various factors underpinning auditors’ perceptions and understandings of PS in practice (including those issues which cannot be directly observed, such as feelings and thoughts) (Lewis & Ritchie, 2003; Patton, 2002). Third, it offers the researcher the opportunity to provide participants with the freedom to retrospectively self-report their cognitive and affective experiences in relation to their PS practice. In this regard, qualitative interviews have commonly been considered an appropriate research methodology to study cognition and emotion in JDM and social psychology studies (e.g. Benner & Tanner, 1987; Cornelius, 1996; Dane & Pratt, 2009; Haidt & Hersh, 2001; Sadler-Smith & Shefy, 2004; Wistrich, Rachlinski & Guthrie, 2014).

This study follows an abductive research approach where the stages of intense theorization, data collection and analysis stretch over time and serve to cross-fertilize each other. Specifically, early empirical evidence (five initial interviews – see below) about auditors’ understandings and application of PS led to a “striking empirical observation” (Lukka, 2014. p. 563), namely the importance of emotional experience in the PS practice, which in turn prompted the researcher’s interest in exploring the relevance of particular theoretical perspectives (the SIM framework) which later informed subsequent data collection (main interviews) and analysis. In making sense of the empirical phenomena observed, the researcher therefore relied on both his empirical
and theoretical work to provide plausible explanations for his observations (Lukka, 2014; Lukka & Modell, 2010; Timmermans & Tavory, 2012).

Abductive reasoning is different from deductive reasoning, which focuses on examining certain hypotheses developed from the extant theories, whilst having some similarities with inductive reasoning, where empirical data leads the analysis process. Abductive reasoning involves a researcher seeking to develop theoretically informed explanations to certain empirical observations. Importantly, whilst not denying the importance of pre-existing theoretical frames, the researcher does not adopt them unquestionably but remains open to the possible need for alternative or revised explanations as (s)he moves back and forth between the empirical data, prior literature, and the theoretical framework (Alvesson & Karreman, 2007; Alvesson & Karreman, 2011; Lukka, 2014; Lukka & Modell, 2010). This means that this study does not employ the theoretical framework of SIM (explained in Chapter 3) with a view to simply test certain hypotheses but makes use of it as a source of plausible theoretical explanations (which are themselves informed by prior empirical literature) for the empirical observations emerging from the data. In employing this perspective, the study therefore remains committed to the ontological position of social constructionism which is contrary to a positivistic conceptualisation of reality as external and independent of the observer.

This study involved considerable effort to ensure an appropriate interview approach, to enable both the freedom to explore some questions in depth and more spontaneous discussions to follow up on the issues highlighted by interview participants (Flick, 2009; Myers & Newman, 2007; Patton, 2002; Rubin & Rubin, 1995). In addition, to enhance the approach and the quality of data collected, the interviews were conducted in two stages: initial interviews and main interviews.

In the early stage of the data collection process, 5 interviews with practicing professional auditors (see Table 4.1) were conducted as initial interviews. These interviews, which were largely unstructured, were conducted to provide initial insights into the topic under study (Arthur & Nazroo, 2003; Daymon & Holloway, 2002; King, 2004; Rubin & Rubin, 1995; Silverman, 2010). During these, it was observed that participants pointed to issues that suggest the presence of more “affective” cognitive experiences rather than
a straightforward rationalistic approach which is so often discussed in the PS literature. Interviewees used certain emotional expressions, such as discomfort, uncertainty or worry while interpreting their perceptions and experiences of PS in practice. Accordingly, we consulted the auditing literature looking for concepts and theoretical frameworks that can be used to help make sense of these emerging themes. It was found that emotion is a perspective that has been highlighted in association with the PS practice, but also that very limited research had been carried out to explore this in sufficient depth (see e.g. Hurtt et al., 2013). This observation from the preliminary analysis of the data collected in the initial interviews led to the interest in exploring the literature on how emotions influence cognition and decision-making.

After a considerable review of the relevant literature in psychology\(^7\), we identified the SIM (discussed in Chapter 3) which differs from other psychological and JDM models in that it values the affective process more than the reasoning process, gives the reasoning process a role to influence the JDM process, and theorises emotion (gut feeling) as a part of cognition which is socially learned and constructed (e.g. Haidt, 2001; Greenwood, 1992). Hence, SIM was identified as a broad theoretical framework for this study (e.g. Collins & Stockton, 2018; Lukka & Modell, 2010). In addition to the discussion above, SIM was deemed useful because; first, it can help capture the emotional aspects of PS which were evident in the interviewee’s accounts of PS, as well as other aspects discussed such as the importance of experience and the effects of individuals’ communications with others. Second, whilst exploring the emotional dimensions, SIM does not negate the role of reasoning and explains the interaction between the two types of cognition process. Third, it presumes the social construction of moral judgment, therefore, interviews were validated as an appropriate method for studying individuals’ moral judgment processes (Haidt et al., 2000; Haidt & Hersh, 2001; Haidt, 2001).

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\(^7\) There is a variety of other theoretical frames used in the psychology and JDM literature to understand how emotions affect the way in which individuals form judgements, such as: cognitive appraisal theories of emotion (e.g. Cornelius, 1996; Forgas, 1994; Frijda, 1993; Lerner, Han & Keltner, 2007; Lazarus 1991; Lerner, Valdesolo, & Kassam, 2015; Power & Dalglish, 1997) and theories of the social function and constitution of emotions which depict emotion as being constructed based on the social interactions and relationships (e.g.Keltner & Haidt, 1999; Gergen, 1985; Greenwood, 1992).
The preliminary analysis of the research data collected in these initial interviews contributed to the development of the interview guide, including the idea of utilising certain practice scenarios (examples) to stimulate discussions during interviews. In addition to 5 initial interviews, 39 further interviews were subsequently collected with professional auditors, representing the main body of empirical materials. During the main interviews, the abductive qualitative approach continued as the analysis process evolved and more data was collected and analysed. As the data collection process went on certain categories and themes emerging from the data were reflected in the later conducted interviews as well as the analysis process where the researcher went back and forth between “bottom-up” and “top-down” approaches (Daymon & Holloway, 2002).

**Interview Guide Development and Rational**

To aid an in-depth exploration of auditors’ internalisation and processing of PS, the researcher, based on his review of the relevant literature and review of the FRC’s AQR reports, developed an interview guide (Saunders et al., 2007). This interview guide has been refined and improved during the data collection process. After the preliminary analysis of initial interviews and selection of SIM as the key theoretical frame, the interview guide has been refined to include the main themes of the SIM and certain examples (scenarios) to stimulate the interview conversation and focus the discussion (see Appendix 2) (Saunders et al., 2007; Rubin & Rubin, 1995). The interview guide that was used in the study’s main interviews which consist of 39 interviews, was refined to cover specifically the following main topics: intuitive judgement, reasoning process, rationalisation and interaction with others, private reflection and reasoned judgement.

The 5 initial interviews also guided the researcher toward the idea of utilising practical examples (scenarios) as part of the interview guide with the purpose of enhancing the richness and reliability of the data collected and encourage the participants to talk freely about the interview main topics and focus the discussion. Saunders et al. (2007) explained that the interview guide (e.g. a list of themes) is necessary to provide a focus for the discussion because “without at least some focus…work will clearly lack a sense of direction and purpose. It will be necessary…to formulate a focus if… work is to make progress” (p. 321). During the initial interviews, as our study is interested to know “how” auditors make sense of their practice of PS, the participants sought to relate their
interpretations to some hypothetical practical examples or actual experiences. Some participants were sometimes striving to draw an example to utilise to interpret their experiences and some occasionally asked the researcher for an example to relate to while explaining their understanding and processing of PS. One participant has suggested to the researcher in a small chat after the interview that he thought having a practical accounting example could have helped him as an interviewee to provide more focused and clear answers and to relate more easily to his actual experiences. This observation guided us to the decision to include examples (hypothetical short scenarios) in the interview guide. Since the objective of having a certain scenario was not to test certain assumptions (hypothesises) or force interviewees to provide specific insights on certain variables, we developed the scenario in a very short and clear manner to represent general cases that auditors may encounter in their everyday practice without trying to test any predetermined assumptions. The objective of using the scenario was to encourage participants to talk openly and freely, and easily self-report their cognitive process and relate to their experiences.

To cater for the participants’ experience and areas of expertise, four short practice scenarios were developed. The scenarios covered aspects of auditing that the content analysis of FRC inspection reports (fully presented in Appendix 1) identified as particularly deficient in terms of the practice of PS (e.g. judgmental accounting issues, sufficiency and appropriateness of audit procedures and evidence and the audit firms’ culture - Figure 4.1). Thus, the scenarios covered areas of audit practice where the exercise of PS can be observed, including accounting estimates (bad debt provision), going concern, fair value valuation and intangible asset impairment (see Appendix 2). Interviewees were invited to select one scenario which best represented their experiences of daily audit practice. Importantly, these practical examples (scenarios) were developed by reference to well-known accounting practice manuals and textbooks (Beasley, Buckless, Glover & Prawitt, 2009; CAQ, 2014; Gray & Manson, 2000; Maltby, 1996; Messier, Glover & Prawitt, 2016).
It has to be noted that the use of scenarios in in-depth interviews may raise concerns around the flexibility of the interview structure and the epistemological position of the study. Therefore, the researcher was careful in how the scenarios were developed and used. Specifically, the researcher made significant efforts to conduct the interviews in a manner which ensures that the interviewees have the freedom to elaborate on their answers in relation to the topics covered without a feeling of being directed towards particular conclusions or answers. This approach where participants self-report their experiences in an interview setting to qualitatively study JDM process and affective aspects has been commonly used in psychology and JDM process literature (e.g. Baldacchino, Ucbasaran, Lockett & Cabantous, 2014; Coget, 2014; Haidt & Hersh, 2001; Hensman & Sadler-Smith, 2011; Hyppanen, 2014; Okoli et al., 2016; Scherer, 2005). Similarly, some prior auditing studies (e.g. Carrington & Catasus, 2007; Commerford et al., 2016) which qualitatively investigated the affective aspect of auditing practice have also relied on interviews where participants self-report their cognitive and affective experiences. For instance, Carrington and Catasus (2007) have used “if only technique”8 (p. 41) to focus the interviews discussion and prompt their participants to freely talk about their experiences of discomfort and comfort states. However, the possibility of participants providing biased accounts or an imperfect or inaccurate recall of some issues or experiences (e.g. Akinci, 2014) remains a potential limitation, in common with most qualitative studies relying on interviews (Daymon & Holloway, 2002).

8 Carrington and Catasus (2007) provided their participants with sentences starting with “if only the audit…” and asked participants to complete the sentences.
**Interview process**

During the interviews, interviewees were first invited to choose the scenario which best represented their experience, but the researcher affirmed to them that the scenario would be only used as an example that they can relate to and they are highly encouraged not to limit their discussion to the specific issues from that scenario. Then, the interviewees were asked questions that cover, but were not limited to, the main themes from the study’s interview guide (see Appendix 2). The researcher made effort during the interviews to encourage participants to discuss issues beyond the structure of the interview guide and scenarios by, for example, asking for other examples from their actual experience, the “how” and “why” questions, and probing other questions based on the interviewees’ previous answers and interpretations. The interviewees were also encouraged to add to the scenario any facts or events that they deem necessary to draw a hypothetical example by which they can explain their understanding and processing of PS.

**4.2.1 Research Sample**

For the purpose of interviewing, the study targeted experienced auditors working for the UK branches of the Big Four audit firms (PriceWaterhouseCoopers (PWC), Ernst & Young (EY), KPMG, and Deloitte). The choice of the Big Four was motivated by the fact that these firms are believed to possess significant resources, both technical and human, that should at least, in principle, enable them to make investments in the maintenance of audit quality and ethics (Choi, Kim, Kim, & Zang, 2010; DeAngelo, 1981; Francis & Yu, 2009; Knechel et al., 2018; Lennox, 1999). Prior literature has also argued that these firms play roles as key sites of accounting professionalism (Samsonova-Taddei & Humphrey, 2014). Finally, as revealed in the study’s analysis of FRC inspection reports presented in details in appendix 1 (see Figure 4.2 for a summary view), these firms are most commonly the objects of public and regulatory criticism underscoring the perceived low quality of audit work.
In total, 44 semi-structured interviews were conducted with an average duration of 1.33 hours (see Table 4.1 for a detailed overview of interview participants). As noted earlier, these interviews have been conducted in two stages: 5 initial interviews conducted at the early stage of data collection process and 39 main interviews. The LinkedIn website was used extensively in order to establish initial contact with target interview participants as well as relying on snowballing sampling techniques to expand the interview sample. Sample interview requests used to establish initial contact with participants are presented in Appendix 3. Most interviews were face-to-face, unless interviewees expressed a preference for telephone interviews instead. Where permitted, interviews were audio recorded and transcribed afterwards. If recording was not permitted, notes were taken during and immediately after the interview.

All interviewees who participated in the data collection process had worked as practicing auditors for a year or more because practice experience has been consistently described in the literature as a significant influence on the exercise of PS (Hurtt et al., 2013; Nelson, 2009; Nelson & Tan, 2005). Furthermore, the interviewees occupied different levels in audit firm hierarchies (from associates to partners) which allowed the researcher to ascertain how professionals in different positions perceive the PS concept in practice. Audit partners and audit managers (including assistance managers, managers and senior managers) are expected to have further responsibilities and more experience in interacting with different aspects of the auditing process, such as communicating with clients’ management, making different professional judgements and leading and managing their relationships with other auditors within the firm. Additionally,
experienced auditors are held responsible for those auditors working under their supervision (Bonner & Lewis, 1990; Kornberger, Justesen & Mouritsen, 2011; McNair, 1991; Sweeney & McGarr, 2011). Moreover, it has been argued that experienced auditors who have management responsibilities have an impact on the level of scepticism exercised by their audit subordinates since firms’ quality control policies, tone at the top and the auditors accountability to their superiors influence auditors’ exercise of PS (Carpenter & Reimers, 2013; Hurtt, 2010; Harding & Trotman, 2016; Peecher et al., 2013). It is worth noting as well that GF, which represents the essence of the study’s key theoretical framework (SIM) (explained in Chapter 3) has also been strongly linked to experience.

It should be acknowledged that professional auditors may vary in terms of the level of pressures and risks that they encounter while they make their professional judgements. This variation, may in turn lead them to practice PS differently. For instance, more junior auditors and auditors with management responsibilities are anticipated to experience greater accountability pressure (e.g. public scrutiny, partners’ monitoring, and regulators’ inspections) as well as other pressures (e.g. budget-time pressure) and risks (e.g. litigation risk) while they make their professional judgements. Partners, on the other hand, are expected to be concerned more with reputation loss risk, client loss risk, violating efficiency objectives and the pressure of public and regulatory scrutiny (Carter & Spence, 2014; Kornberger et al., 2011; McNair, 1991; Seckler, Gronewold & Reihlen, 2017; Svanstrom, 2016).
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<td>8</td>
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<td>1:33</td>
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</table>

*These name codes are used to identify the source of the evidence when quotes are used in the analysis.

Table 4.1 List of the research participants and interview details.
4.3 Approach to Data Analysis

Taking into consideration that the research questions covered three key areas, namely: (1) the way that auditors internalise (conceptualise) their PS practice, (2) the way by which auditors process PS while making their everyday professional judgment, and (3) the role of auditors’ social interaction with others in shaping their PS practice, an iterative analysis process was employed. This iterative process was between the empirical data (including collecting, understanding, managing and organising, reducing, and interpreting the data), explanations and theories discussed in prior literature and the theoretical lens recruited. This iterative process is a characteristic of qualitative research analysis by which the researcher attempts to uncover issues beneath taken for granted concepts and explanations (Daymon & Holloway, 2002; Tracy, 2013).

According to Marshall and Rossman (2006), building coherent interpretation (analysis) of qualitative data means that the data collection process is not, and should not, be entirely separable from analysis. Therefore, in this study, the analysis process started simultaneously with the data collection process (Daymon & Holloway, 2002). As part of the analysis process, the researcher took follow-up notes immediately after most interviews to reflect on and systematise key takeaways (Patton, 2002). All interview recordings were listened to several times to obtain an inclusive view of the matters discussed in the interviews and to specifically highlight relevant aspects. They were also transcribed and uploaded on Nvivo software to enable comprehensive analysis which, includes managing and organising, reducing (coding and categorising the data), and interpreting the data (bringing meaning and understanding to the collected participants’ interpretations and perceptions) (Daymon & Holloway, 2002; Marshall & Rossman, 2006; Miles, Huberman & Saldana, 2013). As noted above, the interview recordings and transcriptions were listened to and read multiple times to help the researcher build closeness with the data and be able to holistically understand what participants were saying in relation to their understanding and application of PS in their day-to-day practice.

From completion of the first interview onwards, the researcher started to engage in the habit of building empathy with the data through having the interview recording and transcription listened to and read several times, and reducing the data; taking analytical
notes, summarising, and coding and categorising the data (reducing the mass data by dividing them up into manageable chunks) (Daymon & Holloway, 2002; Miles et al., 2013). Open codes were first developed in accordance with the interview guide main themes which were included in the initial interviews; the process of making professional judgment in relation to: auditing judgmental accounting issues; challenging the client management representations (sufficiency and appropriateness of audit evidence and procedures), and the accounting firms’ internal culture (e.g. firm review process and relationship with teammates). These first-order codes and categories were developed to capture what the participants interpreted with regard to their conceptualisation and application of PS. As the data collection progressed, the analysis process evolved too and different codes and categories started to emerge. During this analysis process, analytic notes were developed to help keep track of the thought process and key insights emerging from the data. These analytic notes were described in the literature as a key tool to, “move the analysis from the mundane and obvious to the creative” (Marshall & Rossman, 2006. p.161).

At the early stage of the analysis process, while analysing the initial interviews, certain categories (observations) emerging out of the data drew the attention of the researcher. These categories were related to auditors’ use of certain emotional expressions, experience, and meetings and discussions with team members and client personnel to explain their understanding and application of PS. As noted above, this preliminary analysis of the initial interviews encouraged the researcher to recruit the SIM as a key theoretical lens to help comprehensively make sense of the data collected and explain the themes that were emerging (e.g. Alvesson & Karreman, 2007). The SIM was selected because of its distinctiveness by not only capturing the role of emotion in JDM, but also recognising the role of reasoning. At this stage, the interview guide was refined to include the SIM main theoretical themes to capture such issues emerged in the initial interviews, but our coding approach was maintained open to new insights emerging from the data. As the main interviews progressed, our coding scheme was iteratively revisited and refined (e.g. rephrasing certain categories and codes, adding new ones, combining and removing others). These codes and categories were compared and contrasted as well as customised to reflect what is being described in the interviews and being said in the auditing and theoretical literature (Miles et al., 2013; Daymon & Holloway, 2002). This
iterative process moving back and forth between the data (including interviews reflections, analytical notes and summaries), the theoretical framework and the literature led to the focused coding process (analytical coding process) where the theoretical constructs of the SIM were consulted to help make sense and interpret certain themes and patterns emerged out from the data (see Figure 4.3).

Using an abductive reasoning approach (including the use of a particular theoretical lens) which has been suggested to enhance the validity and theoretical endeavours of interpretive research (e.g. Lukka, 2014; Lukka & Modell, 2010) in a qualitative research may be claimed to constrain the flexibility and subjectivity by which interpretive research is characterised. However, the researcher has carefully considered this issue while doing the analysis and interpreting the empirical data. This concern, that using a certain theoretical framework to make sense of qualitative data may raise concerns about providing biased interpretations (the issue of seeing only certain aspects of a phenomenon which can be observed through certain theoretical perspective) (Power & Gendron, 2015; Kvale & Brinkmann, 2009), has been acknowledged in the qualitative research method literature. This issue is related to the idea that “every way of seeing is always a way of not seeing” (Silverman, 2000. p.475). However, it has been emphasised that using such theoretical lens which may be borrowed from other disciplines (e.g. psychology and sociology) can help in producing novelty in understanding and uncovering issues of the phenomenon (PS) that have not been recognised before and providing a significant contribution to the knowledge (e.g. Power & Gendron, 2015; Malsch & Salterio, 2016). Thus, this study used the SIM to bring focus and meaning to the findings emerging from the data and provide plausible theoretical explanations of auditors’ understanding and application of PS. Malsch and Salterio (2016) went further explaining that “choosing a theory in interpretivist research is never a clear-cut process. At one extreme, interpretivist researchers can start collecting data with a theoretical framework in mind” (p.11). Similarly, Collins & Stockton (2018) described the role of a theoretical framework in interpretive qualitative studies as webs of interlocking concepts that are used to organise the empirical data through providing the researcher with interpretive frameworks by which they can make their data comprehensible and rationalise their methodological decisions.
The interpretive nature of this study encouraged the researcher to place considerable effort to remain open to new categories and observations emerging out from the empirical data and pay careful attention to negative cases which may contradict or challenge the SIM key elements by tailoring, adapting, extending and pushing the limits of the existing understanding of PS (Daymon & Holloway, 2002; Kvale & Brinkmann, 2009; Tracy, 2013). For instance, we dedicated certain effort to consider issues where auditors emphasised more on reasoning process (e.g. critical thinking or effortful conduct and collection of audit procedures and evidence) which represent an essential negative case to the SIM main argument which values more the role of gut feeling over reasoning process. Also, as part of our effort to avoid being limited by theoretical framework explanations, we tried different approaches to articulate the patterns emerging from the data in ways that were different from what the SIM explains. However, the SIM has assisted in capturing auditors’ perspective on their conceptualisation and operationalisation of PS in everyday auditing practice and providing the empirical findings in a plausible theoretical manner.

This discussion leads us to acknowledge that the interpretation that this study provides using the SIM as the key theoretical perspective is not the only theoretical explanation that can emerge out from the data collected. And since there is no such theoretical perspective that can capture the whole complexity and people’s subjective interpretations involved in the construction of their social environment, other theoretical understandings may legitimately arise from the same data (e.g. Power & Gendron, 2015; Malsch & Salterio, 2016). Nevertheless, the theoretical perspective that this study employed helped in satisfying the objective of this study, addressing its research questions as well as pushing the limits of the existing understanding of PS.

As a final point, since this study involved analysing aspects related to cognition and emotion, certain epistemological challenges should be highlighted. It has been discussed within the cognition and affect literature that only agents (participants) can directly access their cognitive and affective states and the observer (researcher) can infer such states based on the participant’s behaviour and self-reports. However, emotional experience may be misinterpreted by the researcher as an external observer or mistakenly reported by the participants (auditors) because of the ambiguity associated
with the understanding of the nature of emotion and the conceptual overlap that can exist between different emotional states (e.g. anxiety, worry, fear, disgust) (e.g. Akinci, 2014; Greenwood, 1987; Guenin-Paracini et al., 2014; Scherer, 2005). Guenin-Paracini et al. (2014) indicated that clarity is the only way to overcome such epistemological challenges associated with the qualitative investigation of emotion. Therefore, when such emotional aspects were observed and included in our coding scheme, we attempted to identify a certain understanding of emotion and a certain definition to distinguish the emotional experience that participants reported as associating their practice of PS. As explained in Chapter 3, we adopted the understanding of emotion as being part of cognition using the appraisal theory of emotion (cognitive theory of emotion by Arnold, 1970 and Lazarus, 1991) on which the SIM is also based. Accordingly, we considered emotion state as “a subjective cognitive representation, reflecting a unique experience of mental and bodily changes in the context of being confronted with a particular event, there is no access other than to ask the individual to report on the nature of the experience.” (Scherer, 2005. p.712). In order to capture the emotional experience (gut feeling of discomfort (GFD)) that auditors associate with their practice of PS and prevent seeing the GFD everywhere while analysing the data, we adopted a certain understanding of GFD which is presented and explained in Chapter 3.
4.4 Ethical Considerations

The interaction between the researcher and the research participants in the qualitative research methodology may raise some ethical issues. These ethical issues vary based on the research design and topic, but they should be given careful consideration. Examples...
of these ethical issues include: gaining access to data, relationships with participants, documenting the data collected, safety of participants, confidentiality of participants’ data, and obtaining ethical approval and consent forms (Bell & Bryman, 2007; Creswell, 2014; Daymon & Holloway, 2002; Marshall & Rossman, 2006; Silverman, 2010).

In this study focusing on the practical meaning of the PS concept in auditing, specific care was given to ethical issues that might accompany the research process while designing the research. The study’s research methodology, which includes conducting semi-structured interviews with professional auditors and the potential sensitivity of the research topic, might raise some ethical issues, such as a potential challenge to gain access to participants, the level of overtness employed about the research objectives, researcher bias while conducting and writing the research and the researcher’s interaction with participants (including the confidentiality of participants’ data). The access issue in the auditing field, as well as the sensitivity of the study’s topic (the PS concept), have signified efforts in this research to minimise such ethical risks. Even though obtaining access to the Big Four audit firms or the people who are working in these firms has been listed as a challenging task, this challenge has been overcome through focusing on individual auditors and employing snowballing sampling. Accordingly, Humphrey (2008) and Power and Gendron (2015) have emphasised that the challenge of gaining access to audit firms can be resolved through, for instance, focusing on individuals instead of organisations. Therefore, the study decided to focus on the individual auditors as a unit of analysis, since this level of analysis satisfies research objectives (understanding auditors’ everyday practice of PS) and is considered more manageable than the organisational level to gain access to (Power & Gendron, 2015).

Additionally, since PS is an area of criticism of auditors’ practices, it can be a sensitive topic to auditors (participants). A decision has been made to provide the participants with a general explanation of the research objectives as that can be very helpful for two reasons: limiting participants’ bias towards the relevant areas to the research and reducing the impact of topic sensitivity on participants’ cooperation with the research. Thus, the British Psychology Society’s suggestion was followed, which indicates that the researcher can withhold some of the research details to secure research data validity.
without unethically misleading the participants (Daymon & Holloway, 2002). Additionally, since one of the ethical risks associated with the qualitative research method is securing the participants’ confidential information, a certain coding strategy was utilised which is similar to the “pseudonym” strategy to protect the identity of the participants and to safely keep participants’ information in a secured place. The researcher also made considerable efforts to explicitly explain to participants that their data is going to be kept confidential and utilised only for research purposes (Creswell, 2014; Marshall & Rossman, 2006; Marvasti, 2003).

Furthermore, with regard to obtaining ethical approvals for the research, since the study is going to be submitted as a fulfilment of a PhD degree requirement, the university’s ethical principles were followed. The study ensured that participants voluntarily participated in the research interviews. Additionally, the researcher made efforts to appreciate and respect any cultural differences that he faced while interviewing participants (auditors working in the UK) as he came from a different culture. Relatively, since the research participants (professional auditors) are working in multinational firms (the Big Four audit firms) which interact with multinational clients and carry a diverse work environment, culture differences were not a significant issue within this research project as the research participants were familiar with working with people from different parts of the world. The researcher made his efforts to treat research participants with such manners that they deserve as humans, professionals and volunteer participants (Creswell, 2014; Marvasti, 2003).

In qualitative research design, the researcher plays a significant role in collecting, analysing, and reporting the findings. Although the researcher’s role in qualitative research method might be an area of criticism, as it raises bias risk, the researcher’s background, experience and skills are essential in qualitative design to enrich the research process and the researcher’s interpretation of participants’ view, as long as the research is appropriately and thoroughly designed and conducted. Accordingly, qualitative researchers who consider their role in the research as being essential have criticised positivists and structuralists for claiming that researchers can fully eliminate their bias in the social field (Creswell, 2014; Leckie, 2008). For the sake of assuring research credibility and reliability, the study expended considerable efforts to select the
appropriate participants for research endeavours, plan interviews to increase the possibility of asking the questions that can elicit the appropriate data, audio record interviews, transcribe the interview recordings and use thick description and unbiased language to report the research process and findings. Along with this, the researcher has made efforts to take advantage of other data resources, such as observation within interviews context and review of documentary evidence (relevant literature, theoretical framework and qualitative content analysis of FRC’s AQR reports) to increase his awareness of the research area and accordingly help him analyse and report the research findings.

4.5 Summary
This chapter discusses the research methodology employed in this thesis. The interpretive qualitative research approach is used to understand how professional auditors internalise and operationalise PS in everyday practice. The study mainly uses interviews to collect research data. The interviews were conducted in two stages (initial interviews and main interviews). The review of the relevant literature, review the FRC’s AQR reports, preliminary analysis of data collected in the initial interviews, and selection of SIM as the study’s key theoretical framework have all contributed to the development of the interview guide, and the reliability of the interview evidence. Interviews include professional auditors working in the Big Four audit firms in the UK. Those professional auditors represent different positions in the audit team organisational hierarchy. The data analysis which is informed by the SIM, focuses on uncovering and developing themes that may explain the conceptualisation and operationalisation of PS in practice from the perspective of professional auditors. This chapter also sheds a light on certain ethical considerations relevant to the conduct of this study. The following three chapters provide analysis of interview data (transcripts) regarding auditors’ internalisation and operationalisation of PS in practice.
Chapter 5: Auditors’ Internalisation of PS in Practice
5. Introduction

As discussed in previous chapters, the concept of PS has been subject to a variety of definitions and approaches in the auditing literature (Brazel & Schaefer, 2015; Hurtt et al., 2013; Nelson, 2009; Nolder & Kadous, 2018; Toba, 2011). This chapter explores auditors’ internalisation of PS in practice. More specifically, it shows how auditors tailor their internalisation of the PS concept through risk and tend to adopt a presumptive doubt perspective, especially when risks are significant. This perspective prompts them to recall possible negative scenarios where material misstatements can exist, and internalise PS as being initiated and shaped as an emotional state (gut feeling of discomfort) which is informed by their accumulated knowledge.

This chapter provides empirical evidence to answer the first research question, namely: how do auditors’ internalise the PS concept in practice? This chapter is organised as follows: Section 5.1 explains the perspective that auditors take when they come to practise a higher level of PS, with Section 5.2 discussing auditors’ employment of the risk-based approach in order to make sense of PS. Section 5.3 discusses auditors’ employment of informed GF (feeling of discomfort) in shaping their sceptical judgment, and Section 5.4 introduces concluding remarks and summarises the findings that have been discussed in the chapter.

5.1 What could go wrong? (The Presumptive Doubt Perspective)

The perspective auditors should embrace while trying to make sense of the PS concept in auditing has been an area of inconsistency. As discussed in Chapter 2, studies have expressed different viewpoints on this issue with some arguing that auditors should look at the PS concept from a “neutral perspective”, where the auditor should assume neither the existence nor the absence of material misstatements, while others have argued that auditors should consider the possible existence of material misstatements (“presumptive doubt perspective”) (Hurtt, 2010; Nelson, 2009; Toba, 2011). This section presents evidence of how auditors define the perspective that they embrace in order to construct their understanding of the PS concept.

In the interviews, auditors demonstrated their reliance on the presumptive doubt perspective, while explaining their perception of the PS concept, particularly when the
associated risks are felt as being substantial. Specifically, auditors demonstrated that their role involved challenging client management:

“Scepticism for me is not taking anything at face value.” (Audit Assistant Manager, AH-T)

“…we have to be careful that we are not advising clients on what their accounting policies are and what their processes are, you know, we are auditing them. So, there is a distinction in that. So, really our role is to challenge.” (Audit Director, YS-T)

“So, without anyone wanting to manipulate anything or wanting to falsify anything, it may be just that the people are just their natural bias. But obviously, one thing that I know, I would have to constantly be aware of, [is] the possibility of the client wanting to manipulate things and having a questioning mind.” (Audit Assistant Manager, R-T)

“…in our industry always think of what are the consequences. So, how big is the decision, how material, what are the consequences. I mean things like what is the worst-case scenario? What would happen if that happened?” (Audit Manager, M-Q)

In conjunction with the above, a participant recalled how his subordinates usually feel disappointed when they are told that the issues they discovered are too insignificant to be dealt with, because of an expectation that auditors should be finding things.

“…they get disappointed because the prime of our job is when you find issues. When you find the issues, it means you have done your job well.” (Audit Manager, M-Q)

The participants used common phrases such as “what could go wrong?” or “what is going on?” to describe their perception of exercising PS. Such phrases seem to point to auditors’ appreciation of the possible existence of material misstatements. Auditors’ awareness that a material misstatement may exist in a factual pattern or account balance encourages them to exert efforts in determining “what is going on?”, since there may be other important evidence pointing to a material misstatement that was previously disregarded by client management. Anticipating a possible occurrence of material misstatements is considered a key factor in PS behaviour by auditors.

“We are trained to think in a way to assess where is the risk, what could go wrong …” […] “[Y]ou look at your balance sheet, the first thing you have got is cash you think about how wrong can that be? Or what is the possibility this can be wrong?” and he also explained that “…in everything you look at what is the risk of this guy doing the wrong things and what is
the risk of this guy doing errors, you always have to assess that.” (Audit Manager, M-Q)

“There might be a reason why the lawyer resigned. It is like for example when people resign, you might want to find out what was going on, what was happening, were they threatened, was there a problem with communication, communication broke down or you know… Again, it is about scepticism, you want to find out what is going on?” (Audit Assistant Manager, L-Q)

The presumptive doubt perspective also seems to encourage auditors to heavily concentrate on disconfirming evidence, in anticipation that management can be prone toward misleading auditors. For instance, as judgemental accounting issues entail an inherent risk due to their subjectivity and uncertainty, auditors need to show (evidentially) that they have sufficiently considered the possibility of management misconduct while auditing these risky areas.

“I am aware that strictly speaking you go with professional scepticism, whereby I suppose the client is wrong until proven otherwise...” (Audit Assistant Manager, S-Q)

“You have to have [sceptical mindset] as an auditor; otherwise management are going to walk all over you all the time.”

“[I] was initially very sceptical about management saying oh, we will be able to easily swap this one away in court… I am more sceptical and say: really? I do not think so. I mean it is a £5m claim; you must have done something pretty naughty to do this. And I think that is just a healthy level of professional scepticism.” [...] “[T]hen you would probably seek I guess other sources of information to corroborate management or to disconfirm management’s position.” (Audit Manager, AX-Q)

Participants did emphasise however, that challenging client management should not be construed as auditors distrusting management. They highlighted that they also routinely consider confirming evidence, although its importance diminishes when the risk associated with the task under consideration is considered significant. Some participants explained that the presumptive doubt perspective should be embraced when risk is substantial. Therefore, auditors tend to link their practice of PS to audit risk which triggers the Gut Feeling of Discomfort (GFD) leading to the PS practice; they also see risk as a metric to measure the proper level of PS (see following sections for discussion). This confirms earlier observations by Nelson (2009) linking risk to the exercise of PS in
relation to the presumptive doubt perspective which he saw as the most appropriate stance.

“There is a misconception that all auditors have when they join… when they step into practice that do not trust anything a client tells you.” (Audit Assistant Manager, AH-T)

“…I am not out to find problems with management. But…we need to be careful that we are doing a proper audit and challenging management and applying professional scepticism as and when appropriate.” (Audit Manager, AX-Q)

Furthermore, while acknowledging the importance of not taking what the management says at face value and instead focusing on audit evidence, they do not seem to place much emphasis on the type of evidence (confirming versus disconfirming management’s assertions). Instead, their efforts are focused on collecting sufficient evidence for the audit file which can protect them against any reviews or in case of a legal claim. Hence, the implication is that this approach may lead a narrowly-defined focus on the evidence that supports or confirms management’s representations, especially in the accounting judgmental areas where there is no conclusive evidence to be obtained (see, also, Toba, 2011). Some participants explained, however, that this mindset does not truly represent the proper practice of PS, and that the focus should always be on adequately challenging the management.

Some participants have exercised great care to the possible existence of disconfirming evidence when they explain their concentration on collecting audit evidence.

“You would probably seek I guess other sources of information to corroborate management or to disconfirm management’s position.” […]

“[y]ou need to look for strong sources of external evidence to either corroborate or disconfirm what the management are saying.” (Audit Manager, AX-Q)

“… it is not our job to prove whether managements’ numbers are right… Our job is to critically audit, assess managements’ numbers, we are not there to support the management.” (Audit Partner, H-O)

Another participant clearly explained how these two terms (challenge and corroborate) refer to different orientations, both of which an auditor should be aware of.

“Challenging is much more looking at the results and saying that the conclusion does not make sense. So, if they were saying they have invested heavily in this new segment and that is going to give us new growth, so the challenge would be whether the investment leads to growth but the
corroboration is just making sure that they have actually invested.” (Audit Manager, M-A)

Further, a participant below explains that he specifically looks into how his subordinates particularly consider the nature of evidence provided by the management when he reviews their work. He explicitly refers to the importance of considering the availability of disconfirming evidence and mentions the term “substantiation” to describe a tendency to focus on confirming (corroborating) audit evidence. In contrast, Toba (2011) claimed that the “falsification approach” which represents the attitude encouraging auditors to concentrate on negative evidence, is better aligned with the presumptive doubt perspective and effective exercise of PS.

“I look at the responses of the challenges and then how we have gone on and substantiated or supported them, what corroborative evidence we have obtained, have we considered negative evidence i.e.” (Audit Director, YS-T)

Another participant claims that this problematic orientation, where auditors dedicate their work to supporting what the management says, is a concern; however he also points out that this concern is more a remnant of the past.

“If you went back 15 or 20 years ago, there would have been some people you talked to in an interview like this who would sort of be, well, we are there to support, so we are looking to find things that support where the management is rather than finding things that dispute where the management is.” (Audit Partner, H-O)

Especially with judgemental accounting issues, where reliable evidence is hard to obtain, a participant explains that his goal is to basically support what the management have used to base their judgments. This suggests that the difficulty associated with obtaining reliable evidence to challenge client management on judgmental accounting issues may result in auditors’ tendency to embrace a more confirmatory stance.

“…typically what we look for is how much of the client’s assumptions can we support based on this kind of supportive information.” (Audit Director, YS-T)

5.2 Is it risky enough to worry about?

As part of a risk-based approach, auditors start work on an engagement by conducting an initial risk assessment which then provides the basis for the audit time and budget plan. As a consequence, auditors learn how to assess and respond predominantly to high-risk
areas. Based on the interviews, the risk which auditors are most concerned with and from which all other risks stem is the risk of failing (or as a participant put it, “…the risk is getting it wrong” (Audit Manager, M-A)) (for a similar view, Guenin-paracini et al., 2014). As Pentland (1993) noted, “the basic problem in auditing is that numbers do not speak for themselves”, “[n]umbers may reflect management self-interest rather than reality, or they may simply be wrong” (p. 609). The audit environment is built on the concern that there is a strong possibility auditors will fail to capture a material misstatement and thus, this has made auditors risk-driven in the sense that they base their judgments on the assessment of risk to a greater extent than on evidence obtained (see also Phillips, 1999).

“…we are trained to think in a way to assess where the risk is.” […]
“[I]nitially when people start coming in as junior auditors, they always look up to find issues, but then they start realising oh alright this is an issue or it is not something that I need to worry about because it does not impact the financial statements materially.” (Audit Manager, M-Q)

Similarly, participants have expressed their internalisation of the PS concept as strongly correlated to their exposure to risk. The risk-based approach helps auditors manage their audit in a way that can satisfy the efficiency objective and, as a result, the profitability objective. Nelson (2009) argued that auditors exercise sceptical judgement but would not necessarily translate that scepticism into action unless it reaches a certain threshold, since too much scepticism can lead to the violation of the efficiency objective. However, the current study found that auditors tend to link their practice of PS more to the level of risk associated with such a task. Although the assessment of risk is judgemental, auditors tend to utilise PS to sense risks and accordingly respond to them once they are deemed material. They explain that they would not exhibit PS actions (conducting further audit procedures and collecting further audit evidence) unless such an event is risky enough to prompt them.

“The whole point of an audit is reducing risk to an acceptably low level. An auditor risk is a risk that you have not picked up a misstatement which is material that is hiding in the stuff that you have not tested.” (Audit Manager, AX-Q)

“…you are more worried about the hidden things rather than the obvious things.” (Audit Manager, M-Q)
The act of challenging client management through asking further questions, conducting more audit procedures and asking for more evidence are supervised by the assessment of audit risks. However, the presence of a certain risk is not sufficient for auditors to probe and investigate further; rather, it is considered that risk should be sufficiently high (material) to warrant a matter of concern.

“If it is not a high risk area, then sometimes just a single tick mark explaining what this is, is enough because just saying okay, this is that, I believe that there is no risk, I have seen the material on the statement in this area, we are not testing it at all because it is a tiny balance.” (Audit Assistant Manager, Y-T)

“We do rely on third party confirmations, but in this case I personally think we do some extra work, to get ourselves comfortable, and not just to rely on this and move forward, because it is a risky area, it is a very risky area.” (Audit Assistant Manager, T-O)

Auditors have also utilised the level of risk that they feel in order to describe the attitude that they need to have toward the evidence (positive or negative). Accordingly, they would give focus on the possible existence of negative evidence when the risk associated with such an event or balance is deemed significant. However, when the risk is considered insignificant, they would be satisfied with having sufficient evidence to put in the audit file, regardless of evidence type. Since disconfirming (negative) evidence might be misunderstood to perceive auditors as distrusting management, a scenario might occur where auditors end up comfortable with corroborating what the management is saying.

“…this is a big thing if these guys are being listed as clients, this will be out in the press as well. Then the company who will be taking them to the court will have given a public statement as well. So we will want to look at, the external evidence, external assessment, what they are saying, whether it is contradicting the management assessment or not.” (Audit Assistant Manager, D-Q)

Likewise, factors such as the attitude of client management and the nature of the accounting issue can increase the level of risk that auditors feel in relation to a certain issue (discussed further in Chapter 6). As the level of risk increases, auditors tend to feel that PS should be raised accordingly.

“If they are already aggressive in other areas of judgements, this would increase your scepticism around this judgement as well.” (Audit Assistant Manager, A-T)
When auditors perceive an issue to be of significant risk, they feel a higher level of discomfort and prepare themselves to recall alternative scenarios, which might go against what management is saying. Auditors attempt to recall the negative (contradictory) scenarios because they want to make sure that these scenarios do not exist. For instance, when auditors assess an issue (e.g., a change in the bad debt provision or manual journal entries) to be material, they recall negative scenarios that they encountered previously where the management engaged in accounts manipulation.

“...one thing I have actually seen with some clients over time is they can play around, especially directors who are remunerated based on the performance of the company. I think there is always an issue, especially around estimates for bad debts provision whereby if they know that their firm is doing very well in one year, they can increase the provision to be very high. Then come the following year, they can say things are actually not as bad as they thought and they decrease the provision to boost up their profits...” (Audit Assistant Manager, R-T)

“Certain areas in any particular entity pose more of a risk of management override or manipulation and certain areas do not. A very good example of that is manual journals, if manually I have to give adjustments in my client balance they are prone to not only but also human error. So that is where I would pinpoint my attention and say right this is an area where it is a significant risk so I will pick up more samples, do a bit more digging...” (Audit Manager, S-T)

These two quotes illustrate how auditors are prompted to worry about particular accounting issues – such as that an accounting estimate is risky as it encompasses a high level of uncertainty and subjectivity, or that the manual journal entry system increases the possibility of intentional or unintentional errors. Auditors’ capacity to know what they should worry about is the first step in practicing PS. Assessing (sensing) the risks requires auditors’ ability to consider various possible negative scenarios (disconfirming what management is saying) because their existence represents a chance of an auditor missing a material misstatement. Recalling the possible negative scenarios requires auditors to be able to feel certain risks through certain factual patterns (eliciting events). With vast experience and knowledge, auditors endorse the ability to sense the factual patterns which can prompt their feeling of discomfort to the point where they decide to conduct additional tests and collect further evidence (further discussed in the next section).
In one of the interview scenarios presented to participants, it was hypothesised that while a client was being sued over copyright infringement, the client’s lawyer had resigned. A participant felt that this fact was indicative of the risk of management behaving inappropriately, so he started to draw a picture where he recalled a negative scenario from practice where client management was exhibiting an inappropriate attitude which led him to feel discomfort.

“…it sounds like the management are what we call opinion shopping. In other words, they did not like the advice they got from the first legal firm, so they forced them to quit, and got another piece of advice. Which makes me even more worried that the first lawyer might have actually had some concerns which they were not prepared to put on record… you would get a bit more worried.” (Audit Manager, AX-Q)

In relation to the same scenario, another participant also commented that, since the situation would be considered as high risk, he would challenge client management further to find answers to what he saw as the main question - why did the client’s lawyer resign? In his view, this question needed to be answered for him to be able to regain comfort.

“If it is material, 20 million assets. If you assume it is material, now the question is why did that guy resign? probably some infringement, so maybe this 5 million is the first of 10 more suits to come, so it informs your judgement, professionally that is how you look at it.” (Audit Manager, T-T)

5.3 Gut Feeling of Discomfort (GFD)

Auditors are expected to make professional judgements as a reaction to certain cues or factual patterns in the client environment, and act based on those judgements (Power, 1995). It has also been elucidated (specifically in the PS literature) that when auditors have experience with error/non-error explanations, they can more easily identify the high-risk patterns and carry out additional assurance procedures (Schaub, 1996; Schaub & Lawrence, 1996). As explained in Chapter 3, with experience, people start to employ their GF (intuitive thinking system) more frequently, which is known as the matching pattern mechanism (Evans, 2008; Haidt, 2001).

Smith and DeCoster (2000) explained that GF has been attributed to the so called “pattern completion mechanism” which means that, after accumulating experience over time, individuals are capable of retrieving from the slow-learning memory an entire
range of characteristics pertaining to a particular issue or event (fact pattern) just on the basis of a few such characteristics relating to similar events they encountered previously. In the current study, participants have demonstrated how their scepticism is initiated as a GFD, which drives them to place extra effort, in the form of posing additional questions to client management, conducting alternative procedures and considering contradictory evidence, as a way to manage this feeling and avoid certain negative consequences. This GFD corresponds with the risk of failing, which inherent in the auditing process. In this regard, a participant defined the GFD that auditors get as, “a sense of seeing something wrong, even though nothing is wrong” (Audit Assistant Manager, AH-T).

An audit manager with about 10 years’ experience explained that he experiences a certain feeling when he encounters specific fact patterns. This GFD initiates his PS behaviour and he conducts further procedures and investigates additional evidence.

“…auditing is that when you get a fact pattern like this, most experienced auditors have that gut feeling about which way you are going to go with it. And then if there is extra fact to the circumstances that come out they will either confirm or deny your initial sense of it.” (Audit Manager, AX-Q)

In her experience of auditing the cash balance of a large client, another participant demonstrates how her GFD triggered by management’s uncooperative attitude prompted her and the audit team to be more alert toward the possibility of a misstatement.

“…I was asking her questions in relation to the cash balance, which is very big for the client and their business is the cash business. And on a couple of occasions she just wanted to get rid of me. So intuitively there is a feeling like why can’t she tell me? What is going on?… But further investigations showed that this balance is massively misstated… So, gut feeling definitely comes in, especially when there are so many hints around. Based on your experience what sort of hints might trigger your gut feeling? I mean makes your feelings start to kick off.” (Audit Assistant Manager, AH-T)

Interestingly, she defined this GFD, which drives her to dig deeper into things as follows:

“… There is nothing wrong, you just get the feeling. It just gives me discomfort that something is not right. And that is when you work closer to other things, you look a lot closer in the details… It is just automatically prompting you to be resourceful and look at other things.” (Audit Assistant Manager, AH-T)
Another participant explained, that, “gut feeling comes in when you do not feel comfortable.” He further explained what he would do when he could not let go of this feeling:

“Your experience might tell you otherwise but something in you might just say I am still not comfortable about this. So, you are free to talk to anybody and say, well, I went to that client site, I had a discussion about this which seemed fine, but I still felt I was not comfortable, then you talk… Then you just have that discussion, so they understand where your feelings are coming from and they would help you in terms of how you would address that feeling.” (Audit Manager, E-TIT)

The participants employed different emotional expressions (e.g. worry, concern) to describe their GFD when they encounter certain fact patterns.

“…you are sitting at home, you do not worry that something might go wrong, then you are comfortable, you do not think, you are thinking oh everything is perfect oh the control is working, so you are comfortable, you are able to sleep at night.” […] “[b]ut if you have doubt that something might go wrong… Nothing has actually gone wrong, everything is working as expected, but what if this happens, so it is that what if?” (Audit Manager, E-TIT)

“…concerned, it means that there is clearly something else possibly going on or that there are other factors at play that could confirm my initial suspicion about something.” (Audit Manager, AX-Q)

Likewise, a participant noted that the additional procedures which follow auditors’ experience of GFD are conducted to alleviate that strong feeling which occurs when the risk is significant.

“What if this happens, that is what we need to remove. We know that we cannot remove all the risk but we always look at what if, so that is the feeling if you are not comfortable about something.” (Audit Manager, E-TIT)

Some participants clearly demonstrated that performing extra procedures (including confronting client management with difficult questions) and collecting further evidence (e.g. securing outside independent evidence) are the methods that auditors use to feel stable (comfortable) that they have done what they can to protect themselves if things go wrong or if their work is reviewed. The following pieces of evidence show auditors’ utilisation of extra work to satisfy themselves (undo the feeling of discomfort).
“As auditors we can say that we were diligent and we did our work with diligence and there was not recklessness and there was no negligence and based on our work, if any other auditor would have done this, he would have reached the same conclusion.” […] “[B]asically to save our own, to cover our bases...” (Audit Assistant Manager, W-O)

“If it is a £5 transaction I am not worried about it. If it is £5 million, I am worried about it.” […] “[I] would have to sit with the client and on a line-by-line basis... using materiality because if it is a difference of £5 I am not worried. So, definitely speaking and perhaps obtaining independent information to back up what the client is telling me. So, again it is not about taking everything, as if it was just the truth. So you would need to dig deeper into the evidence.” (Audit Assistant Manager, L-Q)

Another participant echoed the above views by stating that she feels uncomfortable when the client management provides her with short or vague answers to her questions because she recalls that these types of answers will cause issues during review.

“Uncomfortable because I would then not be able to justify myself but my reviewer… I would definitely know the questions were going to come back. So, that again comes with experience. People tend to give you a short answer when they are unsure of something.” (Audit Assistant Manager, AH-T)

Further, auditors have also alluded to different aspects that can elicit their GFD. For instance, participants reported paying particular attention to the so called human factor (e.g. client behaviour) as well as information inconsistency or unfamiliarity as factors that can trigger their GFD (see further discussion in Chapter 6).

“… if you have directors who are always away when you try to ask them something, being a junior member you might just think oh, they do not have time. You just wait until they do or leave it to the partner. But when it comes to experience, sometimes it does make you feel like what do they have to hide? Why cannot they tell me about this? Why cannot they talk about it?” (Audit Assistant Manager, AH-T)

“…so a particular client might have investments in glass and in tables. Clearly there is not much correlation between them specifically, but if we are talking about macroeconomic factors to say markets in the UK, the GDP is going this way and the investments and valuations for both of them had GDP going in a different direction in the same client then again that will cause me to say hold on a second are they just trying to massage the numbers that kind of gets them.” (Audit Director, YS-T)

Interestingly, auditors sometimes describe their GFD as something associated with a questioning mind. When they are prompted to feel discomfort, they also start
questioning their own judgements and decisions and those of the management. One participant explained, for example, that, “the gut feeling only comes in terms of questioning things.” (Audit Manager, M-Q). Another participant also illustrated that he does not feel that he is consciously applying the PS mindset, it comes naturally with experience in the form of GFD.

“…I do not think that I am being sceptic. It comes to my mind. The response is that it does not feel right. From my experience if a client says something, I add more, another thing in my mind of what I expected. And obviously I will be more sceptic, this is how it works.” (Audit Assistant Manager, W-O)

5.3.1 Experience
Experience is one of the individual characteristics that auditing literature has emphasised as positively influencing auditors’ professional judgement (Bonner, 1999; Nelson & Tan, 2005). This experience represents the knowledge that auditors learn over time (stored in the slow-learning memory) in order to be prompted to feel discomfort with certain patterns of evidence (Smith & DeCoster, 2000). Thus, experience can prompt auditors to intuit the areas where high risks of material misstatements exist, and hence, can also influence auditors’ PS (Nelson, 2009; Shaub, 1996; Shaub & Lawrence, 1996).

Interview participants seem to relate their GFD to their experience, to the extent that they define GFD and sceptical judgement as nothing more than experience. They emphasise and admire the level of experience and exposure that auditors have, which others in the accounting field may not possess.

“…if you work for an investment agency you may not be able to have so many examples to share. Whereas working in audit, you tend to have various engagements and you tend to learn so many different things, work in so many different areas of audit.” (Audit Assistant Manager, D-Q)

“The exposure we are getting is quite a lot, interacting with tens and thousands of people, different companies, different industries, dealing with different partners, dealing with different colleagues.” (Audit Assistant Manager, W-O)

The participants also explain that experience shape auditors’ scepticism, since they are able to recall more scenarios from practice and how such scenarios were handled. This supports the idea that auditors’ GFD is informed by real experiences and reasoning that have been accumulated and stored in the slow-learning memory over time.
“…when it’s your first job you might not have enough expertise to properly challenge the client, but when you see situations like this arising from time to time and see how they actually got resolved you are now starting to have a framework as to how to approach certain problems, and based on that you would develop your own scepticism.” (Audit Assistant Manager, Y-T)

Since auditors possess this level of exposure to different clients, industries and accounting issues in auditing, participants exhibited how this experience developed their GFD.

“I have been doing this for a while, I think you have that gut feeling about which way you are going to go with it.” (Audit Manager, AX-Q)

“… it is all about the experience. And the more you work in audit, the more you develop I would say an ability to kind of sense, you know to sense and your ability to feel in a way if that information is correct or not, but a lot of it from experience and you know, it is strange to say, but it is about sensing.” (Audit Assistant Manager, L-Q)

“…it is more of, again, experience in terms of like this happened before with me and turned out not to be nice, so let’s check that, let’s do that. And sometimes things do not make sense, this is where the gut feeling comes in.” (Audit Manager, M-Q)

“… I certainly think experience helps in just, essentially, giving you that background that somebody says something to you, just… It is a professional
scepticism essentially, you’re saying to yourself, does that make sense? Does it pass the sniff test? Does it sound right? …In all of the understanding and the knowledge that you have of similar clients and similar businesses, just does that make sense?” (Audit Partner, San-A)

Auditors’ experience also includes on-job training, which may encompass the review process wherein each level of the audit team hierarchy provides feedback comments on the subordinates’ work. This on-job training provides varied opportunities for learning and professional development and hence is significant in developing their ability to handle practical challenges.

“… you learn from your superiors in the industry. That is where the review process comes in because if I am coming to a reviewer, and I have been asked the question, so you as a junior, you are learning from day one to say actually next time I will ask this, or actually this guy what is telling me, I should have thought of some other things.” (Audit Manager, E-T)

One interview participant recalled how an experienced colleague in her audit team was able, based on his prior experience of similar issues, to rightly identify the risk of a balance being materially misstated despite the absence of obvious clues.

“…I was working with a senior manager on a job and… presented with something that does not look quite right. Obviously, no one else in the team comes to the same… But this person had a feeling. They looked at the information. They checked the information and I think it was concluded that it is not quite right.” […] “[S]enior managers… really understand the business. They have added clients which operate in a very similar way… So, from the experience they might not need to do too much looking around, like we will need to.” (Audit Assistant Manager, AH-T)

Moreover, some auditors also commented on their reliance on the so called escalation and consultation tradition (reporting and discussing important issues to colleagues up in the firm’s hierarchy) as a way to alleviate discomfort about a particular audit issue.

Auditors know the ultimate risk rests with the person (partner) signing off the audit report, so they learn that if they feel a high level of discomfort about a significant risk, they can share that feeling with superiors, which can in turn diminish or further reinforce their GFD.

“When you are explaining to another person… Logically this is how the issue was supposed to go, but I felt, so it is always a question of I felt that this should have gone this way. Then, it is almost as if you are posing a question to them: What do you think? Was I right? and they will say, ‘Yes you were right because this was supposed to’, so… It was good anyway to
have this conversation; then it sort of makes you feel a little bit better.” (Audit Manager, E-TIT)

“We would respect the partner’s knowledge on this matter because he is the one signing, it is his neck on the line so his judgement takes precedence over the management’s judgement. So, once he concludes on a matter, that is, if he says it is an error, then most probably it is an error and if he says it is not an error then case closed it’s not a discussion, everybody is happy.” (Audit Manager, S-T)

Although experience can encourage auditors to know where risks may lie, it may also feed into a familiarity threat, leading auditors to become overly comfortable with certain aspects, to the extent that risks which should have been spotted are unintentionally overlooked. It is also worth mentioning that new experiences can modify or change old experiences. For instance, when auditors who might have non-error experience find a material misstatement, this new experience can reduce the level of comfort that they had developed through their familiarity with a client, industry, or a particular accounting issue.

“Familiarity threat, maybe after some time you get relaxed around the client so much that you might not be in the best position to exercise your professional judgement… And I guess it is one of the riskiest ones because it is not like it rings a bell to say ‘Hey, here I am’… You just assume that everything is fine or often another problem that affects your approach is the fact that you have been with this client for two or three years and everything has been fine, but does not mean that it is always going to be fine.” (Audit Assistant Manager, R-T)

There are other aspects of experience that can also enrich auditors’ slow-learning memory and enable them to identify certain fact patterns as being risky. These aspects may include, for instance, client-specific experience, negative experience with certain issues and industry-specific experience.

**Client-Specific Experience**

The participants mentioned that when they have extensive experience with a client, this usually brings about a better sense of the areas/issues that may prompt their GFD. Through this experience, auditors become familiar with the behaviour and integrity of client management, client business, client industry, as well as the state of the firm over the long term. This experience, which accumulates over time in auditors’ slow-learning
memory, can prompt auditors’ GFD when the fact pattern presented looks unfamiliar or inconsistent with their expectations.

“… if it is a client that we have had for 5 years and I know the client, and I know it is not necessarily the way it should be… because your guard just falls if you feel comfortable, you feel that you know the clients a lot, and it should not literally be this way, but it kind of helps if you have spoken to the client in the previous years. You know the client, you know their activities… You know from the meetings that next year, this is what they plan to do, so you feel more comfortable, you feel that it is not a new territory, so your scepticism might drop a bit.” (Audit Assistant Manager, L-Q)

“If it is a familiar client, sometimes you could know the things that they can do wrong… Sometimes with current clients, you already know where the issues are and you already know what the assumptions are and where the risks are.” (Audit Manager, M-Q)

However, some participants also highlighted that familiarity with clients can be a double-edged sword, as familiarity can also increase auditors’ feeling of comfort and alleviate their discomfort to the extent where they might become blinded to certain fact-patterns which can prompt their GFD. They commented that a friendly positive relationship with client management can also act as a veil or constraint, potentially leading to complacency where auditors over-rely on previous experiences with the client instead of making sufficient efforts to understand the issues they are actually facing. This could mean failing to consider variances in the current year which might normally have triggered different levels of GFD. This corresponds with Popova’s (2013) finding that client-specific experience can exert a positive and negative influence on auditors’ exercise of PS, depending on the type of experience an auditor has with that specific client. The negative influence of a client-specific experience represents the confirmation bias which auditors might develop as they build a comfortable relationship with the client (Penning, 2014).

“I think familiarity with the client… that’s one. So that’s almost a double-sided one so it’s good to have that experience and knowledge of a client and their practices but I think there is definitely a risk for familiarity.” (Audit Director, YS-T).

“So the risk obviously with an existing client is, you have got too familiar with them perhaps, you have seen it all before and they have kind of got it right, and actually something’s changed and you have missed it.” (Audit Partner, J-Q).
Negative Experience with Certain Issues

When auditors have a negative experience with certain client management behaviours or accounting issues, they feel higher discomfort about these issues when presented with similar issues again. Negative experience (e.g. finding intentional or unintentional errors) with a client can exert an influence on auditors’ PS, as indicated in the literature (Nelson, 2009; Penning, 2014). For instance, certain behaviour associated with client management practice can prompt auditors to feel discomfort about the possible existence of a material misstatement which client management might be attempting to conceal, through exhibiting a certain behaviour. This can encourage auditors to recall negative possible scenarios every time they encounter similar issues during audits.

“I had a client where they have not signed the fraud questionnaire, until the very last minute. There is nothing wrong, you just get the feeling. It just gives me a discomfort that something is not right. And that is when you … look a lot closer in the details. Not that I am saying you won't look closely when the client is helpful, but in this case it is just automatically prompting you to be resourceful and look at other things.” (Audit Assistant Manager, AH-T)

“…the experience is based on either him seeing things in a different way in different industries or seeing something similar and sometimes his experience is based on bad actual evidence as if something went wrong and he got screwed and then he learned his lesson… we go under a lot of reviews from regulators... And a lot of the times the regulators, they come to you and tell you by the way when you have done your audit, you missed 1, 2, 3, 4, 5… The next time you go and do it, you realise that okay last time I missed those things, this time I am not going to miss it.” (Audit Manager, M-Q)

Another participant talked about learning an important lesson from a negative experience in the past. While auditing a client’s bank reconciliation statement, he found a non-presented cheque which the client had not adjusted for. In good faith, he asked the client management to adjust for that cheque and correct that misstatement because the amount was substantial. Only at the audit close meeting, where auditors sit down with the client management to discuss the required adjustments, the client management completely denied there was such a matter (non-presented cheque) because they went behind his back and changed the files as if nothing had existed. The participant was unable to defend his position due to having relied on the client’s integrity and not having taken any records or even made a copy of that statement. This negative experience has a significant influence on his future behaviour in relation to this and other clients.
“…they went back and corrected everything, changed the documents, everything. I also did not have a record of what I saw, just relied on people’s integrity. It was like I lied or faked it, that really taught me a lesson from that time and I became more cautious and sceptical about what I received and how I process. So, now I make a photocopy to keep as evidence. I do not trust what I have been given until I prove otherwise and can confirm it according to my own personal reasoning. So, for me that was a turning point to be more sceptical, so I can say it came by experience.” (Audit Assistant Manager, YW-T)

Industry-Specific Experience

One key benefit gained from the auditing experience is that it grants auditors the opportunity to have extended knowledge of different industries and clients. This experience enables auditors to more easily and quickly identify the risky areas where PS should be practised (Grenier, 2017). After spending sufficient time auditing different clients in the same industry, auditors’ experience in the industry can automatically prompt them to feel discomfort about certain areas where things can go wrong because they can recount similar issues with other clients and how they were resolved.

“…if I go to, let’s assume, a building society for the first time, I might be learning more than I am providing.... But, next time, I go to another client, another building society. I might learn more. But when I go for the third time, when they told me that we have done one and two and three, I will be like, no this does not sound right because I went through that thought process before, and I see what other people are doing, other building societies doing something different.” (Audit Manager, M-Q)

Another participant, who specialises in the investment industry, clarified that his expertise in the sector made him realise where risks lied. He explained how he learned that the valuation of investment involves risky areas, so he would feel discomfort about the fair value valuation that the management has come up with, knowing through experience that there is definitely something wrong with it.

“…there’s a saying that we use in investment management, with fair value the only one thing you can guarantee is that it is wrong. That is the one thing you can guarantee. You do not know how wrong it is by, it is a judgement you know whatever a particular person’s judgement. There is not a right answer… So, there is always going to be judgement for that and you know you could, the range of supporting information that you get it can be unstoppable.” (Audit Director, YS-T)
5.3.2 Knowledge

While it has been demonstrated that accumulated experiences contribute to knowledge development, participants have been inclined to differentiate between experience and knowledge in a practical audit setting (Nelson, 2009; Smith & DeCoster, 2000). They explained that the information learned in classrooms or understanding rules and regulations represent knowledge, whereas information learnt through observing, interacting and doing things is considered experience. Participants’ way of looking at the two terms is consistent in a sense with some of their definitions in the English language\(^9\). This differentiation between the two terms can be observed in the following interview excerpts:

“It is not just experience: it’s also knowledge. So… I learnt in college that you must debit cash and credit revenue, but can I, in the work environment, I see that you must debit trade receivables and credit revenue first, because no one today is paying you cash… So, you see: if I did not have that experience, how would I know that if a journal is being posted directly into debit cash and credit revenue - that is an unusual thing. So that is where experience comes in.” (Audit Senior Associate, H-A)

“…the training off the job as like in classrooms, the important thing about it, it teaches you why you look at or how you should think, how you should look at things, it gives you examples from the past things which went wrong and how we learn from our mistakes.” (Audit Manager, M-Q)

For the purposes of this study, knowledge can be perceived as encompassing both information gained through practice and information learned by other means, which can include professional training, education, understanding (reading) rules and regulations and understanding (learning about) client business and industry. Likewise, participants explained the difficult task they face, which involves trying to balance time constraints and knowing most aspects of a client’s business. Therefore, from the nature of financial reports auditing, they come to audit with a risk of failure that fuels their GFD. This means needing to know things and find answers to gain comfort. If auditors lacked knowledge, they would not be able to feel discomfort about things which can go wrong

\(^9\) According to the Oxford online dictionary: knowledge can be defined as “the fact or condition of having acquired a practical understanding or command of, or competence or skill in, a particular subject, language, etc., esp. through instruction, study, or practice; skill or expertise acquired in a particular subject, etc., through learning.” (OED, 2018a). While experience can be defined as “proof by actual trial; practical demonstration. to put in experience: to fulfil in practice.” (OED, 2018b).
and properly challenge client management. In this section, the study focuses on providing pieces of evidence about knowledge gained by means other than experience in informing auditors’ GFD.

A participant described how auditors’ GFD is informed by knowledge gained through training and education or real practice (experience). She compared auditors to doctors who benefit from a wide-ranging information base, to the extent that they develop a degree of intuition and can pick things up.

“When you have so much at the back of your head you can just look at things and ultimately form a conclusion based on that. All the background information, you have an understanding and knowledge and experience then you can just… Like a doctor studying so much and then he sees a patient and because he knows about it. So, it is a general thing like this but in terms of numbers for us. I have more experience, more knowledge, then I can just look at things and see this is wrong.” (Audit Senior Associate, SB-T)

Auditors’ knowledge gained through education and classroom training is crucial in informing their GFD about the risks where the possibility of material misstatement increases. Education (including exam qualification) provides them with the knowledge necessary to feel comfort (confident) while addressing certain risks. Since auditors will interact with knowledgeable people at the client site, they might end up in a position where their GFD on certain issues becomes blocked by other stronger feelings of discomfort about their ability to challenge those people who are more experienced and knowledgeable (see Chapter 7). Therefore, accounting education and training are very important for auditors’ professional self-esteem and authority with the client.

“Comfortable has to do with competency. Maybe they are working on a system that they have not seen before or maybe they have gone to the client site and they feel the client is not friendly - that could also affect your ability to work comfortably. You may be afraid to ask certain questions to the person because you are feeling this person is so intimidating.” (Audit Manager, E-TT)

“I guess it is a matter of being comfortable with your accounting knowledge, being 100% sure of what you are trying to get at and just challenging the client and pushing back...” (Audit Assistant Manager, R-T)

Interviewees also indicated that a good understanding of accounting standards, reporting processes, common risks and auditing procedures gained through education play an
important role by prompting feelings of discomfort and providing tools with which to counter them.

“…K Manufacturing had a contract that I was reviewing. Because K Manufacturing was not performing so well, they were taking on contracts that would allow them to break even… So, K Manufacturing took on this contract that was making an overall loss, but had a positive contribution: it was paying the bills. So,… immediately when I looked at it, I just remembered oh wait, that is a loss making contract. So from my knowledge at college about provisions and on risk leases and on risk contracts… So, you know, I used that knowledge to assess the contract and I documented that way.” (Audit Senior Associate, H-A)

“… for example, I have come across a pension scheme and I have thought ah, actually, wait a minute, something came up regarding this, so I have gone back to my training and looked at it again and said ah, this is what we have got to do. It is just something that springs in the back of your mind, a light that goes off and you think actually, wait a minute, I need to look back and think about my training, what did we say about this, what changed?” (Audit Assistant Manager, S-Q)

Furthermore, auditors’ comprehensive knowledge and understanding of a client’s business model, operation, and context (industry and external environment) is critical in informing auditors’ GFD. For instance, when auditors understand the politics and pressures on the client management, they can become prompted to feel discomfort when client management provides subjective explanations, such as those with regard to accounting estimates. Understanding the full picture of a client business does not only inform auditors’ GFD toward the areas where material misstatement can exist. It also enables them to appropriately respond to their GFD and better communicate their challenge (e.g. through posing further questions) to client management. For example, a participant clearly relates the practice of PS with the GFD that is informed by auditors’ knowledge.

“Like is it a pinch of scepticism or you have to be more kind of worried about the situation. So, the more you know the client, the better you know the client, the better you would be able to apply the scepticism.” (Audit Assistant Manager, L-Q)

5.4 Summary

The auditing profession is distinguished by the level of risk that auditors are exposed to and the vast experience and knowledge they can obtain. As the study participants indicated, the nature of the audit has shifted auditors toward practising auditing services
with a high risk of failing to pick up material misstatements. This high risk makes auditors experience a GFD which they seek to alleviate wherever possible. Auditors come to practise audit with this GFD, but they learn in audit firms that providing a “100% audit” or covering every single risk is commercially infeasible. They are being taught to tailor their GFD to those areas which external and internal reviewers typically focus on, learning that if anything is missed or errors are made, this can entail severe consequences if things go wrong. Therefore, auditors tend to adopt the presumptive doubt perspective when risks are significant, since this prompts their informed GFD, as they recall possible negative scenarios which can contradict management’s representations and indicate the possible existence of material misstatements.

Likewise, auditors learn over time from their experience with different clients, industries, regulators and superiors that certain areas or issues can involve certain significant risks. Crucially, they learn that their job is valued as far as it addresses these high-risk areas. Auditors with a high volume of experience and knowledge become aware of different fact patterns where material misstatements are likely to occur. Therefore, once auditors spot these fact patterns, their GFD is triggered, recalling certain negative scenarios, initiating and shaping their sceptical judgement where different questions related to the negative scenarios are substantiated in order to be asked and answered. These questions arise in the minds of auditors who are trying to make sense of the severity and significance of such negative scenarios. If these questions are found to be difficult to answer for client management and the risks are becoming highly significant, auditors would proceed to implement more procedures in order to comfort themselves that these risky areas have been sufficiently addressed, which can save them if things go wrong. These additional procedures, which represent the sceptical actions, can include posing multiple difficult questions to client management, conducting alternative procedures, considering contradictory evidence, asking for more evidence and proposing an adjustment.

This chapter provides findings that explain how auditors come to practise PS and how they tend to internalise its concept. Auditors tailor their internalisation of PS through the risk-based approach which dominates their work in the auditing profession. The consideration of risks can prompt their informed GFD automatically once significant
risks are sensed and certain negative scenarios are recalled. This means they appreciate (recall) negative scenarios as being very important to practise PS. The importance of GFD in initiating and shaping auditors’ sceptical judgement has encouraged auditors to equate PS (sceptical judgment) with experience, as it might be very difficult to train auditors to obtain that GFD, which is constructed based on their accumulated experience and knowledge in auditing different clients and issues. The ability to recall negative scenarios, which link to their informed GFD, can lead them to challenge client management in the form of implementing additional auditing procedures and obtaining extra audit evidence (observable sceptical actions). When the risk is heightened and the GFD is strengthened, auditors will struggle to give client management leeway on something unless robust evidence is obtained which can protect them. Experience and knowledge play a significant role in informing and strengthening auditors’ GFD that material misstatements can exist to the extent that the contradictory facts or evidence need to be highly significant to change their GFD.

In summary, this chapter has provided different pieces of evidence that showed how auditors internalise PS in practice. In the next two chapters (Chapter 6 and 7), the study will provide and discuss different pieces of evidence which display the PS Process Model (PSPM), a model that delineates how auditors process PS in making their everyday professional judgment.
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Chapter 6: Auditors’ Experience of Negative Consequences and their Day-to-Day PS Practice
6. Introduction

It was argued in Chapter 5 that auditors tailor their conceptualisation of PS through the risk-based approach, which dominates their practices in the auditing profession. Consideration of risks prompts auditors’ informed GFD, leading them to recall negative scenarios and eventually to sceptical judgement and actions, challenging client management and implementing additional auditing procedures. When this GFD is intensified, auditors find it difficult to let clients get away with their representations, unless robust evidence supporting the client is obtained to protect (comfort) the auditors.

These findings have been used to develop the PS Process Model (PSPM), which clarifies the process by which auditors shape their PS (see Figure 6.1). Along with the rest of the chapter, the focus in this chapter is on explaining the PSPM in order to satisfy the second objective of the study, which is to explore auditors’ PS process in making their everyday professional judgement. Specifically, this chapter presents the PSPM and provides an empirical answer to the question: how does an auditor’s exposure to different potential negative consequences shape their day-to-day PS practice? It explains the triggers (facts or events) which give rise to auditors’ GFD and the consequences which auditors have in mind that serve to generate and channel their feeling of discomfort.

The chapter is organised as follows. Section 6.1 provides a general view of the PSPM, while Section 6.2 discusses the triggers of the feeling of discomfort, which can be linked to the task under consideration, client characteristics or the external environment surrounding the auditors’ work and their client’s business operations. Section 6.3 examines the sources of GFD which generate certain negative scenarios that guide auditors’ GFD, and Section 6.4 provides concluding remarks to summarise the chapter.

6.1 Professional Scepticism Process Model (PSPM)

Building on the review of the PS relevant literature, SIM theoretical lens and interview data analysis, a model has been developed to explain auditors’ PS practice as being mainly initiated and shaped as an emotional state (GFD). The PSPM explains how auditors’ sceptical judgement is initiated and processed until it is reflected in sceptical actions. As demonstrated in Chapter 5, auditors’ sceptical judgement is mainly initiated
and shaped as a GFD, which is informed by auditors’ knowledge (element B-1, Figure 6.1). Auditors’ knowledge is developed through auditing experience, education, on-the-job training, and knowledge of standards, clients’ business models, operations and contexts. When presented with a certain fact pattern, auditors’ informed GFD becomes prompted by their interpretations of those presented facts (Circle A and arrow number 1, Figure 6.1).

As represented by line 2 in the PSPM, the fact patterns which trigger GFD act as warnings of certain negative scenarios which might lead to being sanctioned, harm to individual or organisational reputation, or harm to the client relationship. Auditors’ GFD were found to stem from certain sources, which include auditing basic concerns (e.g. getting it wrong) and meeting the reviewers’ (internal or external) expectations. These expectations include sufficiently challenging client management, maintaining professional reputation and maintaining a good relationship with clients. Since auditors
clarified that they tend only to consider their performance to be a failure when reviewers identify it as such, these discomfort-generating issues can be categorised into one theme: meeting reviewers’ expectations. Auditors know that their work will be subsequently reviewed internally by superiors or externally, by regulators or even as a part of lawsuit. Rooted in auditors’ accumulated knowledge, these sources of GFD determine whether auditors interpret triggers as emotionally discomfiting, and as a consequence, whether they make a sceptical judgement to challenge client management. Auditors were found to experience GFD when recalling negative scenarios that may result in them being criticised and required to complete extra work or being sanctioned, which could jeopardise their future career or reputation (line 2 and Circle B-2, Figure 6.1). These sources of GFD and the resulting negative, discomfiting scenarios will be elaborated upon further in Section 6.3.

For instance, the fact that the client is a publicly listed corporation may heighten the threat that reviewers may judge them as failing to identify certain material misstatements. This GFD is exacerbated to the point where auditors cannot obscure or alleviate their discomfort without being guided by their sceptical judgement to challenge the client management and do so by conducting further audit procedures and gathering additional evidence, which can protect them during a review process (line 3, Figure 6.1). However, if no triggers of discomfort arise, or if auditors’ GFD about losing a client are sufficiently strong to override their initial GFD, auditors may be prompted not to challenge client management further (line 4, Figure 6.1). Additional illustrations of the triggers of auditors’ GFD will be provided in Section 6.2.

The PSPM denotes how auditors’ GFD shapes their sceptical judgement and attitude, reflected in the form of asking further questions, conducting additional procedures and gathering additional evidence. When auditors’ GFD intensifies such that client management is challenged, auditors know sufficient reasoning must be demonstrated to communicate their sceptical judgement to others (line 5, Figure 6.1). Thus, similar to the SIM, the PSPM indicates via the two dotted lines, numbered 6 and 7, that auditors’ post-hoc reasoning efforts which they engage in to support their argument can prompt them to reconsider their sceptical judgement or even shape it without having a specific initial GFD. The PSPM depicts how auditors might have only a weak initial GFD about a
certain fact pattern, which could be overridden subsequently by stronger feelings brought about by additional procedures, further shaping their sceptical judgement (dotted line number 7, Figure 6.1). Hence, the dotted line number 6 presents cases where auditors may not have the appropriate knowledge to inform their GFD, leading them to take a different approach. Instead, they may choose to conduct the procedures that their superiors require or that audit methodology dictates without a specific initial GFD. The outcomes of these procedures would then form their sceptical judgement as to whether to continue challenging the client management or not. However, since auditors are often exposed to a variety of experiences and situations, and auditing tasks are commonly allocated based on auditors’ knowledge, cases in which auditors have no specific GF may be regarded as relatively rare. Section 7.2.2 in Chapter 7 will present additional explanations of the instances where reasoning process may influence auditors’ sceptical judgement.

Finally, the PSPM shows that auditors tend to relate their sceptical attitude to their social interactions with others (client management personnel or audit team members) during the audit engagement process. Auditors recognise that their sceptical judgement necessitates reasoning efforts in order to persuade others to accept it. Indeed, auditors’ daily social interactions with others are an essential part of their accumulated experiential knowledge which ultimately informs their GFD. Social interaction is an ongoing process where each side competes to persuade the other (prompt the other’s GF) of its position (see arrows number 8 and 9, Figure 6.1). Within this process, auditors can be prompted to feel discomfort in regard to certain triggers, and then act to communicate their sceptical judgement and influence others to accept it. Auditors’ social interactions with others and their effect on sceptical attitude will be discussed further in Chapter 7.

### 6.2 Triggers of GFD and PS (Circle A)

Participants explained that auditing is about obtaining a fact pattern. This can comprise facts and events that are related to client characteristics, the nature of the accounting issue and the external environment surrounding the client business operations and the work of the audit team. These facts or events provide triggers that give rise to auditors’ GFD. This section focuses on discussing the aspects (facts or events) that can trigger auditors’ informed GFD so as to cause them to challenge client management (Circle A,
Figure 6.1). Conversely, the absence of such triggers might alleviate auditors’ GFD that material misstatements exist to the extent that a judgement to stop challenging the client management can be made. As section 6.3 will explain, this absence can instead strengthen auditors’ GFD about harming commercial objectives (including efficiency objectives) and similarly, their reputation. Auditors also demonstrated that certain other factors can alleviate their GFD. These include familiarity with client management personnel (e.g. the knowledge of client management competency or integrity), obtaining external evidence, observing consistency through the outcomes of audit procedures, and consulting senior people or experts.

6.2.1 Triggers Related to the Task

*The Nature of the Accounting Issue under Consideration*

When auditors investigate a particular issue, the facts involved can frequently heighten auditors’ GFD to the extent that additional testing efforts (sceptical actions) are conducted. These facts can be related to the type of accounting issues, the interest of reviewers, type and size of the client business operations and the industry they operate in. In the interview data, participants explained that their initial GFD is directly linked to the level of risk they attributed to a fact pattern.

During interviews, interview scenarios involving judgemental accounting issues were commonly interpreted as highly risky by auditors and seen as areas prone to manipulation by client management. The complexity and uncertainty associated with these issues may contribute to auditors’ GFD about “getting it wrong”, since there is often no correct answer and solid evidence to validate judgements. Hence, when issues involve client management estimates, this automatically triggers auditors’ GFD. Auditors explained how the lack of evidence and guidance in judgemental areas makes it difficult to challenge the client.

“…with any estimate, we would have to do more work, we cannot just take what the management is saying…Whenever we think that a judgement is involved we highlight that as a significant risk because, again, the management can be biased in making their assessments… Make decisions or estimates which are favourable to them.” (Audit Assistant Manager, D-Q).

“…some accounts, like inventory provisions or bad debts… Regardless of whether they may be immaterial, they’re still of risk because they require
an actual human estimate, and that’s what makes it a riskier area…” (Audit Assistant Manager, Y-T).

Participants consistently compared judgemental accounting issues to other more factual types of accounting issues. They stated that they experience higher GFD when auditing judgemental issues, since audit standards and firms’ methodologies do not prescribe definitive outcomes. Such accounting issues intensify auditors’ GFD heightening the importance of exercising PS.

“…the books are silent where management judgement comes into place and that is why the more critical areas where the estimates are involved. The book... Might be able to talk about things that exist that are factual. How to verify a fact is easy compared to how to verify a thing that is not a fact, which is a judgement, an estimate that is where your professional judgement is involved… That is where scepticism is more.” (Audit Assistant Manager, ZSH-Q).

Auditors’ GFD when auditing judgemental accounting issues also seems to be influenced by the fact that audit regulators have consistently highlighted such issues as areas of particular focus due to previous instances of audits being judged as sub-standard.

“…and again, this is all on the assumption that I've found this claim is valid, is correct and the amounts are right. And they say well, we estimate we're going to be able to defend this. If my conclusion is even if you can defend it, you should still be making a disclosure about it. It gives people the information of what is going on in that company, because again, it comes back to what the FRC are talking about… this is the regulator saying we feel there's not enough disclosure about these sort of things.” (Audit Manager, AX-Q)

Moreover, auditors’ personal experience of dealing with particular accounting issues can heighten their GFD as such experience can inform them that these issues can go wrong or that reviewers consider them risky. Participants provided examples of issues they consider to be risky, such as issues known as areas of errors, industry specific issues, or the past financial health of a client.

“…so we actually had a lot of training on what are the most frequent occurrences of fraud, and if you look at the graph most of the cases where an actual fraud was committed came from revenue recognition... Statistically, that is the most likely way for a firm to commit fraud, which is why this is almost always an area of significant risk. … normally whenever you start any audit… Automatically launch in the system, and that is kind of
like that first procedure you would do to make sure that you cover that kind of risk.” (Audit Assistant Manager, Y-T).

“… there is probably fewer things that could go wrong with a flower shop than with a mine…” (Audit Manager, AX-Q).

Auditors can also feel high discomfort at times when client management makes certain changes, such as changing accounting estimates, their management team or business operations. For instance, a change in lawyer or the bad debt provision rate was discussed in interviews as likely causes of discomfort. Their GFD in these cases was related to recalling a negative scenario an interviewee encountered previously where client management had been implementing these changes to hide material misstatements.

“…I think a change in an estimate like that, I would be more sceptical about and really look at the reasons that they have done it.” (Audit Senior Associate, R-Q).

“That would definitely increase my suspicion. I would be very, very suspicious. And I would want to understand more as to what led to the resignation of the lawyers and if possible, get their thoughts… I would need to satisfy myself that the reason they left has nothing to do with the case and it was a mutual understanding or a different thing.” (Audit Assistant Manager, YW-T).

Furthermore, when the monetary amount of an accounting issue significantly exceeds the materiality level set up by the audit team, auditors can become increasingly uncomfortable about as it is known for being an area reviewers concentrate on. If things go wrong in these accounts, serious consequences can be encountered, both individually and organisationally. Placing emphasis on areas perceived as high-risk is of course part of the risk-based audit approach. However, our findings suggest that, instead of feeling discomfort about certain issues based on their qualitative content, participants mentioned that it is the account balance being significantly larger that most often prompts them to feel discomfort.

“… you use materiality to know what is risky or not risky… So… if it is a £5 transaction, I am not worried about it. If it is £5 million, I am worried about… so it is about the monetary issue…” (Audit Assistant Manager, L-Q).

The client industry can also signify the level of auditors’ GFD about certain accounting issues, as these issues are known in the industry as common areas of misstatements in
which reviewers would be specifically interested. For instance, while participants who audit financial institutions exhibited a higher level of GFD in relation to the loan losses, those specialising in audits of investment management entities displayed heightened GFD in relation to asset valuations. While discussing how risky these industries are, participants recalled most recent financial crises as negative scenarios leading to the collapse of several financial institutions and heightened public and regulatory concern with auditors’ work.

“…a bank gave a lot of loans, this is the biggest risk they have. As auditors, this is what we call a significant risk…” […] “[the] risk in a bank … would be that those assets which you basically gave loans to people. And those loans are backed by mortgages for example. So, here you would know that the risk is that people would not service the loans. And if they did not, the risk would be that you have to repossess the house and then sell it and then get back your money. So, there would be like the risk of whether those assets are impaired or not.” (Audit Manager, M-Q)

“… when we are doing our planning we will identify what the significant risks are and typically especially within an investment management firm the valuation is a very key area...” (Audit Director, YS-T)

**Inconsistency**

Auditors are prompted to feel discomfort when a client presents a fact pattern which is, according to their knowledge and experience, unusual in the client’s industry, business model and operation or compared to general accounting traditions. Participants described how they build up knowledge through which their GFD of failing to meet reviewers’ expectations becomes strengthened once a fact pattern does not seem to be consistent with previous similar experiences.

Based on the previous knowledge and relationship with the same client or similar clients, auditors develop preconceived expectations. If client management present something that does not correlate with these expectations, auditors are prompted to consider the question of why this discrepancy exists. For instance, auditors expect clients in a certain industry and with a certain business model and operations, to have some misstatements or difficulties in certain accounts. Therefore, auditors’ GFD becomes heightened when certain accounts or statements surprisingly appear “too perfect”. Besides the inconsistency between what auditors might expect and what clients claim, auditors can
feel discomfort when inconsistencies are observed between client management’s justifications (verbal statements) and what is actually disclosed in the accounts.

“…when you find an inconsistency it would prompt you. It would prompt this feeling… that for me instantly is the sign of something that we would need explanation for.” (Audit Assistant Manager, AH-T).

“… When something is unusual, based on my experience with them, my knowledge of the client and the entity, the industry that they are in, what happened in previous years, my expectations for the year and my expectations from them. So, when I receive documents and the variance is too far from what I expected, that always triggers my scepticism.” (Audit Assistant Manager, YW-T).

“…even if things seem to be perfect, there is always all of these questions, this control is too perfect!! How can it be? So, there is always that professional scepticism I would say that kicks off and say we think there might be something wrong.” (Audit Manager, E-TIT).

6.2.2 Triggers Related to the External Environment

The social, political and economic environment that surrounds the client’s business operations and the auditors’ work were found to exert significant influence on auditors’ GFD. Participants explained that making better judgement requires auditors’ to understand their client’s external environment. Events such as the collapse of a company operating in a client’s industry or the implementation of a regulatory policy (including a new accounting standard) seen as negatively affecting the client’s industry were all highlighted as likely triggers of GFD.

“… you need to understand context, so how is the company performing, what pressures are there on management, what market expectations are there, and what would the implications of an impairment, because the concern you have as an auditor is that management are going to do something that is inappropriate.” (Audit Partner, H-O)

Awareness of the context (industry and general external environment) was discussed as one of the key aspects that informs auditors’ expectations. Based on the understanding of client business and industry, auditors would be more able to form their expectations about the client’s operations. When client management’s representations do not match their expectations, auditors reported feelings of concern and discomfort. One participant explained, for example, that if he found that a client’s net income was declining while its competitors’ income was improving, he would feel an intense discomfort, recalling a
scenario where the external environment might have incentivised the client management to manipulate the FS to look better.

“…If the economic environment is improving and their own income is declining, they have shot themselves in the foot from the start because the macroeconomic climate might be improving but their specific scenario obviously is that it’s decreasing. So, for us, you would have identified at the start there’s an incentive here to overstate profit because it’s been consistently declining, especially if you have got… A listed client… public perception is everything to them. That’s something you would have to be alert about.” (Audit Assistant Manager, S-Q).

Another participant explained that he would feel significant discomfort if the client management’s representations did not line up with the state of the industry. He elaborated that if the industry in general was suffering, and client management was trying to sell the idea that they were outperforming the market, this could increase his GFD. He implied that situations such as this would trigger memories of previous cases from practice where the client management was behaving inappropriately.

“…the environment in which the business is operating will set the backdrop against which you are looking at performance and so on. So if they had told me that the company was just beating its market expectations by a little bit, that would also put me on extra alert to be worried about perhaps some smaller amounts than I had normally worried about as potentially being material… But I would actually get worried if they had done something deliberate for just a little bit more than a million in that circumstance, so it just sets the background against which you are auditing in a different way.” (Audit Partner, J-Q).

Participants cited how an auditor might feel discomfort about certain accounts due to the media coverage of the client’s industry. They specified that the importance of being aware of the external environment has increased as businesses and industries have become increasingly intertwined.

“…partners… come to you and tell you could you go check that, you will be like why he is asking me about that. Then, you realise that he actually found it in the news in terms of like, he was watching Bloomberg and he was like blah blah blah, this is happening, then something like that [snapped], how would that impact my client? And this is the thing with auditors that they look at the external environment, how they are going to impact the client?… You have got clients especially the big clients… Are highly interlinked with the economy and society that they live in.” (Audit Manager, M-Q).

“… When Brexit happened and everything, in general there was a notion of there might be a lot of bad debts increasing and everything so generally we
would expect clients to be a bit more conservative and... Slightly increase more their provision in anticipation of the possibility of debtors’ defaulting ...” (Audit Assistant Manager, R-T).

Auditors’ GFD may also be heightened when an audit failure occurs, since they know this will lead to public criticism of the profession and greater regulatory scrutiny. Since the data collection process for this study was conducted immediately after the collapse of Carillion, one of the largest construction companies in the UK, triggering heavy public criticism of the company’s auditor, participants frequently referred to this case when trying to justify their GFD. Besides the Carillion case, auditors referred to other high profile audit failures, such as recent cases in South Africa and the Enron and WorldCom cases in the US in the early 2000s, indicating that failures such as these result in greater scrutiny. It can thus be interpreted that the fear of an audit failure, as well as public and regulatory concerns, can trigger auditors’ GFD to the point that such failure scenarios move to the forefront of their thinking and can ultimately lead them to further challenge client management.

While participants were referring to the Carillion case as an example of how wrong things can go if auditors do not diligently challenge client management, they also showed that when a failure occurs, there is usually a degree of negligence involved, related to some partners’ feelings of discomfort around harming their commercial objective outweighing other feelings (Section 6.3 provides further discussion). Participants emphasised that the fear of censure for not challenging management would incentivise them (auditors) to be hard to convince.

“... like that case with Carillion when auditors for so many years have been issuing an ongoing concern based statements, even last year was issued on an ongoing concern basis there was no indication whatsoever. But then the next year the company was bankrupt despite those. So it’s quite obvious that at some point, not enough due diligence was made to substantiate the claims that the company was making, and the partners just probably made the decision to hell with it, we’re just signing it, we don’t really care.” (Audit Assistant Manager, Y-T).

As the occurrence of auditing failures heightens the pressure on auditors to employ better judgement and sufficiently challenge client management, over time these issues become a vital part of an auditor’s knowledge, informing their GFD in future audits. For instance, a participant who specialises in auditing financial institutions explained that
they would feel a high degree of discomfort with regard to banks’ loan impairments since they have previously observed how that can be incorrect in the 2007-2008 financial crisis. He elaborated that they have seen how large banks collapsed and auditors were questioned. This has triggered them to feel high discomfort when auditing these accounts because they have seen how risky these types of accounts are for banks and how significant it can get if they do not challenge client management about such issues.

“… an example of a bank that gave a lot of loans, this is the biggest risk they have. As auditors, this is what we call a significant risk because if they have 40 billion worth of loans … But wait, is that really 40 billion, how do you know this guy is not going to pay his mortgage? How do you know this guy is not going to abandon his car and not pay your bank? And there is a big chance and this is what happened in the financial crises where the banks used to have very bad credit policy whereby they gave credit or basically loans to everyone…” (Audit Manager, M-Q)

6.2.3 Triggers Related to the Client Characteristics

Auditors are inclined to associate the GFD that they experience with their social interactions with the client management personnel. For example, auditors differentiate between two scenarios: a continuing client and a new client. With a new client, auditors experience a higher GFD because they are unfamiliar with the client personnel, the business model, and operations. When auditing a new client, auditors’ unfamiliarity with client management personnel leads to recall of negative scenarios where material misstatements can be easily overlooked and accordingly, intensify their GFD about “getting it wrong”. Participants emphasised that since they do not know the new client management’s personality, integrity and competency, uncertainty can cause a high level of discomfort when interacting with the management. They report a feeling of entering a new territory where everything can be a possible source of harm.

“When you are going to a new client… it is like you are starting everything from scratch, you do not know how their controls operate, it means you spent a lot of time obviously for the new client, you will have a lot doubt. So, it is just by nature say I do not understand this environment. So, you will prop you know more just to understand…” (Audit Manager, E-TIT)

One participant mentioned that, when a change of auditors occurs, this can be due to a rotation policy but also many other reasons which are often unknown. Therefore, he would be alert to the scenario where the previous auditor had left and would be likely to
experience very high levels of GFD that would shape his sceptical judgement and decisions as to whether or not to challenge the new client’s management.

“…obviously, whenever we go to a new client you even have to have a higher level of scepticism. Because you do not know that if anything you are getting in there is true… So, obviously exercise a very, very high level of scepticism and be very cautious at the time because you are not sure what is actually going on especially with estimates… And I would think okay this is a new client it can be a scenario where they might just automatically manipulate things because it is the best time for them to change things and try anything they want to try because I am new so I do not really know much.” (Audit Assistant Manager, R-T).

Some auditors commented that they could be in a better position to assess areas of risk when they have a previous relationship with the client. Their previous experience can inform their GFD when things seem unfamiliar, because they know the client well and therefore have a reasonable expectation of how things should look. When auditors have been working with a client for a number of years, the knowledge gained enables them to more accurately determine when to challenge client management further. This knowledge can also help them ask the right questions in the right way due to their understanding of the client’s business and its personnel.

“… the key issue comes to understanding the nature of the client and the type of people involved they affected with how the business is operating. So, to me now it just comes like naturally picking this and interpreting information and just say ‘Look, in this case, this is going to be the risk…’ But obviously, at the same time, I want to do it in a professional way without sounding as if you are being more aggressive, especially in situations where you’re asking a client where you have been there for 3 or 4 years, there’s that bit of familiarity and you can relate quite more…” (Audit Assistant Manager, R-T).

“…so to ask a follow-up question is difficult. But you’ve been working with the client for a number of years, say it’s a continuing client. You might have enough understanding of the business to follow-up with open questions to get them to talk about it, rather than is this right?” (Audit Assistant Manager, AH-T)

**Client Management Integrity**

Throughout the audit engagement process, auditors interact with client management and other personnel through discussions and meetings. Participants emphasised that since there are time limitations necessarily present in audits, social interaction with client personnel is a critical procedure for them in understanding the clients’ business and
operations and getting to know the people who have prepared the FS being audited. Auditors manifest their sceptical judgement in the form of asking different questions to client management prior to accepting their representations (further discussed in Chapter 7).

“The issue at the end of the day is you are not working in isolation. You are not just doing your own thing and leaving. You are working together with the management.” (Audit Senior Manager, Raf-T).

“…apart from looking at numbers the job of the auditors is obviously to deal with the client on a day-to-day basis.” (Audit Assistant Manager, AH-T)

As explained in Chapter 5, auditors’ GFD is informed by their accumulated knowledge, which includes the experience of interacting with different types and levels of client management personnel. During this social interaction process, their GFD becomes intensified in response to certain verbal and non-verbal signals, which may be interpreted as indicators of a potentially negative scenario where management may be involved in something inappropriate. Many interviewees pointed out that assessments of the integrity and behaviour of client personnel represent some of the key aspects of their work. For instance, when client management provide false statements or have improper qualifications or skills, these details were reported to trigger auditors’ GFD as the chances of material misstatements occurring are perceived to be higher.

“…the human interactions are a little bit more important for you to have a successful audit. So, how you make a judgement is, for example, through conversations. You speak to someone and you feel that they are telling you the right thing, you are looking at the evidence, and the evidence is telling you that something else different. I think judgement would go towards experience and the conversations that you have been having with your peers and your client, so that would form the basis of the judgement.” (Audit Manager, E-TIT).

“…throughout the course of the audit have they been honest… Disclosing information. When you request your sample or when you request a response to a particular matter in the audit have they been helpful? Have they been thorough? Or have they been wishy-washy, if you like? Have they been keeping it to a minimum? Because for a lot of companies their attitudes towards auditors are very different.” (Audit Assistant Manager, AH-T)

**Verbal Triggers**

Discussions with client management and other personnel provide a range of verbal statements which may serve to strengthen or ease auditors’ discomfort. For example,
they may make statements that seem misleading because they are, for instance, irrelevant to the questions asked by auditors, incorrect in terms of auditors’ knowledge, or simply inapprehensible. This can trigger auditors’ GFD about negative scenarios and increases their determination to pose more questions and apply further procedures in order to protect themselves. In these types of instances, the possibility of things going wrong has increased since client personnel might be giving false information in order to cover material misstatements, or it may stem from a lack of competence.

“We… Closely analyse the answers they give us and the way they give us their answers because when people are telling me they are looking here and there, it means they are trying to hide something from us. So my questions need to be more in-depth to actually get the right information… If they are telling you the wrong things to basically mislead you then obviously… I cannot basically trust the management anymore.” (Audit Senior Associate, SB-T).

Likewise, interviewees emphasised the importance of having social interactions with a variety of people from the client organisation in order to build up a fuller picture of the firm, as different personnel from different departments can often provide new or supplementary information. On the negative side, this varied interaction can trigger auditors’ GFD, particularly when information is contradictory or the same answer is being given by several sources to a particular issue, prompting them to examine things more closely or even consider negative scenarios associated with client management behaviour.

“… you look to discuss with lots of people in the organisation, and actually a suspicion to me as an auditor is if I get told the identical story every time because at that point I think they are trying to sell me something… if everybody sort of says the identical thing, for me as an auditor, that makes me suspicious.” (Audit Partner, H-O).

As mentioned previously, very brief, vague answers or limited information provided by client management can also heighten auditors’ GFD about negative scenarios or about management concealing information. This type of behaviour prompts questions in the auditors’ mind around the sufficiency of the information provided.

“… when the answer is very brief. So, you cannot just say to me trade payables has decreased, timing of the payment. What does that mean? I understand what it means, but it is very standard, vague and an answer that anyone could have given me.” (Audit Assistant Manager, AH-T).
“... If they start giving me general answers, I was like okay, but you are not answering my question. If they are able to prove something they will address that question specifically. If they are not able to prove it they start talking about generalities.” (Audit Assistant Manager, S-Q).

One participant described a specific example where his audit team had discussions with staff from the clients’ marketing department which exposed inconsistencies in representations provided by their contacts from the finance department, hence prompting his team to pursue further sceptical actions.

“...we went and spoke to the marketing director and that person brought to our attention certain information which was critical and the finance team never brought it up. Now not sure...that’s because they missed it or because you know they intentionally hid it... So all of that would factor into the mind-set and the way you would go about doing that.” (Audit Senior Manager, Raf-T).

Non-Verbal Signals

It is not only verbal signals provided by client management during interactions that can trigger auditors’ GFD. Non-verbal messages can also cause auditors’ GFD to be intensified. These signals can typically include a client management team member pretending to be busy, individuals leaving the office when auditors show up, avoiding meeting the auditor, appearing to be intimidating when interacting with auditors or looking threatened when asked certain questions. Participants interpreted all of these examples as signals of client personnel trying to hide material misstatements. As auditors gain the experience to interact with different levels of client management personnel in the auditing profession, they recognised that behaviour such as that outlined above could be an indicator that a misstatement is likely to be found.

Any type of behaviour consistent with the examples mentioned above would make the case for concealment or a negative scenario that could lead to covering a material misstatement highly compelling. Therefore, the general feeling is that further investigation is required to find answers that can have the effect of reducing GFD about the possible occurrence of material misstatements. Accordingly, some participants explicitly link their exercise of PS to their experience of such GFD which is prompted as certain non-verbal signals are available.

“It is not something you can physically define, it is through experience. It is from body language, the way they answer your questions, the way they
approach you, the way they make things available to you. So, it is not something tangible to you, it is body language and it is intuition.” (Audit Partner, ZS-A).

Another participant specifically indicated that the PS is “just a sense of seeing something wrong, even though nothing is wrong... if you come across someone who is always away when you try to ask for meetings, delaying meetings, does not want to do the fraud assessment, stuff like that... There is nothing wrong, you just get the feeling. It just gives me a discomfort that something is not right.” (Audit Assistant Manager, AH-T).

The same participant provided a practical example where a member of client management had been exhibiting some of the aforementioned behaviours. She explained that her GFD was intensified as the client management member kept trying to avoid answering her questions. As her GFD was heightened, she was compelled to question why she was unable to answer the relatively straightforward questions.

“…going to speak to the client and again, this client ... Any time anyone from auditing comes to see her she just wanted to get rid of us. She was just standing up from her desk, leave the room, or pretending to be very busy. And I was asking her questions in relation to the cash balance, which is very big... And on a couple of occasions, she just wanted to get rid of me. So intuitively there's a feeling like why can't she tell me? What's going on? These are not hard questions... And we did alternative procedures... And we have discovered that they massively misstated their cash balance...” (Audit Assistant Manager, AH-T).

Consistently, some client management personnel might behave in a certain way (e.g. endeavouring to shake confidence through threatening, shouting or using complex language) when dealing with junior auditors, for instance, in order to get away with a misstatement.

“Especially if you have an individual who they perceive to be below them and whom they do not think they can respect. Certain people will try to intimidate them to basically get them off their back.” (Audit Assistant Manager, S-Q).

“… so you have the full range of conversations that I have had, I’ve been shouted at and called names and told to leave the building and my boss complained to about me, but that’s sort of part of what happens. If you want to be an audit partner, you need to have some thick skin.” (Audit Partner, H-O)
6.3 The Sources of GFD (Circle B-2)

As mentioned in Chapter 5, auditors tended to reflect a presumptive doubt perspective. As the previous section demonstrated, certain triggers elicit auditors to recall certain negative scenarios which may arouse discomfort. These factors giving rise to discomfort encompass auditing basic concerns (e.g. “getting it wrong”) and meeting the reviewers’ expectations, which implies striking a balance between upholding professional ethics and maintaining the client relationship. In essence, these two sources represent factors which may generate negative consequences for auditors personally.

Auditors may experience GFD upon realising that a material misstatement can be easily overlooked, due to the difficulty of auditing every single detail when timeframes are normally restricted. The very nature of audit practice prompts auditors’ GF by perpetuating the feelings of discomfort, or what Guenin-Paracini et al. (2014) otherwise referred to as the “fear of failing”, linked to a realisation that they may end up overlooking a material misstatement. Audit practice ‘basic concerns’, which include the unique nature of auditors’ relationships with clients, create different negative scenarios that auditors learn to feel discomfort about. Since auditors interpret their audit practice to be a failure only when the reviewers consider it so, auditors use the review process to define the different discomforting scenarios that can lead to negative consequences. Failure to meet auditing basic concerns (“getting it wrong”) can therefore be seen as one of the major sources of GFD.

“… you are working to make sure that it is going to be good enough for internal, external reviewers as well, because that is what the manager is working towards. So, even though you may not necessarily see that side of the process that is the way the manager is going to be approaching it.”
(Audit Assistant Manager, S-Q).

The interview excerpt above illustrates that auditors learn to manage their GFD to the extent that they will be able to pass such quality reviews. This means having to juggle the client relationship, satisfy efficiency requirements and sufficiently challenge client management, all while meeting the external reviewers’ expectations. Interview participants confirmed the GFD experienced around failing to satisfy the reviewers’ expectations. In this regard, prior audit literature\textsuperscript{10} echoes that above by highlighting the important role that seniors play (tone at the top) in shaping auditors’ professional

\textsuperscript{10} Chapter 2 has explained this in a greater detail.
judgement (e.g. Carpenter & Reimers, 2013; Fei Gong et al., 2014; Harding & Trotman, 2016; Peecher et al., 2013). Junior auditors (e.g. associates and senior associates) can feel discomfort about their reviewers’ perception of them if they have failed to do what was instructed or expected of them. Conversely, senior participants (e.g. managers and senior managers) who are normally expected to deal with higher risk areas and interact more with client management, highlighted how they feel discomfort about certain issues, including failing to inform the partner about certain risks, properly supervising subordinates and interacting with the client management.

While considering these expectations, auditors highlight negative consequences where a violation of such expectations can harm their personal reputation or, worse, have them sanctioned. The participants indicated that auditors feel discomfort about being in a weak position where an external reviewer who has come to review their work perceives them as being more concerned with pleasing rather than challenging client management.

“So we do not want to be in a position where someone else, or the regulator who comes in and says that although it is not material you did not raise it with the management. That would show that we were more friendly to the client...” (Audit Assistant Manager, D-Q).

Since auditors’ GFD is intrinsically linked to reviewers’ expectations, auditors would show more work on high-risk areas, because reviewers are expected to specifically concentrate on these areas. This means that auditors’ GFD about getting things wrong could be stronger in these areas.

“…so typically if something is a significant risk, there is more review around those areas than something that is not a significant risk.” (Audit Director, YS-T).

“If this is identified as a high-risk area you are going to have to go to town with it regardless of whatever happens… Because if we have the AQR come in or the regulators, they do their little review. And they turn around and say to us this is an area that you identified as high risk but you failed to investigate further on it. It is going to look bad on us.” (Audit Assistant Manager, S-Q).

Participants also demonstrated how considering reviewers’ expectations is one of the first things they feel discomfort about when challenging client management. Part of the process can potentially lead to the possibility of their work being investigated as part of regulators’ inspections, which in itself is a daunting prospect for auditors. In the worst-
case scenario, auditors may even end up being a part of court proceedings. Auditors stressed that this means having to exert certain additional efforts to appease reviewers and minimise their own GFD.

“…anybody else who was done with the FRC reviews would tell you they are not easy. They are the worst thing to happen to you. Even if you come out of this side and say things are fine.” […] “[T]hey will look at emails, they will look at you know these chats like Microsoft Link, …Skype chat, Skype for business… They can always get records of everything… So, there is no hiding” (Audit Senior Manager, E-T).

“… the first thing I would be thinking of if someone would take me to court what would I be able to bring just to substantiate the fact that I have done enough procedures to cover that risk.” (Audit Assistant Manager, Y-T).

The variations of reviewers’ expectations may simultaneously source different feelings of discomfort which can conflict with one another making it harder for auditors to alleviate such feelings of discomfort. The most dominant feeling may then shape their sceptical judgment whether to continue challenging the client management. For example, auditors know that they cannot accept assertions provided by the client management unless they can obtain audit evidence that is sufficient to cover (comfort) them during a review process. Given time pressures, modern auditors are also acutely aware they cannot keep pursuing sceptical actions infinitely; in other words, they conduct procedures and collect evidence primarily to ensure that GFD is sufficiently reduced. Therefore, the participants highlighted the importance of a documented audit trail as an important means of achieving comfort, with some participants claiming that modern-day auditors are more concerned with “justifying themselves” than carrying out actual audit work. However, it is worth noting that this inclination towards “self-justification” through focusing on documenting everything may also increase their workload, which can intensify their GFD about violating the efficiency objective, thus constraining them from practising the appropriate level of PS.

“…you want to do it, you want to apply it correctly but you have then got somebody shouting in your ear… saying we have got to make some money on this client. Then you have got somebody else saying, you know, don't get sued. Somewhere in the middle is the right balance. It's really hard.” (Audit Senior Manager, I-A)

“…to know whether your procedures are sufficient, it is an area of judgement… It is more a case of documentation rather than anything. So, you will find that on a job with very tight deadlines that sometimes people just… Documents, rather than really trying to go out there and do
everything that they can. It is more of a case of justifying themselves. Because if you carry out a piece of testing and if you cannot justify why you have done that procedure, the next thing, the manager and the partner is going to come at you and say you need to do something else…” (Audit Assistant Manager, AH-T)

**Negative Consequences**

The chief source of auditors’ discomfort around meeting their reviewers’ expectations is the knowledge that failing to do so could mean facing negative consequences, such as being penalised, damaging their career prospect and reputation, and harming their relationship with the client. The following subsections will introduce different pieces of evidence to show how these negative consequences generate auditors’ GFD and ultimately shape their sceptical judgement.

**a. Penalties**

Participants consistently indicated an awareness that they can be held subject to severe sanctions as a result of failing to do so. These sanctions may include being fined individually or organisationally with substantial monetary amounts, being suspended individually or organisationally from providing auditing services or, in extreme cases, having licenses withdraw.

When participants attempted to illustrate their GFD, they frequently used a picture of the severe sanctions that they might end up facing as a result of a certain scenario (failing to meet reviewers’ expectations) to show the source of their GFD, which can lead them to challenge client management.

“…if the FRC finds out that they were negligent in forming their opinions, they have not done their work properly. So there might be bans… So, that is why auditors are very careful: they go on and ask for more and more information so that if something turns out bad, they are like they do not have any liability for that.” (Audit Assistant Manager, W-O).

“… I do not want to go to jail because of professional negligence. That is something that I have to be pretty good about.” (Audit Assistant Manager, ZSH-Q).

“…not to get in trouble by the regulators and everybody from the outside, who are also watching the audit firms, you do the extra procedures to protect

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11 (Institute of Charted Accountants in English and Wales [ICAEW], 2018; FRC, 2016d)
12 (“Companies Act 2006”, 2018)
yourself from the consequences of not being a licenced… Not being taken away for that.” […] “[A]t the end you will be the one who will be fined or sued, so you have to cover your own risk as well” (Audit Assistant Manager, T-O).

Another participant commented on how recalling these consequences, coupled with the increased public scrutiny over auditors’ work, can have the effect of heightening the level of GFD that auditors can experience in practice. This high level of GFD, which is associated with regulators being stricter in their demands of meeting their expectations, is reflected in the implementation of more audit procedures and the collection of further audit evidence, which eventually represents the communication of auditors’ sceptical judgement.

“…I mean from the FRC and other regulatory agencies. The emerging issues in practice now, it sort of puts the auditor in a more sceptical mind-set in the sense that you do not know who else is looking and the regulators have also increased their vigilance so they also require us to do a lot of work.” (Audit Assistant Manager, Y-T).

b. **Harming Auditors’ Reputation**

Auditors also function with the awareness that failing to satisfy reviewers’ expectations may harm their reputation, a factor which is critical in maintaining and developing their personal and organisational goals. Auditors’ failure to meet reviewers’ expectations, which can include failure to sufficiently challenge client management and maintain a good relationship with them, can eventually manifest itself in harming their reputations as independent and competent professionals. Since auditors perceive themselves to be professionals who are providing a service highly dependent on their competency, they consider their reputation as being one of the foremost assets needed to secure their future in the profession. Therefore, if their reputation is being threatened, they are more inclined to uphold their professional image (Koch & Salterio, 2017).

“…it is a knowledge-based business, services. We are not selling anything. We are literally using our brain. We are just a group of people who have got a very specific skill, and we apply it to an organisation… We have to make sure our argument is robust so that when we do go to the client, we do not look stupid.” (Audit Assistant Manager, S-Q).

“… if I as an auditor do not do my work and it is as simple as that, then my reputation also goes down. I have to do the work of an auditor…” (Audit Manager, AX-Q).
Consistently, participants demonstrated that junior auditors (e.g. associates, senior associates, and assistant managers) are in a “privileged position”, since the main risk to which they are exposed is to failing to satisfy their superiors’ (internal reviewers’) expectations, which can exert a negative influence on their future in the career.

“I feel like we are in a very privileged position as associates or in charges in the sense that you’ve got a lot of accountability to the partners directly, but in as far as external reviewers and external parties you’ve not got very much accountability to them. So the risk for us is if things go wrong the partner will perceive us wrongly, and the partner has the potential to ruin your career within that given organisation.” (Audit Assistant Manager, S-Q).

The participants also mentioned that PS practice is shaped by the internal review process in which auditors challenge themselves. They explained that PS practice is embedded through the internal review process, which provokes auditors’ GFD that their work is going to be reviewed, and that there will be consequences in terms of gaining a good or bad reputation.

“… I challenge that, and equally more senior people than me challenge us again on their review. So, I think that scepticism, to a certain extent, is built into the process, and certainly our riskier engagements; there will be separate partners, or quality review team personnel, who will equally go through things, areas like estimates or areas of judgement to ensure that… With a cold pair of eyes that the team has properly considered…” (Audit Senior Manager, N-A)

Equally, a participant who is an audit manager explained that when he reviews the work of his subordinates, he also experiences a GFD about failing to meet the reviewers’ expectations. If his superiors review the file after him and find that his juniors did not sufficiently challenge client management, they would challenge him on approving the junior’s work. Thus, he can also, by association, suffer from the same GFD, since if he approves a file with an insufficient challenge to the client’s representations, his reputation with the rest of the team could decline.

“… my senior manager would come to me and say how did you approve this because this person did not cover it correctly. So, I need to make sure that they do that and as it goes to the ranks everyone else will be saying that it is correct or no it is not correct, you need to do more.” (Audit Manager, E-TIT).

Whilst the negative scenario that senior auditors feel discomfort about could be the failure to inform the partner about high-risk issues, participants stressed that the ultimate risk of failing to properly challenge client management is associated with the partner
who signs off the audit report. Therefore, the most serious consequences rest with partners who are held accountable by both external (e.g. regulators) and the internal parties (e.g. quality review partner).

“So, my risk was really to inform that to my superior. I have seen this, this is a concern for me what do you think?… This guy carries the pen. So, if it goes wrong, it goes wrong on him. So, he wants to be sure that what they are doing is actually sufficient.” (Audit Senior Manager, E-T)

The negative impact on auditors’ reputations can go beyond their own, affecting both the reputation of the firm and the profession itself.

 “… as a firm, we do not want to bring a bad reputation to our profession and then on the name of the brand as well. Otherwise, that is the key, and then as auditors, we have to uphold the professionalism.” (Audit Assistant Manager, D-Q).

c. Damaging the Audit Commercial Objective

Where auditors fail to maintain a good relationship with a client and satisfy the efficiency objective, this can undoubtedly affect commercial objectives, negatively impact auditors’ image within the firm and hinder future career potential. Internal reviewers’ aim to maintain a good relationship with the client because “without a client, there is no audit” (Audit Assistant Manager, AH-T). For instance, when auditors enter the profession, they learn to interact diplomatically with client management personnel as maintaining the client relationship is the top priority of their superiors (partners). The auditing literature has indicated that bringing new clients and embodying soft skills while interacting with client management personnel represents the most significant qualities for auditors to satisfy internal reviewers and climb up the organisational hierarchy (Bol, Estep, Moers & Peecher, 2018; Carter & Spence, 2014; Guenin-Paracini, Malsch, & Tremblay, 2015; Kornberger et al., 2011; Turley et al., 2016). Failing to maintain a good relationship with client management can be a source of reputational loss, internally restricting auditors’ opportunity to obtain promotions, because the expectation is not to upset client management. Auditors feel discomfort about harming the client relationship. This discomfort shapes their sceptical judgement to stop challenging the client management, or at least softens their communication when doing so.
Although auditors feel discomfort about failing to sufficiently challenge client management, which represents the main expectation of regulators, they can also feel discomfort about failing to meet commercial objectives. One participant described how theoretically auditors are regarded as being angels who come to do good without any personal interest to worry about, when in practice the service is only provided for monetary compensation. Hence, reviewers’ expectations concentrate on retaining the clients and in practice this may mean they do so but with a primary focus on the commercial aspect.

“… when you do exams and things like that, the way they present the audit is very blue sky thinking where these people who are the angels sent by God come in and they do a perfect job. But the reality is it is a commercial service, you have to make money, and certain corners are always going to be cut.” (Audit Assistant Manager, S-Q).

“There is this thing in general life, they say the customer is always right. In audit, customers are not always right. But you cannot tell them that they are very wrong. This is the human factor within all of the audit jobs that you have to be diligent. You have to have professional scepticism about how you deal with the client.” (Audit Assistant manager, AH-T).

“…you have got three objectives in a professional organisation with accountancy… A happy client is one. Number two, you do not get sued. Number three, as an organisation you make money...” (Audit Senior Manager, I-A).

Participants also observed that they had seen their reviewers struggle to decide whether to continue challenging the client or stop in order to maintain a positive relationship with them. They have seen partners struggle with these two competing scenarios, which can involve failing to maintain their commercial interests (including profitability objective) versus failing to protect themselves when things go wrong. The reason for this struggle is because both scenarios generate a GFD, but for entirely different reasons. If their GFD about failing to meet reviewers’ expectations is stronger than their GFD about maintaining their firms’ and superiors’ commercial objective, they may be prompted to uphold their position and look at the contradictory evidence to communicate their sceptical judgement, while negotiating matters with client personnel. In other words, the scenario of harming their reputation or being subject to regulators’ sanctions becomes more compelling than the scenario of harming their relationship with an insignificant client. This can be the case when, for instance, the client is perceived by partners as insignificant due to the audit fees generated.
“…you have got to challenge the client, but there is a commercial decision as well, partners struggle with that. But you can actually see the reason somebody struggles with a decision because there is a commission as simple as that, it should not be the case, but I am telling you in confidence that is because it is a normal part of business.” (Audit Senior Manager, E-T).

“… If they think it is a client that is not very important to them and they are willing to sour that relationship you will get a scenario where they probably try to probe it a bit further. At the end of the day for them, it is a matter of the money that they are getting from the fees versus the bad relationship.” […] “[I]f the partner says I think this is a really big fee, it is a £100,000 fee and I want to keep this guy in, they are going to bend over backwards to make them happy...” (Audit Assistant Manager, S-Q).

This scenario was mentioned by a partner who indicated how being in a stronger financial position has enabled him to better challenge the client management personnel and have problematic conversations with them. His emphasis on the idea of having a good financial position explains clearly how the GFD about the possibility of losing a client (an important audit fee) becomes significantly reduced compared to his GFD about his reputation being tarnished after accumulating substantial experience in the profession. This can also suggest that auditors (partners) who are in a lower financial position might struggle to choose between the two gut feelings of discomfort which might guide them to stop challenging client management.

“Now… That is what you get after 20 years of experience as a partner, and I was actually chatting with my other partner who is a senior partner and we did observe that when you get to our stage of your career and you are in a much financially stronger position, having those conversations is easier.” (Audit Partner, H-O).

Additionally, auditors (especially those in the mid to low-level positions) reported experiences which suggest high levels of GFD related to balancing efficiency-related concerns, such as budget and time constraints, with the need to obtain and interpret sufficient audit evidence (Hurtt et al., 2013; Nelson, 2009). Auditors appeared to have learned through experience that good auditors are regarded as those who are sufficiently competent and diligent but also able to finish the job on time and within budget.

“Well, you might make a judgement and then not have time to develop on it, especially with tight deadlines. Sometimes people will tell you to just move on, just get it going.” (Audit Assistant Manager, AH-T).

“… if that certain thing is within the materiality threshold and procedures on it that is going to meet the manager’s and the partner’s requirements and
also the external quality reviewer’s requirements then you are done. Because if you go above and beyond that, we are not being paid extra to do that, and at the same time you have already met the external quality reviewer’s requirements so what is the point?” (Audit Assistant Manager, S-Q).

Some interviewees openly admitted that auditors’ GFD about failing to meet the audit plan or the time-budget target can be stronger than their GFD related to a potential failure to provide quality audit.

“… It is always that auditors work in that kind of time pressure environment where at some point, it becomes less important to do the job properly than to just do the job, and people just sometimes overlook things that might have been important because they just simply have a deadline to meet…” (Audit Assistant Manager, Y-T).

Thus, this and other negative scenarios lurking in auditors’ minds make the exercise of scepticism more problematic, as evidenced by the perceived importance of the so called ‘soft skills’ (described in the interviews as being indulgent, realistic, pragmatic, diplomatic, and polite) in managing the relationship between auditors and their clients. Indeed, while discussing the importance of sceptical judgement, such as in the form of probing questions, participants also stressed the need to avoid confrontation with client personnel.

“… you’ve just got to take the pragmatic approach where do I bring this up with a client and they shoot me down. Because you have got to remember it’s a very precarious situation to be in as an auditor. You’re still providing a service to them and they’re paying you for it, so you have to be polite even though you have to exercise scepticism… When you’re presenting it to the client you have to be a bit more humble about it, a bit more diplomatic.” (Audit Assistant Manager, S-Q).

6.4 Summary

This chapter has described the PSPM, which has been developed based on a review of the PS literature, the SIM psychological theoretical lens and the interview data. The PSPM delineates the process through which auditors’ informed GFD can include different, competing feelings of discomfort, which eventually form the basis of their sceptical judgement and action. This study has shown that certain facts or events can trigger auditors’ GFD. When auditors’ GFD is intensified to the extent that the negative scenario (e.g. the client management might be doing something inappropriate) becomes compelling, auditors respond to that feeling by sceptical actions, such as conducting
further audit procedures, collecting more audit evidence or more extensive audit documentation.

Different types of triggers have been identified which strengthen auditors’ GFD. These triggers are varied and include matters that are related to the task under consideration, client characteristics and the external environment. Auditors’ heightened GFD about the possible existence of material misstatements may compel certain questions in their minds which then may lead them to challenge client management further. Interviewees specifically highlighted how their social interactions with client management and other personnel and audit team members (including reviewers) expose them to important triggers that can influence their GFD, and thus guide their sceptical attitude (see Chapter 7).

Auditors’ knowledge that their work is going to be reviewed and potential personal negative consequences that could follow (e.g. reputational harm or being sanctioned) if they fail to meet reviewers’ expectations has been found to present a key type of discomfort. The study has shown how auditors come to audit with a certain level of GFD about “getting it wrong”, associated with auditing basic concerns. However, failing and facing the related negative consequences can be in large part dependent on meeting reviewers’ expectations. Reviewers’ different expectations can generate different feelings of discomfort in auditors’ minds, since external and internal reviewers may seek competing end goals.

This chapter has also shed light on certain factors that may prevent auditors from responding to their GFD and accordingly practise the appropriate level of PS. When an auditors’ GFD about violating an internal reviewers’ expectations in relation to the efficiency objective and relationship with client, this may override their GFD about missing material misstatements, which in turn may lead them to make a sceptical judgement and stop challenging the client management, or soften the language used in challenging. Auditors (specifically juniors) know that their reputation can be damaged (e.g. look incompetent) if they fail to meet the internal reviewers’ commercial objective, which includes maintaining the client relationship and meeting the efficiency objective. Thus, when auditors experience a high level of discomfort about violating the
commercial objective, they become constrained from cognitively recalling other negative scenarios that violate this objective.

This chapter has shown the process by which auditors’ GFD initiates and shapes their sceptical judgement. The next chapter continues to examine auditors’ PS process in making their everyday professional judgment by presenting evidence which reveals how auditors’ social interaction with others can shape and refine their PS process.
Chapter 7: Exploring the Manner in Which Auditors’ Social Interaction with Others Shapes Their Daily PS Practice
7. Introduction

As explained in Chapter 6, auditors practise with a level of discomfort that accompanies them during the whole process. This GFD stems from the different negative consequences they could encounter if they fail to meet reviewers’ expectations. As conducting an audit involves interacting with other people, auditors are aware that they may have to convince them of their sceptical judgement. Reviewers expect auditors to demonstrate suitable PS in their record of an audit, in line with auditing standards and a firm’s methodology.

The evidence from this study suggests that auditors’ social interactions with others influence their PS practice in two ways: First, others may communicate certain verbal or non-verbal signals which can trigger auditors’ GFD. Second, auditors’ communication of their sceptical judgment involves interacting with others whereby they may dedicate certain efforts (including employing certain factors or strategies) to influence others to accept their sceptical judgment. As Chapter 6 has provided to an extent of details evidence on the first way that auditors’ social interactions with others may influence their PS, this chapter focuses more on presenting evidence regarding the latter way of influence. Therefore, this chapter broadly outlines how auditors’ social interactions with others shape their daily PS process. This specifically includes showing how auditors act on their sceptical judgment in such interactions to influence others to accept their sceptical judgment through utilising certain factors or strategies. The findings here supplement those in Chapter 6 relating to this study’s second objective of exploring auditors’ PS process in making their everyday professional judgement.

This chapter focuses on the following research sub-question: how does an auditor’s social interaction with others (specifically client personnel and other audit team members) shape their day-to-day PS practice? This chapter is organised as follows: Section 7.1 discusses the importance of social interaction in the PS process while Section 7.2 presents evidence regarding the factors and strategies that auditors may utilise to persuade others to accept their judgment in such social interaction. Finally, Section 7.3 summarises the key findings of this chapter.
7.1 The Importance of Social Interaction in the PS Process

Auditors may feel wary about acknowledging that their sceptical judgement is based on mere GF. However, as has been shown earlier in the thesis, auditors’ GFD strongly determines their sceptical judgment and attitude. Even though auditors’ GFD provides them with direction when carrying out audit procedures, it is still treated as a vague and elusive factor that, despite being informed by prior experiences and accumulated knowledge, is not explicitly referred to in the audit profession. In light of severe public criticism of auditors in recent years, the participants commented that emphasizing the significant role of emotions, including discomfort in auditors’ decision-making, can be misinterpreted and seen in a negative light.

“…the gut instinct gives you direction and then you follow that direction. There are procedures and there are checks to go through in terms of that.” […] “[T]o be honest with you, because of the way the audit profession is, we do not talk about relying on our gut feeling and things like that. It is not something that is formally talked about. It is more a case of you develop it as you go along.” (Audit Assistant Manager, S-Q)

Although some participants argued that feelings did not play a role in drawing the comfort line, relying instead on following prescribed audit methodologies (e.g. ticking all the required boxes on the checklist), they acknowledged that these methodologies usually prescribe only generic audit scenarios, which may be different to those encountered in practice. This may imply that a form of intuitive GF is necessary as auditors attempt to interpret specific audit issues.

“…there is always an element of you have to kind of draw a line in the sand somewhere and make an assessment to say, right, am I comfortable? It is difficult to say because there is not a particular one thing…” (Audit Director, YS-T)

“…as long as you feel that sufficient evidence has been obtained which either supports management’s conclusion or goes against it, and you are now happy on a certain position then that is what you go with. This is not a fixed benchmark, this is a matter of professional judgement that satisfies you.” (Audit Senior Manager, Raf-T)

Other participants openly acknowledged that their informed GFD shapes their judgement, noting that social interaction with others can specifically prompt them to feel more or less discomfort. Accordingly, they mentioned that while following their firm’s audit methodology, their social interactions with client personnel or other audit team
members may yield verbal and/or non-verbal clues that can trigger GFD and subsequent sceptical action.

“…those methodologies are clearly approved and supported by the world’s regulatory bodies, be it FRC in the UK, or the PCAOB in the US… So, as long as I can see that we have followed that methodology, then a large part of my confidence comes from that.”

“[however] maybe something not quite significant enough to follow up on but you have found something else somewhere that casts a little bit of doubt on the conclusion you have gone to. Quite hard to define that stage. And then the sort of the more gut feel of things, the people you have spoken to, perhaps not having a huge amount of credibility in what they are trying to assert to you would lead us to potentially dig a little bit deeper into something.” (Audit Senior Manager, N-A)

In explaining SIM, Haidt (2001) indicated that moral judgement is shaped by an ongoing process of social interaction stretching over time and across many people, and that people apply post-hoc reasoning in order to persuade others to accept their moral judgement. He defined this persuasion process as people’s ability to prompt others’ GF. Likewise, auditors’ regular ongoing interactions with others were found to shape and refine their sceptical attitude in at least two important ways. Firstly, auditors’ GFD can be triggered by verbal or non-verbal signals observed during their interactions with others (see Section 6.3, Chapter 6). Secondly, auditors’ communication of their sceptical judgement, through raising certain matters, posing questions and applying certain procedures, involves social interactions where they may pursue a range of reasoning efforts to justify their judgement and influence others to accept it, and also address possible questions from reviewers (explained further in Section 7.2). That is, social interaction both influences auditors’ PS and is used by them to achieve acceptable outcomes in the light of sceptical judgements. Rowe (2019) clarified that part of auditors’ efforts to gather evidence involves gaining confidence in order to defend their opinion (judgement) against critics (e.g. reviewers or client management). Auditors are cognisant of the fact that reviewers expect them to justify their sceptical judgement with evidence gained through audit procedures. These may include testing procedures, consulting specialists, benchmarking against the industry or previous years and inquiring with client management (Circle D, Figure 7.1).
Interview participants indicated that they would not survive a review process without presenting adequate reasoning efforts. When auditors attest a judgemental accounting issue which lies in the reviewers’ area of interest, they know that they may potentially face negative consequences if they fail to meet reviewers’ expectations. In order to alleviate their GFD and the negative consequences associated with it, auditors first engage in reasoning efforts to satisfy themselves and then use that to persuade others (including reviewers) to accept their judgment (see line 5 and 8 - Figure 7.1).

“…the partner, he or she would be asking you that question. So, I would think to myself, well what would they ask?... Because I have got to convince them that the answer that I have now got I am happy with. If I cannot convince them that I am happy that the client’s response is correct, then I have not got enough. So, the audit partner's mentality is very much a case of, I do not believe it until you show me something…” (Audit Senior Manager, I-A)

“I cannot audit a balance based on significant risk because I have a feeling it might be wrong. If I put that down on my file, the regulators will absolutely tear us to shreds because it is just not tangible enough.” (Audit Manager, S-T)

After auditors are prompted by their GFD to continue challenging the client, they would typically go on to conduct further audit procedures and collect evidence (lines 3 and 5 - Figure 7.1) to be able to rationalise their judgment to others (arrow number 8, Figure 7.1). However, the reasoning grounds (evidence and procedures obtained) may reshape their sceptical judgment by eliciting other feelings which may contest and override initial feeling (see Expertise and Reasoned Argument in Section 7.2.2). It should be noted that the PS process is not all one linear sequence, however, it could effectively be a repeated cycle throughout the audit engagement.

“…when you get a fact pattern like this… You have that gut feeling about which way you're going to go with it. And then if there's extra fact to the circumstances that come out they will either confirm or deny your initial sense of it.” (Audit Manager, AX-Q)

As reported briefly in Chapter 6, participants emphasised that their social interaction with others are a key factor in prompting GFD and thereby in shaping sceptical judgement. Social interactions assume greater significance when issues involve significant judgement. It is worth noting here that social interaction between auditors and others (irrespective of level) is a two-way process (see arrows 8 and 9, Figure 7.1),
where each side attempts to influence the other to accept its position. Throughout the course of audit engagement, auditors engage in a variety of social interactions with others (including client personnel, audit engagement teammates or other firm members). These social interactions which might be work related or non-work related may all influence auditors’ PS practice. However, the evidence provided in this chapter is more focused on work related interactions. Hence, participants commonly referred to the audit process as one which involves constant discussions, meetings and various other forms of communication. These can include, inter alia meetings held with the client prior to formally accepting the engagement, in the planning stage, during evidence gathering and at the clearance meeting where auditors finalise their work and report their audit opinion. Apart from their clients, auditors engage in regular social interactions with their team members to plan the audit, monitor progress, consult and review the work of subordinates. Participants stressed that such meetings are important not only to identify the risks associated with a client, but also, for audit team members, to understand their superiors’ expectations, a key element of their GFD.

“…you have planning meetings with the whole team, and you discuss what is going to happen, what is going to go around… I think what we try to do is, we talk about continuous challenges. Have a few catch-ups to see how it is going, is there anything that you want to discuss before you discuss opinion you also have final chat… Close our meeting. Sometimes you can have this as a team, sometimes you have it with the client themselves…”

(Audit Manager, T-T)

Auditors’ social interactions with others involve a variety of communication methods. Some of the literature highlights that face-to-face communication enables auditors to challenge the client management better than digital communication as it gives them the opportunity to build a relationship with client management, properly read the non-verbal triggers and present adequate follow up questions. Auditors can also show their interest in understanding contradictory evidence, as well as confirming evidence, which client management might be inclined to focus on. In other words, the key benefit derived from face-to-face communication is that it exposes auditors to the full fact-pattern (including those non-verbal cues), which can better inform their GFD. Importantly, these studies have specifically emphasised the importance of social interactions between client management and auditors in shaping auditors’ sceptical attitude (Bennett, & Hatfield, 2018; Koch & Salterio, 2017; Saiewitz & Kida, 2018).
Participants explained that when their GFD is prompted by an unfamiliar issue or situation, the first reaction is to share it with other team members. Experiences shared amongst colleague(s) can both add significance to or alleviate their GFD and shape their sceptical attitude. For example, junior auditors consider consulting their superiors not only beneficial in terms of technical insights gained, but also as validation of their judgement when their superiors’ response is positive. The knowledge and expertise shared by their supervisors can both increase or diminish auditors’ GFD (see Section 7.2).

“...we do a lot of discussion about how we are feeling things, how we think something is right or wrong...So if it is a serious matter then obviously we discuss that with our senior people like, for example, manager, senior manager, partner. For example, it has happened sometimes in my experience that there is something that I thought might be risky or could be an issue, but then I discuss it with my partner, he explained to me and he made me
understand that okay, it is an issue but it is not a big issue… It is not a big issue that it affects.” (Audit Senior Associate, SB-T)

On the other hand, senior auditors’ (e.g. partners) GFD about missing material misstatements can also be influenced (intensified or alleviated) during the interaction with their subordinates. Their subordinates’ verbal and non-verbal signals can influence seniors’ GFD about client representations and the work the audit team has established. For instance, if a junior auditor failed to understand an issue on which a judgement has been made, the superior’s GFD could be prompted, creating fear that the audit team has not produced sufficient justifications to protect them if things go wrong and consequently making a sceptical judgement to further challenge the client management.

“I will take their word because they are the one on the ground, they are the ones doing the testing. Usually, I would ask them to say if you think it is wrong then can you explain to me why you think it is wrong? And if they convinced me that it is wrong then that is the time where we’re starting to need to have those discussions with the management...” (Audit Manager, E-TIT)

“I would be a lot more in the details, so, I would be looking at detailed testing for example, going through each account. Have you tested enough? Have you applied materiality sufficiently? It was much more bottom-up, whereas my approach now is much more top-down. It’s more, what is the risk, how have we dealt with it and does it make sense? And if it doesn’t make sense, that’s when you know you have to probe further.” (Audit Partner, ZS-A)

Part of auditors’ accumulated knowledge is their experience of interacting with different people. During interactions, this accumulated knowledge can influence their response (GFD) to certain fact-patterns and lead them to a sceptical judgement, which may determine whether or not to continue challenging client management (Smith & DeCoster, 2000).

“…in-house trainings in the firm, your experience, your discussions with your partners, and team members. All these things, when they blend in together, they help you think from a critical point of view, that what you should be doing and what you should not be.” (Audit Assistant Manager, T-O)

The participants indicated that time pressures during audits necessitated reliance on social interactions with others, both client personnel who develop the FS and audit team members who might review their work or have more knowledge. This is because certain
information can be communicated through verbal or non-verbal clues, triggering auditors’ GFD, leading them to further challenge certain areas where material misstatements are more possible.

“So, most of the times, we will be given for example two weeks to test controls. You have lots of controls to test, you have so little time. So, the reason why we ask questions is because to reduce that time.” (Audit Manager E-TIT)

“When there are key judgements, there will be quite a lot of discussions to have. And also, because of the nature of the client, if it is a listed company it is given the attention it deserves because it is more risky... It is constant communication. From all those discussions, you get to know how everyone in the process has exercised their judgement over the certain letter that you are talking about.” (Audit Manager, T-T)

Participants also indicated that they tend to excise a level of PS based on their social interactions with client management personnel. This came in the form of meetings where they would ask questions and follow them up depending on the client personnel’s reactions. During these interactions, client management may provide further explanations (e.g. highlight certain inconsistencies or reveal new facts that are inconsistent to auditors’ knowledge) which can strongly influence auditors’ GFD to make a sceptical judgement on the merits of continuing to challenge client management.

“Whenever you speak to a client you apply professional scepticism. So, you listen to what they have to say and you never accuse them of lying, you do not say that they are wrong in what they say, because it could be true, it could not be. But you see if it makes sense in the context of your understanding and the evidence that you have got.”

“[a] lot of it would stem from the discussion with management. But I think a change in an estimate like that, I would be more sceptical about... Because it's a judgement area with estimates. To an extent it's open to manipulation.” (Audit Senior Associate, R-Q)

“I was asking someone to write a letter to confirm a debtor balance from a customer, but the client has told me no, you cannot do that because we don’t want to send confirmation to this customer… because of their relationship with the customer. Then in that case, it might ring a bell off saying why is that the case? And why has the client not informed us about this relationship issue with the customer?” (Audit Senior Associate, H-A)

In summary: the SIM recognises how an individual’s judgement can be influenced by social interaction; in the context of audit engagement such interaction is relevant both to
the way auditors form sceptical judgement and how they act on that judgement to achieve acceptable outcomes; and while over the course of an engagement auditors will engage in a wide variety of interactions which may influence their PS, those interactions involving client personnel and other audit team members are particularly relevant to the level of scepticism and consequential actions applied in practice. The following section presents evidence from the interviews relating to this important aspect of auditors’ judgement and PS.

7.2 The Role of Social Interaction in the PS Process

As noted earlier, the PSPM recognises how social interaction can influence judgement and the formation of a sceptical attitude; and also how an individual uses social interaction to act on the results of judgement (see arrows 8 and 9, Figure, 7.1). This section presents evidence that arises from the interviews about the role of social interaction in relation to auditors’ sceptical judgement. The evidence includes both influence on judgement and actions by auditors to bring about what they consider to be acceptable outcomes on the basis of judgement, but the emphasis is on the latter.

Haidt (2001) has documented in the SIM that people pursue certain efforts to persuade others to accept their moral judgment. In this study, it was found that auditors may rely on certain factors to persuade others to accept their judgement, as represented in the PSPM’s arrow number 8. Interview comments that are presented in this section included reference to a number of significant factors and the strategies related to those factors that are employed by auditors. In particular, the discussion is organised to reflect significant factors around rank/seniority, reasoning efforts and interpersonal relationships. It is acknowledged that this may not be a complete representation of all factors around social interaction, but it is those on which evidence can be adduced from the interviews in this study, that shows the role of social interaction in the practice of PS in auditing.

It is worth noting also that this list of significant factors and related strategies does not suggest that auditors can only rely on a one of these factors or related strategies as a

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13 The persuasion efforts do not necessarily suggest that social interaction involve only conflicts or disputes, but it implies that each side of the social interaction may attempt to influence the other to reinforce, change or initiate judgements.
combination of them can be used as a means to persuade others, and make them aware a challenge is being made. For instance, auditors may employ benchmarking against the market or the client’s status in previous years (“expertise”), make reference to relevant standards (“regulatory authority”) and involve seniors (“escalation”) in the interaction to show client personnel that the assumptions, estimates, or judgements that they had made are different or in non-compliance with the regulations. This can eventually affect their organisation’s FS, causing further obstacles to both the firm and the individual concerned. However, the variations that might occur in accounting situations or interactions with people may instruct the use of a certain factor or strategy, or a combination of them. The following sections will mainly present different pieces of evidence to demonstrate the factors and its related strategies that auditors may employ in order to persuade others (client management personnel and audit team members) to accept their sceptical judgement. They will also show others’ possible utilisation of similar factors and strategies which may influence auditors’ GFD and accordingly sceptical attitude.

7.2.1 Rank/Seniority

**Rank Relative to Client Personnel (Escalation to Persuade)**

Auditors may rely on seniority (in terms of age or position) to persuade client management to accept their sceptical judgment. The participants explained that having the right representation in terms of seniority is important in negotiating with management as this can make them more hesitant in pushing back against auditors’ challenge. They emphasised that it is preferable for more senior staff to have the more significant discussions with client management, because client management personnel’s interpretation of these auditors’ seniority may include expectations of their knowledge, experience and authority. This can then prompt them to accept the auditor’s challenge. Client personnel might expect these senior auditors to have access to their upper management levels, which can create a concern not to disregard the auditors’ challenge. This factor is manifested in the escalation process that the audit team is trained to utilise when struggling to persuade client management to accept their challenge. More senior auditors might have considerable experience with a particular client or have been known to work in the same industry for a number of years, and consequently can forge a close
relationship with client personnel such that those personnel accept their challenge comfortably without extensive reasoning efforts.

The strategy of relying on the authority of seniority can be interpreted as causing client personnel to feel in a weak position to disagree with the auditors, since they know that the auditors concerned have more experience than them, have access to their superiors (e.g. audit committee) and probably have strong relationships with them, specifically when it is a continuing audit engagement. Therefore, when auditors fail to persuade client management because, for instance, the client personnel do not take their challenge seriously, more senior staff are invited to get involved in the discussion.

“Management know their business better than you. So, when you sit in there, you’ll be exchanging fire. They know their business. They have been working there for years, you have been auditing for 3-5 weeks, you come in to change their numbers so they will challenge you as well. So, that’s why the conversation needs to be led by the audit partner, the audit partner needs to sit there and have the conversation.” (Audit Manager, A-T)

“If I have to discuss it for three hours, whereas a partner might just need to mention something for five minutes because he has the level of seniority. Maybe he’s been working for the client for five years, maybe he knows him very well and just needs to present it in five minutes and sometimes, it can solve problems.” (Audit Assistant Manager, L-Q)

One participant explained that he succeeded in persuading an initially resistant client manager through gaining access to the client manager’s superiors. This incident may indicate that since client personnel perceive senior auditors as having access to their superiors, they can feel concerned for their reputation within the organisation and end up doing what auditors are proposing or may even be questioned by their superiors for not cooperating with auditors.

“Recently I had a client... We have had the conversation and we have had to ask someone for a bit more information, they have taken it personally... So, I was able to go up to someone a bit more senior than them and say look, this is the conversation that I’m trying to have, this is the reason why we’re having the conversation, I think it’s reasonable, what do you think? Said, yes, actually I think you’re very reasonable to have that conversation and it’s not an issue on your part, I’ll have a word with them. So, he has had a word with this individual and I don’t know what’s been said between them, and now all of a sudden this individual is very cooperative...” (Audit Assistant Manager, S-Q)
Participants also commented that they may accept the judgement of others (e.g. senior client personnel) because they are known as senior people. For example, the seniority of client management personnel which can imply having more experience, knowledge and access to auditors’ superiors may trigger junior auditors’ GFD to accept their assertions and stop challenging them (see Chapter 6). Once junior auditors perceive client personnel as being more senior than them, they might more readily accept what they provide because they can be prompted to feel high discomfort about maintaining their reputation (stronger than their discomfort about missing material misstatements) and do not want to appear ignorant or incompetent while interacting with these people.

“Now more comfortable in my skin, more experienced to challenge and discuss stuff with top management as opposed to when you are just starting off. If you sit with a group of CFOs, you need to ask them questions, they tell you something you don’t understand, you are not going to challenge it as opposed to now you are more experienced, you have dealt with management judgments...” (Audit Assistant Manager, A-T)

“…they will be furious with you, they’re going to challenge you, they will ask to speak to your boss, you know. It can actually be very emotional and messy…” (Audit Assistant Manager, R-T)

Auditors’ GFD about appearing to be incompetent becomes significantly intensified as they consider the negative consequences for their reputation or their personal goals, which can include earning a promotion or moving to industry or the consultancy business. Thus, client personnel may bring senior people to such interactions to influence auditors to accept their reasoning. Senior client personnel may attempt to intimidate auditors perceived as being junior or inexperienced, or attempt to intimidate these juniors to the extent that it clouds their GFD linked to detecting possible material misstatements. Auditors’ lack of competency (including communication skills) can heighten their GFD about harming their reputation (including being reported to their superiors as being incompetent) to the extent that it affects their practice of PS.

“…they would really try and intimidate them… Especially if you have got an individual who they perceive to be below them and whom they don’t think they can respect. Certain people will try to intimidate them to basically get them off their back.” (Audit Assistant Manager, S-Q)

“… mostly… It's a very difficult meeting because client tries to pressurise you and say that we had this issue last year and why now… Why you are raising this and these kinds of things? They try to, you know, pressure
tactics and try to get things done and in meetings things get tough as well.”
(Audit Assistant Manager, W-O)

“Some are more aggressive than the other. It’s not in terms of mannerisms, it’s in approach generally, they want to go with their own reasoning.” (Audit Senior Manager, Raf-T)

**Rank/Seniority within the Audit Team**

Within the audit team, more senior auditors can easily persuade their subordinates to accept their sceptical judgement about certain issues due to their seniority (which generally encompasses experience and technical knowledge). The participants highlighted how they tailor their GFD and, accordingly, their sceptical judgement to meet their superiors’ GFD. What was observed was that participants linked their GFD to the level of discomfort that their superiors exhibit. If their superiors’ discomfort about the existence of a material misstatement was very low, this would be reflected in the behaviour of the subordinates, who would tend to treat the issue similarly. This implies that superiors do not need to exert a great deal of efforts to justify their sceptical judgement to their subordinates.

“…if I think differently, but partner think differently, then I would change my opinion to suit what’s partner’s opinion... We might differ and I would say I don’t agree with you but anyway I am doing it…” (Audit Assistant Manager, W-O)

Senior auditors tacitly illustrated that if they presented their sceptical judgement to their subordinates, their rank as seniors who are assumed to possess the authority, experience, and ultimate responsibility of audit work would automatically prompt their subordinates to accept it and act accordingly. Since the partner bears the ultimate risk in the audit, the mid and low-level auditors must show that certain efforts have been expended in order to persuade the partner to accept their sceptical judgement. The partner will experience GFD about their subordinates’ failure to properly assess and address the risks associated with certain fact-patterns. (S)he needs to see that certain justifications have been made which in turn can provide protection and comfort if things go wrong. Thus, auditors broadly seek to persuade their team members (specifically superiors) to accept their sceptical judgement when it comes to challenging client management. If this cannot be achieved, auditors’ GFD about harming their reputation becomes strongly intensified, guiding them to stop challenging the client, or at least hinders their practice of PS.
Therefore, they tend to focus on persuading their own team (superiors) to accept their sceptical judgement that an additional challenge is necessary by utilising combination of the factors and related strategies discussed in this section.

Senior auditors may choose to be difficult with their subordinates, as this may stem from feeling uncomfortable about a certain issue or a feeling the subordinate might have got something wrong. Thus, they seek certain justifications (e.g. understanding of the issue, performance of certain reasoning efforts and compliance with the standards and firm’s audit methodology) from the subordinate to alleviate this GFD before accepting their sceptical judgement. It has been highlighted that it is only when superiors feel uncomfortable about the possible existence of material misstatements, that they would be minded to accept their subordinates’ challenge to client management in order to take a sceptical action (e.g. discuss the issue with client management).

“… I still have a position, I want to protect now because I have a higher probability of them disagreeing with me. So it’s always, this is the area of judgement, this is what I intend to do, this is why I think this is sufficient. They would either agree or disagree, more often than not, really challenging me on that making sure… that I’ve considered everything in forming that conclusion.” (Audit Manager, M-A)

“So, he wants to be sure that what they are doing is actually sufficient. So, again it is about risk say if this goes wrong, he will come and say okay did you think of this and this rather than just say okay you do not test thinking that is low risk.” (Audit Senior Manager, E-T)

When the mid and lower level auditors fail to prompt their superiors’ GFD in a certain issue, superiors’ commonly respond by saying that, “it is not a big issue”, which really means the degree of discomfort caused to the senior has not reached the level where it would prompt them to accept their subordinates’ sceptical judgement to continue challenging client management. The superiors’ response (which may include their good reasoning) that such an issue is not risky enough to them can have the effect of significantly reducing the subordinate’s GFD about failing to meet the superior’s expectations. Auditors’ social interaction with their superiors and its effect on shaping their level of comfort has been highlighted in the literature, as has the link to PS (Carpenter & Reimers, 2013; Cohen et. al., 2017; Harding & Trotman, 2016; Peecher et. al., 2013). However, when the subordinates succeed in communicating the risks associated with an issue by answering superiors’ questions and showing their GFD that
the client management might be doing something wrong to the extent that it outweighs their superiors’ GFD about them failing to understand the issue, their superiors’ heightened GFD can lead to a decision to continue challenging client management.

“… there have been instances where I’ve had the partner telling me that, look, what you are presenting is right, but management is not too far from wrong and that is fine. So, let’s move forward, let’s just go with what management are saying… The ultimate responsibility is with the engagement partner, so if he or she is fine or agrees with management, then that will… Whatever I think or feel about it.” (Audit Assistant Manager, Y-T)

Consistently, senior auditors stressed how they want their subordinates to be able to articulate relevant risks to them regarding a client with sufficient lucidity, so that a sense of discomfort is created. If risks are clearly identified and well-reasoned, this would make superiors more likely to accept sceptical judgements from their subordinates.

“I catch up with my teams regularly and when they have done their work, my approach is to look at the risks that are obvious… So, I would start by talking my team through where I see the risks in the business and inevitably from that discussion, things come out that they have seen that they might not be comfortable with. That’s when what looks serious and what you need to look at in a bit more detail.” (Audit Partner, Z-A)

In contrast, although more junior level auditors might not be highly interested in knowing the reasoning of their superiors’ judgement as much as dedicating their efforts toward following their edict, they did note that their superiors tend to justify their sceptical judgement. While it might have appeared that participants made an effort to show they have an open environment in their accounting firms where they can challenge their superiors, the tendency was for them to always end up justifying their superiors’ position by stressing their sceptical judgement was correct due to their experience, knowledge, seniority, ultimate accountability of the audit engagement, and eventually the precedence of their judgment.

“…if my opinion was we need to increase the estimate and my manager and partner were like, no, it's fine. But could you tell me why it's fine? Because I do not see why it's fine, I think it should be changed. And then, they go through their reasoning with me as to why it's fine. And to be honest they're probably going to be right, they're very knowledgeable, they do know more than me… But ultimately if the partner says it's fine, I mean he's the one signing off on the account, so if he's happy to sign off then it's fine.” (Audit Senior Associate, R-Q)
“We would respect the partners' knowledge on this matter because he is the one signing, it’s his neck on the line...So, once he concludes on a matter that is it, if he says it’s an error then most probably it’s an error and if he says it’s not an error then case closed it’s not a discussion, everybody is happy.” (Audit Manager, S-T)

“...sometimes when you raise a finding or insight the manager will just tell you to delete it or drop it because it’s not an issue. He has other information from the client that proves what you said to be wrong so you have to drop it.” (Audit Assistant Manager, YW-T)

7.2.2 Reasoning and Persuasion

Expertise and Reasoned Argument

The participants explained that exhibiting the possession of the right expertise and knowledge can be effective in persuading others (e.g. client personnel) to accept their judgment. Auditors attempt to show their expertise and knowledge of the client’s operations and transactions by laying out the factual details of an issue, similar examples from their experience, the audit procedures that have been conducted and the evidence gathered. This can make client personnel feel vulnerable, because auditors would seem to know more than they might have expected. Participants also displayed that they may accept the judgement of their superiors, internal experts and the client’s experts because they appear as knowledgeable and experienced people.

As detailed in Chapter 6, once auditors’ GFD is triggered by a certain fact pattern, compelling questions arise about the management’s possible attempt to manipulate the FS figures. This will prompt them to implement certain procedures, which are typically listed in the firm’s audit methodology. The participants stressed they have to illustrate these procedures since they will be expected by others (specifically reviewers), and they can elicit or hinder their initial GFD that client management might be doing something inappropriate. If the outcomes of these procedures confirm their initial feeling, this provides grounds (reasoning) to justify their challenge to client management personnel.

Participants emphasised that evidence collected regarding judgemental accounting issues cannot be definitive, because they are by nature, subjective, uncertain (future driven) and affected by different factors and assumptions. Despite this difficulty, the participants argued that they would make their efforts to prompt client personnel’s GF by showing
their expertise that this estimate can substantially impact the FS and audit report. Through presenting their expertise, auditors can persuade client personnel to either accept their challenge or at least reach a “common ground” which auditors can tolerate.

“I like to make those as fact-based as possible, but if you think it’s a terminal growth rate of 3% is reasonable, I think 2% is reasonable, we’ll have a debate about it, I will explain why I think that is and I will get some external evidence different to management’s that says, all our experience 3% is at the top end or we’ve yet to see a transaction at 3% and that’s why I think it’s unacceptable. Now, if they say, well, we’ll move it to 2.5%, I might say, well, I can live with 2.5%…” (Audit Partner, H-O)

One participant illustrated his challenge about a judgemental accounting issue on a factual basis to show client personnel that he knew their business better than they might have expected and thereby prompt their GF to accept his challenge. He clarified that having an understanding of the issue is critical when challenging client personnel, as it is common for them to query and challenge things and elicit his GFD, thereby seeking to harm his reputation by claiming greater knowledge of their own business.

“…would say... You come here for a month after a year and now you think you can tell me about my debtors. I know my debtors’… Obviously, the client knows his business and stuff, and at the same time, the client wants things to be in a certain way. So… You say, ‘Look, this is what I’m judging with, this is your debtor, they owed you this much, they have paid you this much within 90 days you recovered 87% so based on this recovery, your estimate should be within this range. Why is not yours the same?’ And if you do that to them they will know that okay, this person has a valid argument...” (Audit Assistant Manager, R-T)

Furthermore, auditors will sometimes recall similar cases based on their experiences to show client management how things may eventually transpire. This can also help in resisting a challenge from them. Where an auditor is able to call on previous industry experience, this can discourage some client personnel from disputing the auditor’s argument, as they may perceive him or her as being more knowledgeable.

“…you go in a meeting, and you explain to them that this is very different from what the market is following. So, we have similar clients, like building societies, and we have their workings. Without disclosing the names and stuff, we show them... This company is following, this is a percent of the rate, which is acceptable by the regulators, but what you are following is not... Then you have all these backing and then you have this IFRS book with you, and you show them, okay, the standard says this, your regulators, say this. FCA has this regulation. If you do not do this, they will put this penalty on you.” (Audit Assistant Manager, T-O)
Where an auditor is able to provide similar examples of past cases, client personnel can be convinced that it is wrong (or even dangerous) not to accept an auditor’s challenge. Participants remarked that not all client management will try to maintain their judgement at any cost; some of them are more interested in providing reasonable, fair representations. Past cases are not only a deterrent, but can also highlight to management the proficiency of the auditor.

“…you have to find a clever way of demonstrating that something did go wrong or sometimes you go with a benchmark. A benchmark is sort of like information that you give them to say we have seen this happening at other clients and this is how it went. And it is up to them to say, oh it happened to other business industry is that in the same industry as us? Then, therefore, we should take their opinion seriously.” (Audit Manager, E-TIT)

The reasoning process employed by auditors to convince clients mirrors the approach they adopt with colleagues, except for one key addition. Auditors will focus on showing having sufficient understanding of the accounting issue and gathering sufficient evidence to help the team survive a review process (specifically external reviews). They need to exhibit that they have properly understood the issue in order to identify certain associated risks and have followed the firm’s audit methodology (and thus reviewers’ expectations) to obtain evidence, which can protect them if things go wrong.

“In exactly the same way as you would prove that to your reviewers. You would show them evidence or the lack of evidence to substantiate that estimate - and yes, that would be what you will use to persuade the client to do something…” (Audit Assistant Manager, Y-T)

“…they do definitely as long as it has backed by because we have something that we call audit methodology… So, sometimes they tell you, yes, we are doing that, or you told me to do that, but in reality, that audit methodology tells me to do that, and I will be yes that’s fine.” (Audit Manager, M-Q)

“…what partners don’t usually like is saying ‘well you haven’t done any work and you’re asking me to make a judgement, based on what?’…” (Audit Senior Manager, Raf-T)

Consistent with the SIM, which gives reasoning a role and importance in refining people’s moral judgement, this study found that when auditors do not particularly have a certain initial feeling or at least a weak one about a certain issue, their reasoning (procedures and evidence obtained to reason their argument) can become the source of
their sceptical judgement (see dotted line 6 - Figure 7.1). Although auditors have varied experience and considerable technical knowledge, they can and do encounter different, complex cases as businesses become more complicated. In these instances, auditors may not be able to rely easily upon feelings or intuition about certain issues. As showed in Chapter 6, auditors can be prompted to feel discomfort about “getting it wrong” if such issues or facts look unfamiliar, but their GFD may not guide them to the specific areas of concern. This scenario can also be influenced by what is dictated by their superiors or the firm’s methodology. These additional factors can shape sceptical judgement and determine whether a further challenge is needed or not, particularly when the estimations of client management do not concur with the evidence obtained.

A good example of this is the inexperienced auditor with limited knowledge who is unable to consider the possibility of alternative scenarios rather than the one with which they are being presented. Some participants highlighted their naivety when they first started auditing, citing that they would focus only on the facts presented without any feelings about the bigger picture which could elicit a GFD. They would go straight into testing the facts that client management told them based on the brief provided by their supervisors, without a specific GFD that a material misstatement may exist. This issue may fall outside of their procedures, or may have only come to light if highlighted by their supervisor.

“…when you just start you normally focus on whatever is assigned to you by your field manager and you just focus on a small section and you actually don’t see what’s the overall impact of that.” (Audit Assistant Manager, Y-T)

“So when you are new, you operate in a very naive… You would listen to the client, you would write everything down. And then consider things are different angles. So for someone new, it's just… I feel like they would concentrate on the facts…” (Audit Assistant Manager, AH-T)

However, auditors rarely come to audit a fact-pattern without having a feeling that is developed by their knowledge, the information learned through the planning meetings and the allocation of the job tasks method, all of which combine to ensure that issues are being dealt with by appropriately experienced auditors. This suggests that auditors would usually have a certain initial GFD (more or less discomfort) that may shape their
sceptical judgement. This makes the scenario where auditors do not have a specific initial feeling about a fact-pattern somewhat infrequent.

The findings suggest that auditors’ reasoning may at least trigger a different feeling, which can impact (modify) a preceding feeling (GFD) that an issue is risky enough to warrant a sense of discomfort or not (dotted line 7 in Figure 7.1). Participants also highlighted that learning new information by such reasoning can make them reconsider their sceptical judgement. This new information can cover a multitude of things such as evidence the auditor was previously unaware of, new events or facts not considered or new regulations that they were not mindful of. One participant commented that if he could not find evidence which confirms his GFD, for instance, that a client’s customers are not going to pay their debts, then whatever contrary evidence he obtains may prompt other gut feelings that contest his initial GFD and eventually form his sceptical judgement (dotted line 7 - Figure 7.1).

“It’s usually a case of we’ve got a massive debtor of half a million pounds from one person and you’ve got to prove that they’re not able to pay it back as opposed to you’ve got to prove that they are able to pay back… So, I wasn’t able to prove that, but then we got a bit of evidence which suggested exactly to the contrary, so I had to sit back and say there’s nothing within this email that says that they’re not going to be able to pay it back. They’ve actually said they are going to be able to pay it back. Does that give us 100% concrete evidence? No. But equally, it suggests that they may be able to pay it back.” (Audit Assistant Manager, S-Q)

**Regulatory Authority**

Persuading client management to accept auditors’ sceptical judgement regarding judgemental issues can be very challenging, as that which is being challenged can often negatively affect management’s personal interests, and by extension, the company’s interests. It is inevitable therefore, that management will seek to challenge the authority of the auditor to some extent. To pre-empt this scenario, auditors usually present their sceptical judgement as matters of fact, but this can become complicated when some of the relevant issues are subjective, and so may lack guidance or evidence. Referencing regulations represents an effective tool in the armoury of the auditor, giving immediate credence to his or her challenge. Presenting information and challenging management becomes easier when regulations are stipulated. Using regulations can also help alleviate potential challenges, as the auditor can stand behind them whilst also appearing to be
sympathetic toward a client’s representations. Firms also know that if they try to challenge things they risk the potential ramifications of non-compliance.

“…the best way, especially with the client, is referring back to the standards. So, if you are doing provisions quote this is the accounting standards to comply with, this is a legal compliance thing, this is the accounting standards… you quote the standards and just present the standards to them. Then that is the thing that usually frightens them…They reach a point where they realise ‘no, he is actually right’ and then they have to do that adjustment.” (Audit Assistant Manager, R-T)

“People would not be easily convinced. And especially…in the case where management - their business will be significantly impacted by that accounting estimate which I’m challenging… so management will not be easily convinced. And the best…to do in that case is to give the accounting standards because that is where everything would lie…” (Audit Senior Associate, H-A)

**Threat**

Auditors can persuade others by showing them the possible negative implications, whether individual or organisational, if they did not accept auditors’ judgment. This can prompt others’ GF to accept their view of such issues. Negative implications can include, for instance, threatening to qualify the audit report, or to escalate the issue to the board of directors or specifically the audit committee.

“…sometimes if you just say to someone you are wrong, what is the person going to do? They are just going to get defensive. I think you need to show them all the facts and circumstances that back something up and then go and say right, my conclusion as an auditor is that this needs to be disclosed, this is significant, it is going to affect the thing.” (Audit Manager, AX-Q)

Some interviewees openly acknowledged that they are often successful in applying a threat of escalating the issue by reporting it to the audit committee. This suggests that auditors may attempt to effectively trigger client personnel’s GF, such as a fear of a form of retribution instigated by the client’s oversight boards.

“…they do not want to do it and we say right you do not want to do it, that’s fine, but we will just propose adjustment and put it in the paper to the audit committee. Then they say they are going to do it.” (Audit Assistant Manager, W-Q)

Auditors can also use the threat of qualifying the audit report as another means of persuading the client. In reality, this option is seldom used by auditors due to the implications of a qualified opinion, such as increased regulatory scrutiny. Nevertheless,
some respondents did claim to have raised this threat, thus prompting a change in client position.

“…if you are not doing it our opinion would be qualified and we would inform shareholders of this and put it in our representation letter… So it is like a threat… Because otherwise, you do not have any other threats.”
(Audit Assistant Manager, W-O)

“…I have had discussions with some clients, if you do not give us this… This is how the opinion is going to come like. So, do you want this one or do you want to give us this?’… But again, qualifying is not as easy, because the question is if you are qualifying one area, are you really sure the other areas are fine? And then in the following year, if you qualified last year, if you are not qualifying anymore, you need to go through judgement again. Is it really now ok? Qualifying should really be last option. You do not want to do that, but if you happen to do that, then a lot more judgement goes on.”
(Audit Manager, T-T)

7.2.3 Interpersonal Relationships

Social ties (prior relationship)

Auditors’ social ties as, for instance, friends, allies, and familiarity (prior relationship) with others may persuade others to accept their sceptical judgment. However, as auditors’ interaction with others is a two-way process where each side attempts to influence the other, they may also be influenced by such social ties factor to accept others’ judgment (explained further in Chapter 6). As discussed in Chapter 6, auditors may build a relationship (become familiar) with the client management personnel when the client is a continuing one. This familiarity which includes their understanding of the client personnel’s personality may serve auditors in persuading clients to accept their challenge. For example, the participants displayed that they may not need as extensive efforts to persuade ex-auditors who work in the clients’ finance department as others. They implied that since these people were once auditors they tend to appreciate the objective of auditors’ work.

“You know, you build a relationship with them, that actually after a couple of meetings you can get a feel as to, oh right so this is how this client likes to be handled and then what you try and do is mirror their social style almost to get the most out of them, from a relationship point of view.”
(Audit Senior Manager, I-A)

Participants explained how their initial GFD about failing to detect material misstatements can be alleviated when interacting with people who have previous auditing experience and who forgive being challenged, since the objective of the
auditors’ work is understood. Participants implied that they may see those people as allies, because they have previous experience in the auditing profession and may therefore appear to be more cognisant of the merit of auditors’ work. This view is supported by Albrecht, Mauldin and Newton (2018) and Favere-Marchesi and Emby (2017) studies, which have asserted that auditors tend to favourably view the client management personnel’s accounting competence and accordingly reduce their response to the high-risk issues when the client personnel exhibits strong accounting/auditing experience (ex-auditors). Therefore, the participants commented that since they increasingly observe people who are ex-auditors, who might foresee auditors’ challenges, joining clients’ finance departments, they need to be fully prepared before interacting with them as otherwise they might fall into accepting what these people are saying in order to avoid looking incompetent.

In comparison, participants emphasised the difficulty of interacting with non-financial people who may not understand audit work and perceive auditors’ challenges as a personal attack, which can cause negative reactions. These reactions can prompt auditors’ GFD that these people might be doing something inappropriate. Although the participants emphasised that they feel more discomfort about being misled when interacting with experienced client personnel, they did describe feeling less uncomfortable in their interactions with financial people. This may be due to the perception of seeing financial people as allies (i.e. speaking the same language) who might have worked in the audit profession and so understand the auditor’s position.

“…there’s a lot of finance professionals who are ex-auditors... These are people because they’ve done the audit, maybe they’ve done it to the level of manager in the Big Four, they know their stuff, they’re not stupid. For example, you’d have been saying to them look, this is what I’m going to do and this is what I’m hoping to find and if I don’t find that then I’m going to propose an adjustment, and nine times out of ten they are people who come from the audit profession themselves... They usually understand. So, they’re in the loop. They know what’s going on…” (Audit Assistant Manager, S-Q)

“…they bring in non-financial people: sometimes CEO comes in and he gives his own logic which he doesn’t have any kind of idea about finance… They try to pressure tactics and try to get things done...” (Audit Assistant Manager, W-O)
The social interaction that takes place between auditing colleagues can shape auditors’ GFD and eventually their challenge to client management. When auditors are uncomfortable about speaking to their superiors on certain issues due to how they are perceived by them, they could instead speak to/interact with their peers/colleagues who they may consider friends. Those friends may have had different experiences and so can help to either alleviate/increase the level of discomfort about certain issues.

“… I’ve built a good network and I think that’s very important across the firm where I could call friends of mine, people I saw as friends and just consult with them on issues that would help me to know if I was making the right judgements and if I was missing anything.” (Audit Partner, R-A)

“…so you have friends… colleagues …I might be asking them some stupid question that I might have…” (Audit Senior Associate, SB-T)

As detailed in Chapter 6, auditors audit with a level of GFD, which means they might err and consequently fail to meet their reviewers’ expectations. In the review process, internal reviewers utilise their social interaction with junior auditors, for instance, to form juniors’ GFD, which shapes their sceptical attitude. While the internal reviewers tend to show junior auditors the significance of maintaining a good relationship with client management, they are inclined to construct junior auditors’ GFD by challenging them (e.g. asking them different questions that external reviewers might investigate) because the reviewers accept ultimate responsibility if things go wrong. However, when senior auditors socially interact with their subordinates, their GFD about their juniors’ failure to properly challenge client management and consider the negative scenarios associated with certain issues can be alleviated if they have had a previous working relationship with these juniors or familiarity with their competency (e.g. being qualified).

“Sometimes it can be counterintuitive, but actually, you go, well this person I've worked with so long, if they say it's right, it must be right. But you generally, rightly or wrongly I think you give newer team members more of the time than you do people that you've worked with and known over time. So, I think that's just part of human nature.” (Audit Senior Manager, I-A)

Empathy

As illustrated in Chapter 6, auditors’ GFD around failing to maintain a good relationship with the client may soften their communication of their sceptical judgement and lead them to avoid confronting the client management. This is because confronting them can
harm the auditor-client relationship which could harm auditors’ reputation with their superiors. Although auditors might find some issues which may cause them to feel a high level of discomfort and prompt a challenge, they must exercise caution as a poorly/inappropriately communicated challenge could lead to the latter becoming defensive, thus jeopardising the auditor-client relationship. Some auditors’ challenges may be viewed as insulting (e.g. questioning their integrity) or at least threatening to their interests. The participants suggested that while interacting with client personnel, empathy and a desire to build a social relationship by presenting their challenge in a softer, more amiable way can prompt client personnel acceptance. This view complements the findings of Guenin-Paracini et al.’s (2015) study which indicated that in order to maintain a good (cooperative) relationship with client personnel, auditors may attempt to strategically exhibit such good manners and empathy while interacting with client personnel.

“…if you think the client’s been stupid you’re not going to tell them to their face. So you’re very open, but when you’re presenting it to the client you have to be a bit more humble about it, a bit more diplomatic.” (Audit Assistant Manager, S-Q)

“…we try and be pragmatic with the management to make sure they agree with… we as auditors cannot push them. We are not there to correct them, we are there to guide them… to be honest, you have to be very diplomatic with them …” (Audit Manager, S-T)

As a final point, at times auditors might not be successful in prompting others to accept their sceptical judgement by employing these factors and strategies but instead succeed in triggering others’ GF to provide further information, which can modify (strengthen or alleviate) their GFD and consequently their sceptical judgement. For instance, client personnel can only succeed in pushing back an auditor’s challenge if they can provide new information that the auditor may not have previously been privy to. The new information provided in that social interaction may then elicit auditors with a feeling of comfort, which can help diminish their initial GFD regarding client management’s judgement. This is because this new information may, for instance, protect the audit team if things go wrong, or at least help them to survive a review process.

In some cases, participants mentioned that they would not rethink their judgement unless there was someone else challenging them. Social interactions with client management
may lead to new information which can cause auditors to have a different response, which may challenge their GFD. Auditors’ regular social interactions with their audit team members can also introduce them to new information, eliciting the same effect. For example, participants explained how they might present their judgement that a certain accounting issue is risky and should be challenged further, but then the others might reveal new information that has not been communicated before, alleviating the initial GFD. In the case of a strong GFD on a particular issue, participants suggested that they would need certain evidence from client management to allay fears and significantly alter their initial GFD.

“… the client might turn around and give you a bit of information which completely blows your case out the water, or they might not do so.” (Audit Assistant Manager, S-Q)

“…some information is held by the partner or manager, and this information is not well trickled down to the person at the bottom of the engagement hierarchy. So… When you discuss it with the manager then they say, well, this is not an issue, they have already provided this, I’ve seen this and that and I’m ok with it...” (Audit Assistant Manager, Y-T)

“…Because of the experiences you have had …you tend to go in the right direction but yeah if a colleague says you are looking at this wrong that would force me to rethink…” (Audit Partner, Z-A)

The participants provided examples of the types of new information which others may communicate in such interaction causing them to reconsider their initial GFD. These include facts that had not been communicated, new evidence that had not been revealed before, or a new understanding (interpretation) of accounting standards that they had not applied before.

“…if management was able to provide you evidence which supports their position and you find it reasonable then that will make you re-think your own judgement. It’s not about ego, I have made a judgement so it must be right. Fact-based, if management is able to provide evidence to support their position… Fine.” (Audit Senior Manager, Raf-T)

“Basically, it’s more about a discussion, you tell them, I’ve considered these IFRS requirements, this line says this, and the practice of the client is completely contrary to what they were thinking… And maybe your managers or senior managers can say, but in that standard there is this exception that they can take on, and you’d be like, okay, I haven’t considered everything correctly.” (Audit Assistant Manager, T-O)
7.3 Summary
This chapter continues explaining the PSPM. It has specifically investigated the role of social interaction in the process of PS in auditing. It shows that auditors’ social interaction with others is important to their practice of PS in two ways: Firstly, others’ reactions (verbal and non-verbal clues) can intensify or alleviate their GFD to develop a sceptical judgement to continue/stop challenging client management. Secondly, auditors use such interaction to act on their sceptical judgment and dedicate certain efforts to influence others to accept their sceptical judgment.

As Chapter 6 discussed to an extent the way that auditors’ GFD can be triggered by others’ communication of certain verbal or non-verbal signals in a social interaction, this chapter focused more on providing empirical evidence which shows how auditors may communicate their sceptical judgment during such interaction and devote certain efforts to influence others to accept their challenge. For example, auditors may employ extra efforts to persuade others’ to accept their sceptical judgement when interacting with others with regard to judgemental accounting issues in particular because they by definition involve ambiguity and can give rise to conflict. Thus, in order to persuade others (e.g. client management personnel and audit team members) to accept such challenge, auditors were found to utilise certain factors and strategies which can be categorised into: rank/seniority, reasoning and persuasion, and interpersonal relationships. These factors and strategies show that auditors may utilise their social ties (e.g. pre-existing social relationship) as much as reasoning efforts (e.g. a reference to regulation and similar examples) to persuade others to accept their view. The chapter also displays that such interaction with others is a two-way on-going process where auditors are challenged as much as they challenge others.

Additionally, this chapter has shed the light on certain instances where the reasoning efforts (evidence and procedures obtained) that auditors are generally expected to rely on to support their argument and influence others to accept their judgment may become the primary factor shaping their sceptical judgment. These instances were highlighted (early on in auditors’ careers) where they might not be prompted to have a specific initial GFD when auditing certain fact-patterns, although auditors are generally allocated tasks
commensurate with their experience. In these instances, they would tend to rigidly follow their superiors’ orders or the audit methodology guidance. However, this type of case is quite rare, as invariably auditors will usually have some knowledge which can elicit a certain feeling when presented with a particular fact-pattern. In other instances, auditors’ reasoning efforts may trigger a different feeling which may influence (modify) their initial feeling (GFD) and accordingly reconsider their sceptical judgment.

This chapter has introduced evidence that shows how auditors’ social interaction with others is important to their PS practice and how auditors act on their sceptical judgment in such interactions to influence others to accept their sceptical judgment. These findings help revealing an important aspect of auditors’ PS process in making their everyday professional judgement.
Chapter 8: Discussion and Conclusion
8. Introduction

This chapter summarises the empirical evidence reported in this study, discusses possible practical implications arising from those findings and makes some suggestions for future research. The main findings of this thesis have been presented and discussed in Chapters 5, 6 and 7, where the perceptions of professional auditors working in different positions in the audit team hierarchy regarding how PS is applied in practice were investigated. This thesis contributes to the literature on auditing, the JDM process and comfort in decision making by developing the theoretical and empirical approaches to understanding the meaning of the PS concept and its practice. Rather than relying on hypothetical proxies for PS, the study focuses on how professional auditors themselves internalise and process PS. Specifically, it provides an explanation of auditors’ own conceptualisation of the PS concept and its constructs, the process by which these constructs interact to influence PS practice, the role of auditors’ social interactions with others in shaping PS practice and the role of GF (emotion) in the auditor’s JDM process.

Most prior studies in the auditing literature focused on this topic have employed a positivist approach, but this has provided a limited understanding of PS as a practical concept. These studies generally construct hypotheses derived from different philosophical, organisational and psychological theories to predict the association between different factors (e.g. accountability, client pressure and rewards) and certain proxies of PS (such as personal traits, level of risk and proposed adjustments) that could be indicative of variations in the practice of PS and that could show possible cause and effect. This thesis makes a complementary contribution to the body of knowledge on PS practice and the JDM process by opening up auditors own understanding of the PS concept and their application of PS in everyday practice.

This chapter is organised into three main sections. Section 8.1 provides a review of the study’s findings. The contributions to research and the practical implications of this study are highlighted in Section 8.2. Finally, Section 8.3 discusses the limitations of this study and future research opportunities.
8.1 Summary of the Findings

This section summarises the main findings concerning how professional auditors internalise the PS concept, then process it in making everyday professional judgements and the factors that can constrain their practice of the appropriate level of PS. The practical meaning of PS surpasses the debate regarding whether it should be defined as a state, trait or both because professional auditors explained PS as an ongoing process that is initiated and shaped as an emotional state. This emotional state is triggered by certain facts, including those related to social interactions with others, to the environment or to audit tasks. It is channelled through knowledge and experience, particularly concerning certain negative scenarios and finally communicated through certain actions to challenge client management and to meet internal and external reviewers’ expectations. The communication of such sceptical judgment (initiated and shaped as GFD) involves engaging in certain reasoning efforts as well as social interactions with others (e.g. client personnel and audit teammates) which may expose auditors to facts or events that may reinforce or challenge (reshape) their sceptical judgment. As discussed in Chapters 3 and 5, the emotional state is interpreted in the form of GFD, which has the characteristics of the Type 1 thinking process.

In Chapter 5, evidence collected through the semi-structured interviews with professional auditors is used to explain their internalisation of the PS concept in practice. The insufficient exercise of PS has been highlighted (for example in the FRC’s AQR reports) as a frequent auditing deficiency. Prior studies have argued that insufficient exercise of PS can be attributed to the inconsistent understanding of PS (Carpenter & Reimers, 2013; Glover & Prawitt, 2014; Olsen & Gold, 2018; Popova, 2013). The findings of this study reveal important practical insights which can increase the understanding of the PS concept and can resolve certain inconsistencies addressed in the auditing literature regarding the nature of PS and how it should be defined. In accordance with Glover and Prawitt’s (2014) continuum, it was found that auditors tend to align their understanding of the PS concept with the risk-based approach to auditing, which is instilled in them from their first day in the auditing profession. The risk is that material misstatements might exist and that they might fail to discover them. Therefore, auditors tend to manifest their understanding of the PS concept with a presumptive doubt perspective, specifically when the risk involved is significant. Auditors embrace this
perspective, demonstrating the PS practice through recalling and appreciating the possible existence of certain negative scenarios which can result in significant negative consequences for the individual auditors, audit team, audit firm or even auditing profession. This appreciation of the possible existence of negative scenarios guides auditors to concentrate more on negative evidence, which disconfirms management’s assertions. However, although the presumptive doubt perspective guides auditors to go beyond the mere collection of evidence to a focus on negative evidence, it was found that auditors focus less attention on the type of evidence irrespective of whether or not it confirms management’s representations when the associated risk is perceived to be insignificant. These findings are important because an understanding of the stance that auditors embrace when exercising PS has been discussed in different ways in the auditing literature.

Since auditors are concerned about a negative scenario, where they might fail to capture material misstatements, it was found that auditors practise audit with a level of GFD. This finding is in line with Guenin-Paracini et al.’s (2014) findings that auditing as a work activity is associated with a feeling of fear as well as with other studies that have described auditing practice as a process (Carrington & Catasus, 2007) or a ritual (Pentland, 1993; Power, 1997) used to produce comfort in society. Auditors were found to internalise the PS concept in the form of an emotional state which initiates and shapes the PS process. Auditors’ GFD is informed by their accumulated knowledge and is prompted when certain facts or events are available. Therefore, once certain triggers are observed, auditors’ GFD is automatically elicited, recalling certain negative scenarios, which can go against what client management prescribes, forcing certain pertinent questions to be asked.

The knowledge that informs auditors’ GFD reflects auditors’ different experiences, which accumulate over time and are used to interpret certain patterns of evidence, whether discomforting or not. When auditors’ GFD is intensified auditors are more likely to challenge client management by actions such as posing difficult questions and asking for further information in order to avoid the perceived potential negative consequences. The role of auditors’ GFD in initiating and shaping their sceptical
judgement has been emphasised and that aspect of PS has been strongly linked to their accumulated knowledge and experience in auditing different clients and issues.

This study shows the significance of knowledge and experience in informing auditors’ GFD, and accordingly their PS practices, to the extent that the lack of knowledge and experience represents a major constraint on auditors’ exercise of PS. These findings demonstrate that the substance of PS is primarily manifest in an emotional state (GFD). This study also shows that certain audit traditions (e.g. respecting the audit team hierarchy or following a firm’s audit methodology) might constrain junior auditors in particular from reacting to the available facts or events and from responding to their GFD because their GFD about violating the traditions and harming their reputations can override their GFD about missing material misstatements. Specifically, when auditing judgmental accounting issues regarding which rules are indefinite and complex, auditors feel relieved from their GFD that material misstatements might exist by simply “ticking” as many boxes as they can from the audit methodology’s checklists or by following what superiors instruct. Hence, the increased standardisation of auditing practices was found to reinforce a checklist mentality, which can constrain auditors from exercising the appropriate level of PS by intensifying their feeling of discomfort regarding violating the efficiency objective to outweigh their GFD about the possible existence of material misstatements.

The findings reported in Chapter 6 supplement those above by explaining PS as a process. The PSPM is presented based on the review of the relevant literature, the SIM theoretical lens and the analysis of the interview evidence. This model explains how auditors’ sceptical judgement is mainly initiated and shaped as an emotional state (GFD) and processed until it is reflected in sceptical actions. It explains the process through which auditors’ can be prompted to have different conflicting feelings of discomfort, which eventually form their judgement regarding whether to challenge client management.

PS practice is dependent on auditors’ exposure to certain facts or events, which trigger their GFD, which in turn initiates and shapes the PS process. These triggers vary to include matters that are related to the task under consideration, such as client
characteristics, including verbal and non-verbal signals and the external environment surrounding them and their clients. When auditors’ informed GFD is triggered by certain facts or events, certain sources of GFD prompt auditors’ interpretations of those facts or events as being discomforing or not and accordingly shape their judgement regarding whether to initiate any action. The sources of GFD were found to be strongly linked to perceptions of the reviewers’ (internal or external) expectations, including sufficiently challenging client management, maintaining a professional reputation and maintaining a good relationship with clients. Based on these sources of GFD, auditors’ accumulated knowledge recalls certain negative images, reflecting the negative consequences that may follow as a result of violating reviewers’ expectations.

These perceived negative consequences vary to include being subject to certain penalties and sanctions, individual or organisational reputational harm and damage to auditors’ commercial objectives. These consequences can prompt auditors to experience different and conflicting feelings of discomfort, but the strongest GFD, whether related to harming a reputation or a relationship with a client, shapes an individual auditor’s PS practice. The study has shown that once auditors’ GFD about the possible existence of material misstatements strongly outweighs other feelings of discomfort, auditors’ feeling of the need to respond intensifies, reinforced by possible negative scenarios, prompting them to ask and prompts compelling questions. Answering these questions involves engaging in certain observable actions, such as applying additional testing and communicating their discomfort to client management in the form of posing further questions (including asking for additional evidence) or proposing certain adjustments. On the other hand, the study has also shown that when auditors’ GFD related to harming their commercial objective is the prevailing feeling, it shapes their sceptical judgement in a manner that may lead them to stop challenging client management or at least to soften their communication of the challenge to client management. These findings can provide an interpretation of the threshold that Nelson (2009) identified as the point where auditors reflect their sceptical judgement in actions, in the sense that the threshold can be linked to the tension between different feelings of discomfort and comfort.

The evidence discussed in Chapter 7 indicates that auditors relate their sceptical practice to their daily social interactions with others (e.g. client management personnel and audit
team members) to the extent that PS practice is generally highly dependent on social interactions. It should be emphasised that this social interaction is an ongoing process in which each side attempts to influence the other to reinforce (accept its position), change or initiate certain judgements. Social interactions shape and refine, often simultaneously, auditors’ PS practice in two ways: being triggered to feel comfort or discomfort by certain verbal/non-verbal messages communicated by others and embodying PS practice in the form of challenging (e.g. asking difficult questions or asking for further evidence) client management.

This study has identified that auditors’ GFD, specifically in relation to judgmental accounting issues where there is no conclusive evidence, cannot be alleviated without some reasoning efforts (e.g. evidence obtained or further procedures exerted) in order to persuade others and satisfy reviews of their activities. Because auditors cannot continue conducting reasoning efforts (audit procedures) infinitely; rather they direct these efforts to the point where they can protect themselves if challenged by others. However, reasoning efforts might uncover additional facts that can confirm or alter auditors’ initial GFD and reshape their sceptical judgement to continue or stop challenging client management. These findings complement and extend Carrington and Catasus’s (2007) findings by showing how the tension between feelings of comfort and discomfort plays a significant role in shaping auditing practices through the exercise of PS.

Auditors’ social interactions with client personnel and audit teammates are a significant construct of PS. These social interactions have been highlighted in that PS may not be acted upon without socially interacting with others through different meetings and discussions. The time pressure involved in the auditing process adds to the significance of auditors’ social interactions with others in shaping their PS practice. Through these interactions, auditors can be exposed to different verbal/non-verbal signals arising from the client personnel’s behaviours or representations, which can intensify or alleviate their GFD and can shape their judgement. Because each party in these interactions simultaneously attempts to persuade others, auditors employ certain factors and strategies to persuade others to accept their sceptical judgement. These factors and strategies were found to include: rank/seniority (in terms of age and position), reasoning and persuasion, and interpersonal relationships. For instance, when the interaction is
with client personnel, factors and strategies that auditors may use to persuade them could include referencing regulations, using examples of precedent, threatening to qualify the audit report and threatening to escalate to more senior management (e.g. the audit committee). However, the study also suggests that although auditors consider the qualification of the audit report a powerful strategy (threat) to persuade client personnel to accept their viewpoint, they rarely employ this option because it can have negative implications for them as well. This complements the findings of Guenin-Paracini et al. (2015) that auditors may strategically strive to avoid “brutal enforcement options” in order to maintain good (cooperative) relationship with client management.

In addition, the study has shown that if auditors socially interact with their audit team members (specifically their superiors), they generally attempt to persuade them by demonstrating that the issues that they are challenging are risky enough to have a negative consequence on the audit individuals’ and the firm’s position in review processes. They also attempt to persuade their superiors who have a feeling of discomfort that they might not have properly understood the issues by highlighting the robustness of their efforts and how these efforts give them a better understanding of the issues.

The findings also suggest that auditors can persuade others to accept their sceptical judgement (or at least to consider a move to common ground) or can be persuaded to alter their sceptical judgement. For example, if client personnel are on the other side of the interaction, they may attempt to persuade auditors by exhibiting intimidating behaviours, involving high-level representations, emphasising their commercial relationship with auditors and highlighting their better knowledge of their business.

As mentioned above, it was found that auditors may employ certain factors and strategies (rank/seniority, reasoning and persuasion, and interpersonal relationships) to persuade others to accept their sceptical judgment. For instance, junior auditors’ GFD regarding possible harm to their individual reputations can lead them to reduce their challenge and accept the position of seniors or ex-auditor client personnel or their superiors, deferring to their seniority and experience rather than reasoning efforts. Similarly, audit partners might effectively persuade client personnel to accept their
sceptical judgement based on their seniority, which involves, for example, their competency and accessibility to the client’s upper level of management.

The study has also indicated that when auditors avoid confronting client personnel and attempt to communicate their challenge in a softer manner, showing empathy and understanding of the client position, they can persuade client personnel because they are friendly and social. Auditors also rely on their reasoning efforts which others (specifically reviewers) expect them exhibiting in order to influence others to accept their sceptical judgment. These reasoning efforts mainly involve, among others, explaining the possible negative implications for client personnel and the organisation by benchmarking against the market, industry and previous cases, the evidence gathered and reference to the standards and guidelines. It is worth noting that these different factors and strategies might be used concurrently to persuade others to consider and accept auditors’ judgement.

Further, the findings of this study indicate that auditors’ lack of knowledge may constrain their ability to recall specific scenarios where certain GFD can be strongly elicited to initiate and to shape a specific sceptical judgement. Thus, the reasoning efforts that are dictated by auditors’ superiors or by a firm’s audit methodology and its outcomes (evidence) can shape their judgement regarding whether or not to challenge client management. However, it was found that it is rare that auditors audit a fact-pattern without having a specific feeling that is developed by their accumulated knowledge. This is because they gain considerable knowledge related to clients’ risky operations and transactions during audit engagement planning meetings, and audit tasks are usually allocated in a manner that ensures that the issues are being handled by auditors with the appropriate experience. These findings show that auditors usually have a certain initial GFD (more or less discomfort) that commences and shapes their sceptical judgement and approach to procedures to employ. Accordingly, it was found that during such reasoning efforts that auditors engage in to satisfy themselves and support their argument to influence others to accept their judgment, they may learn new information (e.g. new facts, evidence or standards) which may elicit a different feeling which can influence (modify) their initial feeling (GFD) and hence make them reconsider their sceptical judgment.
Although auditors might not succeed in persuading others to accept their sceptical judgement, they might succeed in obtaining further (new) information, which can in turn modify (strengthen or alleviate) their GFD and accordingly their sceptical judgement. When auditors are exposed to new information while challenging client personnel or consulting audit team members, the new information can prompt feelings of comfort/discomfort that can heighten or diminish their initial GFD that a material misstatement can exist. The dominant feeling, which wins the contest, constructs auditors’ sceptical judgement to continue to challenge the client or not. New information may comprise new evidence, new events or facts that they had not considered or new regulations that they had not properly recognised.

8.2 Contributions and Implications of the Study

By using a theoretical perspective from the field of psychology and a qualitative research approach, this study makes a theoretical and empirical contribution to the research fields of auditing (specifically PS literature), the JDM and the theory of mind (dual process framework) literature. The study provides a new perspective in interpreting PS practice as a process that is initiated and developed as an emotional state, emphasising the role of GF in the auditor’s JDM process and providing empirical evidence that demonstrates how professionals’ feelings of comfort/discomfort can be more related to their own well-being than those people they are acting on behalf of. The majority of existing literature on PS provides a mixed and varied understanding of PS and a limited interpretation regarding the way in which this concept is manifested by auditors in reality. The SIM was used to highlight the substance of PS and its cognitive constructs, the process by which PS is constructed by professional auditors and the role that emotion plays in JDM within the audit process. This introduces a new understanding of the PS concept, which considers the complexity associated with applying PS in practice and explains the process by which auditors develop their everyday professional judgement.

The thesis responds to calls by both regulatory bodies and academics for further research to explore and to explain the ‘backstage’ of PS on practice, particularly its substance, constructs (Brazel et al., 2016; Knechel et al., 2018; Olsen & Gold, 2018; Ying, 2015)
and application (Glover & Prawitt, 2014). The insufficient exercise of PS has been a cause for concern for some time and continues to be highlighted as a significant deficiency in auditing practice (BEIS Select Committee, 2019; CMA, 2019). This thesis extends prior studies by exploring and explaining the practical meaning attributed to the PS concept and the role of emotion in the auditing JDM process (e.g. Brazel & Schaefer, 2015; Commerford et al., 2016; Glover & Prawitt, 2014; Hurtt et al., 2013; Olsen & Gold, 2018). It responds to the call for qualitative research to obtain insights from the auditing practical context in order to improve understanding of PS (Brazel & Schaefer, 2015).

The literature has suggested that PS studies should investigate its complexity and multifaceted nature (Glover & Prawitt, 2014; Hurtt et al., 2013; Toba, 2011; Ying, 2015). Some have criticised prior studies for investigating different auditing practices, including the PS practice, in a “black box” manner, which has limited the understanding of these practices (Humphrey, 2008; Power & Gendron, 2015; Sikka et al, 2009). This thesis therefore provides methodological and empirical contributions by employing interviews as the main data collection method and including professional auditors working at different levels of the audit team hierarchy as research participants to explore and explain their perceptions of the practical meaning of PS. The findings induced from the professional auditors’ interpretations of their experiences demonstrate the complexity of PS and show the process through which auditors’ PS practice is shaped and communicated. In particular, this study highlights the affective nature of the PS process and its importance in auditors’ everyday professional judgement (Bhattacharjee & Moreno, 2013; Commerford et al., 2016; Nolder & Kadous, 2018; Olsen & Gold, 2018).

Professional auditors’ internalisation of the PS concept and interpretations of the process by which they practise PS extends the understanding of PS in a number of ways. Firstly, this study suggests that auditors associate their exercise of the appropriate level of PS with the presumptive doubt perspective, which stresses the recognition of the possibility that material misstatements exist. However, although the presumptive doubt perspective encourages the collection of contradictory evidence, as auditors are aware of negative scenarios to which they might be vulnerable, this orientation towards contradictory
evidence lessens when the risks associated are perceived as insignificant. This is because reviewers are expected not to focus on these areas, and any type of evidence can defend auditors’ positions if challenged by others. An emphasis on the presumptive doubt perspective when defining the PS concept may therefore enhance auditors’ practice of PS.

Secondly, the literature has provided varied approaches to understanding the nature of PS (whether it should be defined as a trait, a state or both) and its constructs. The findings of this study also contribute by providing a different perspective to explain the PS concept as a process. This process is initiated and shaped as an emotional state (GFD) regarding the possibility that a material misstatement can occur, but this GFD must be strong enough to initiate and determine auditors’ judgement and eventually lead to sceptical actions. This process also complements studies that have considered the practice of PS in auditor-client management relationships by emphasising the role of auditors’ social interactions with others in shaping their PS practice.

An additional contribution to the auditing and JDM literature is that the empirical insights from the accounting profession explain the role that an affective process (GF) plays in constructing auditors’ everyday professional judgement. This study brings to light another way of demonstrating how professionals’ GFD interacts with their reasoning process to shape everyday professional judgements. The findings demonstrate that auditors’ GFD shapes their judgement regarding the sufficiency of audit evidence and procedures. Thus, this study does not limit the auditor’s JDM process to the reasoning system as is common in prior studies. Both types of thinking systems (GF and reasoning) are assigned a role in constructing auditors’ professional judgement and the function of GF, which prior studies may not have emphasised sufficiently, is considered.

In addition, this thesis highlights an additional aspect of the feeling of comfort or discomfort that professional auditors experience while practising an audit. It explains how professionals’ (auditors’) feelings of comfort or discomfort can be mostly generated by their concern for their own wellbeing (personal factors) rather than the wellbeing of those whom they are professionally required to protect by their assurance services. It shows that auditors do not only feel discomfort because such accounting treatment is
odd, incomplete or incorrect and can harm the public interest, but rather they mostly feel discomfort because it can harm their personal wellbeing. In contrast, prior studies in nursing and other disciplines have focused on explaining that professionals can have a feeling of discomfort about, for example, the wellbeing of patients for which they provide a service. They feel discomfort that something is wrong that could result in patients’ death or severe health deterioration. However, this study shows that auditors’ GFD can be mostly stimulated by the reviewers’ expectations, which if violated, can result in certain negative consequences for auditors’ wellbeing (personal factors) as professionals.

This study also contributes to explaining how auditors use their accountability to reviewers to generate and to colour their emotional reactions, their understanding of risk to tailor their practice of PS, their accumulated knowledge to interpret certain events or tasks as discomforting or not and their relationship with client management to demonstrate their practice of PS. It shifts the questions about PS from focusing on examining PS as a personal trait (e.g. interpersonal disposition to distrust), which may not be possessed by all auditors, or a state that is only accessed in a deliberate manner towards broader questions that treat PS as a process with certain constructs. It provides a more holistic consideration of the different stages of PS, including its initiation as a GFD, the tension between different feelings of discomfort and comfort and the communication of sceptical judgement to others in the form of observable actions.

Additionally, the findings of this study challenge the argument implied in the auditing literature that PS is mainly a conscious cognitive state in which emotions (GF) have either no function or a weak one. Although this study does not argue that auditors practise PS based on mere emotional valence, it provides a holistic explanation of PS as a process in which auditors’ accumulated knowledge informs their GF to react to certain fact-patterns in a particular way and accordingly shape their judgement regarding whether to challenge client management. Responding to prior calls for more consideration of the two dual process framework (theory of mind) in studying auditors’ professional judgement (e.g. Griffith et al., 2016), the study contributes empirically to the auditing JDM literature by providing practical evidence on the important role that auditors’ GF plays in the auditing JDM process.
The social interactions that auditors have with their client management personnel and audit teammates are an important construct in explaining auditors’ practice of PS, as shown in the PSPM presented in Chapter 7. In this way, the study complements the findings of previous studies, which have attempted to proxy auditors’ practice of PS through their likeability (relationship) to client management personnel (e.g. Schafer & Schafer, 2018; Aschauer et al., 2017). However, this study provides a further explanation that emphasises auditors’ social interactions with client management because in these interactions: auditors are exposed to the fuller fact-pattern, and persuade client management personnel to accept their sceptical judgement, which is communicated by certain sceptical actions such as posing further questions, asking for more evidence or proposing an adjustment. Moreover, although the findings of this study complement previous studies, which have highlighted the influence of accountability on auditors’ exercise of PS, they also indicate that displaying accountability not only to superiors but also to external reviewers can contribute to developing auditors’ GFD. The PSPM indicates that internal and external reviewers’ expectations generate different feelings of discomfort that shape and refine their subordinates’ PS.

This study responds to calls for qualitative studies to expand the understanding of auditing practices, specifically PS practice, by providing an in-depth exploration and explanation of the practical meaning of the PS concept and the process by which PS is applied in practice (Brazel & Schaefer, 2015; Power & Gendron, 2015). Empirically, this study provides an overview of PS that considers the complexity associated with PS by including the different hierarchy levels of the audit team. Since reviewers’ expectations that generate auditors’ GFD might differ based on their positions in the audit team’s organisational hierarchy, the findings provide a broader understanding of these variations (in terms, for instance, of experience and accountability) that explains auditors’ experience with GFD. Exploring and understanding how different levels of the audit team hierarchy internalise and approach PS contributes a richer understanding of PS, which can explain auditors’ internalisation and processing of PS in everyday practice without controlling or excluding certain factors or variables.
The PS practice is explored based on its practical and contextual settings where professional auditors who make sense of PS in reality interpret PS based on their experiences and interactions with others (e.g. client management, audit team members, external reviewers). Rather than examining PS in a controlled experimental design, the interviewees’ interpretations explain the different aspects that are associated with the practice of PS and how these aspects are jointly processed. The interpretations provided in this study offer an overarching view of PS that goes beyond the alternative perspectives in the literature. This study has argued that PS is more than the mere idea of deliberate access to a certain (‘questioning’) mindset, because auditors’ knowledge, experience and the context in which they apply PS by interacting with certain facts, events and people tacitly construct their PS practice. This study has indicated that auditors do not practise PS in isolation but work together with client management personnel and audit team members. The findings highlight that certain aspects of the auditing context, such as internal and external reviewers’ expectations and auditors’ knowledge (e.g. different experiences with clients and tasks), can generate different feelings of discomfort, which shape and refine auditors’ sceptical judgement regarding whether to challenge client management. This contextualised understanding of PS offers a holistic view of PS as a process that captures and explains the role of different aspects (e.g. risk, knowledge, interaction with client management, accountability) in constructing PS practice. This extends prior studies that have focused on independently examining the influence of some of these aspects (variables) on PS practice or that have described their possible influence without supporting empirical evidence.

The findings could have some implications for the regulation of auditing practice. From the point of view of regulators and professional bodies, the implications relate to how policy makers should define the PS concept in a more practice-focused way that can encourage auditors to better exercise the appropriate level of PS. The findings have shown that the conceptualisation of PS should explicitly reflect the presumptive doubt perspective as the preferred perspective to embrace the exercise of PS, as auditors tend to internalise this perspective. This can reduce the level of inconsistency associated with the understanding of PS, which can be attributed to the emphasis on the neutral perspective that correlates more with the commercial objective. An emphasis on presumptive doubt should not be confused with the expectation gap discussion regarding
auditors’ fraud detection responsibility because auditors know that they are expected to be responsible for challenging client management. Therefore, the emphasis on the presumptive doubt perspective need not increase auditors’ responsibility as much as it renders the requirement of challenging client management more explicit and prevailing.

The study’s findings can encourage regulators to increase the level of scrutiny (monitoring) not only on auditors’ work but also on audit firms’ internal control policies, specifically the review process. When the review process is greatly focused on challenging client management, it can strengthen auditors’ GFD regarding the possible existence of material misstatements to outweigh any other feelings of discomfort about failing to satisfy the efficiency and commercial objectives. This includes holding not only the partner but every level of the audit team accountable for their challenge to the client management and linking this to certain consequences on individual auditors. Similarly, this study highlights the importance of associating auditors’ violation of the PS requirement to certain penalties and sanctions because these negative consequences can strengthen their GFD to the extent that it overrides any other feelings of comfort/discomfort that constrain their practice of PS. Therefore, this study challenges the argument that the focus should be shifted from penalising auditors when they fail to rewarding them when they succeed in exercising costly PS even if no material misstatements are found (Brazel et al., 2016), and complements the findings of Brazel et al. (2018), who could not identify a clear impact from rewarding costly PS behaviour on levels of PS.

In addition, the study findings can encourage regulators and audit firms to direct further efforts towards specifically training auditors regarding the negative scenarios that can occur intentionally or unintentionally for certain accounting issues. This is important because when auditors only accumulate positive experiences and knowledge that do not recognise the possible negative scenarios by which material misstatements can occur, they become blinded from the fuller picture in which certain facts or events prompt their GFD that certain material misstatements might exist. This study has also shown that auditors’ accumulated knowledge plays a significant role in drawing auditors’ emotional reactions to certain fact-patterns. Therefore, auditors’ knowledge of negative scenarios with regard to certain fact-patterns obtained from practical experience or learning about
their existence in classroom training can strongly prompt auditors’ GFD, to the extent that they cannot feel comfortable without further challenge to client management.

This study has also indicated that although audit firms invest in certain technologies to conduct audit work efficiently, auditors still have the responsibility to practise PS, which is greatly dependent on their social interactions with client management personnel or audit teammates. This study demonstrates that auditors’ social interactions with others are essential to properly practise PS. Thus, this study may encourage regulatory bodies and audit firms to mandate specific training in certain skills, such as communication and negotiation skills, in addition to the technical auditing and accounting training to assist auditors in better communicating and persuading others to accept their sceptical judgement without being constrained by their lack of knowledge and communication skills.

8.3 Limitations and Future Research
Although the findings of this study may have introduced a number of contributions and implications, certain potential limitations should also be noted.

First, there are limitations related to using interviews as a data collection method, related to participants providing answers that they may perceive to be more socially desirable rather than that reflect what they actually do, and to the interviewer’s influence on the participants’ answers (Daymon & Holloway, 2002). However, carefully constructing the interview guide, providing participants with sufficient flexibility and reciprocity, allowing them to freely and openly answer the interview questions, and obtaining similar interpretations from professional auditors working across the audit team hierarchy may have helped in reducing the possible bias and increasing the validity of the data collected from the interviewees (Cook, 2008; Diebel, 2008; Jensen, 2008; Miller, 2008a; Miller, 2008b; Plano Clark, 2008; Roulston, 2008).

Second, observing auditors’ everyday practice in the context actual of audit engagements and analysing some audit firms’ organisational documents (e.g. performance appraisal forms, reviewed audit files) would also be useful in terms of providing insights into PS practice. Although audit firms were invited to nominate individual auditors to participate
in the study, gaining access to audit firms at the organisational level was not successful. Therefore, access to these types of data was not possible. However, the primary focus of this study is on individual auditors’ interpretations and experiences rather than the audit firms’ official policies and their organisational environments and the evidence collected from the variety of participants satisfies the objectives of this study. Future studies could provide further insights into the role of audit firms’ organisational environments on the development of PS practice by following a more ethnographic type.

For this study, the sampling was opportunistic. Thus, the number of participants from each accounting firm and management position of the audit team differs. For instance, some of the audit firms or management positions might have slightly more representative participants than other audit firms or management positions. However, since the SIM and the PS literature highlight the role of experience, the sample was purposely constructed to cover this key factor. Participation in the study was restricted to auditors with at least one year of experience to ensure participants’ awareness of the topic and accordingly to increase the reliability of their statements. As this study focused on exploring and explaining auditors’ internalisation and application of PS practice, the analysis is mainly based on more experienced auditors’ interpretations of their experiences, but it also includes perceptions across different levels within audit teams. In focusing specifically on professional auditors’ perceptions and interpretations, another potential limitation is that the study did not include other key parties who can influence, or observe, the practice of PS, such as regulators and client management personnel. Future research can extend the findings of this study by investigating the perceptions of these key parties in relation to auditors’ practice of PS.

Finally, using a qualitative research approach involves some limitations, such as the potential lack of generalisability and the high subjectivity that might exist in the research process. Qualitative research designs do not aim to provide generalizable findings because interviewing a representative number of participants might take a long period of time and is not practically feasible (Daymon & Holloway, 2002; Donmoyer, 2008; Lewis & Ritchie, 2003). Future studies can extend the findings of this study by using surveys to expand the number of participants and to increase the generalisability of the findings. However, semi-structured interviews, which represent the main data collection
method of this study, satisfy the objectives of the study to reveal individual auditors’ perceptions of PS and to specifically identify the constructs and process through which they make sense of their practice of PS. As explained in Chapter 4, efforts were made to develop research procedures in a robust and rigorous manner, including the collection and analysis of the research data. Although efforts have been made to address such limitations, acknowledging their potential impact is important to help position the study in the broader context of the research field this study contributes to. These limitations can also prompt some suggestions for future research.

For example, as noted above, an ethnographic study, which includes observations of auditors’ everyday practice and work environment and access to organisational documents, could provide further insights and a more holistic view to supplement and to extend the PSPM. Such research would have to overcome significant challenges regarding gaining access to audit firms, including access to organisational documents or attending audit team meetings and meetings with client management. The PSPM highlights the role of culture and organisational norms that enrich auditors’ knowledge with certain experiences that colour the emotional state that shapes and refines their PS practice. An ethnographic research approach, which can help researchers to experience the process by which PS is constructed, could extend the findings of this study by exploring how the cultural and organisational factors influence the PS process. Future studies could also examine how organisations perceive the practice of PS when new technologies (e.g. artificial intelligence tools and big data analytics) are increasingly recruited to help conduct auditing practice. They could explore how accounting organisations employ technologies to encourage the practice of PS. This may be relevant because the PSPM highlights the role of internal reviewers’ expectations, which can channel auditors’ GFD, and the employment of these technologies may alter or redefine these expectations.

Additionally, the PSPM emphasises the role of other parties, such as external reviewers and client personnel, in influencing and channelling the emotional state that initiates and shapes auditors’ practice of PS. It would be particularly interesting to explore how the external reviewers perceive auditors’ practice of PS at the organisational and individual levels as well as how they internalise the appropriate practice of PS. This could extend
the findings of this study to investigate whether PS is more or less than what is perceived and criticised by reviewers in reality. The findings of this study highlight the role of auditors’ social interactions with client management personnel in influencing auditors’ experience of GFD and accordingly their practice of PS. Future studies could further explore auditors’ social interactions by including participation from client management personnel, in order to investigate how they perceive auditors’ challenges and whether they strategize to influence auditors’ PS process.

The findings of this study, which emphasise the role of emotions in auditing practices and explain the interaction between GF, which is cognitively produced, and the reasoning process, might also suggest future research to further examine the significant role that emotions play in constructing auditors’ practices. The PSPM can inspire future studies investigating auditing JDM to creatively design studies to explain the auditing professional JDM process beyond the predetermined hypothesis that auditing is solely based on reasoning (evidence). For instance, future studies could consult neuroscience to help examine auditors’ minds and accordingly explore the emotions that play a role in the auditor’s JDM process and its interaction with reasoning. This is important because the findings of this study explain that although the recruitment of new technologies might alleviate some of the auditors’ burdens, professional judgements are still made by individual human auditors whose cognitive system is not limited to the reasoning process, but instead is one in which emotions (intuitive reactions) also play a significant role.

In addition to exploring the role of emotions in auditing and JDM, the PSPM also provides a guideline for future research to investigate PS practice as a process rather than debating whether it should be considered a mere mind-state or personal trait. Further research can extend understanding of PS practice by investigating how the constructs of the PSPM might be used to develop certain strategies or methods to regulate and to elevate auditors’ practice of PS.

8.4 Concluding Remarks
This chapter has summarised the main findings of this study, highlighted their main contributions and implications, underlined the limitations of the study and introduced a
number of research opportunities for future research. In seeking to expand understanding of the operationalisation of PS in auditing practice, as perceived by practitioners, this study highlights how professional auditors make sense of PS in practice. It indicates that PS should not be considered as limited to certain personal traits that can only be possessed by some people or an indefinite cognitive state in which the nature of PS is absent, and it provides a more holistic and practical understanding of PS practice as an ongoing process. This process is initiated, constructed and refined through an emotional state (GFD) that auditors experience. This emotional state is prompted, shaped and channelled through auditors’ accumulated knowledge, the fact-pattern available and certain triggers of GFD, for example reviewers’ expectations. The tension between the feelings of comfort and discomfort that auditors can experience shapes the PS process. The PS process is manifested by being prompted to feel discomfort by certain fact-patterns introduced by others and is guided to communicate certain sceptical judgements in observable actions to others, which emphasises that PS practice is socially constructed.

This study complements and extends previous studies, such as those conducted by Pentland (1993), Power (1997), Carrington and Catasus (2007) and Guenin-Paracini et al. (2014), who emphasised that auditors’ feelings play a significant role in shaping auditing practices because auditing broadly aims to produce comfort in society regarding the entities’ FS. The study provides an understanding of PS that goes beyond constraining PS to the definition of trusting or distrusting client management or black-boxing PS as a state of mind or a personal trait which people might be gifted with or not. It rather explains PS as a process that recognises the role of both GF and reasoning and illustrates the interaction between the two thinking systems. The study extends the understanding of PS, which is considered the crux of the auditing practice, and sheds more light on the elements that should be considered when defining the practice of PS or developing methods to enhance the level of PS practised.

As auditing practice is still criticised by the public and auditing failures continue to occur, auditors’ practice of PS is still considered to be a source of the deficiencies that cause such failures. For example, the Carillion case has involved additional criticisms of auditors’ practices in the UK, to the extent that a call has been made to break up the Big
Four firms on the basis that they are accused of pleasing client management rather than challenging them and protecting the public interest (BEIS Select Committee, 2019; CMA, 2019). This study, and the PSPM it has developed, help to provide an understanding of auditors’ practice of PS and can help both regulators and audit firms to better regulate and promote actions to elevate the practice of PS.
Appendices

Appendix 1: Qualitative Review of the FRC’s AQR Reports

Introduction

As a part of the FRC’s efforts to enhance the quality of auditing practices in the UK, they conduct periodic quality inspections on audit firms. These inspections broadly focus on significant areas, such as auditing areas of judgement, audit procedures, firm’s internal controls, and compliance with auditing standards and ethics codes (including appropriate application of PS). This review aims to develop an understanding of the status of PS in the audit practice in the UK. More specifically, the purpose of conducting this review is to answer two questions that are important in establishing the relevance of this research topic, namely: “how do the regulators (FRC’s inspectors) view the PS concept in their inspection reports?” and “what are the main issues that are related to AQR comments about the exercise of PS?”. The FRC’s inspectors are found to increasingly criticise auditors’ practice of PS and tend to define the PS concept as being a state, which can be established and enhanced through different issues that can be generalised into three broad themes: auditing areas of judgement, audit evidence and audit procedures, and audit firms’ internal culture. The following sections are dedicated to provide a brief discussion of the qualitative content analysis process that have been applied on the AQR reports, the AQR inspectors’ view of PS in their reports, the general themes that were found linked most to the practice of PS and a comparison between audit firms’ practice of PS based on the AQR reports.

The FRC’s AQR Reports

The FRC’s main mission is to support high-quality corporate governance and financial reporting to enhance investments in the UK. Its activities and initiatives include among others: developing and maintaining auditing and assurance standards and guidance, funding and commencing research in relevant auditing practice matters (e.g. two papers conducted in 2010 and 2012 to establish a common understanding of PS and reaffirm the importance of PS), and issuing various reports to promote the quality of auditing practices (FRC, 2017b). Therefore, the FRC’s AQR team14 conducts the AQRs on the audit firms to fulfil its mission by monitoring and encouraging high-quality auditing practices.

14 This unit was also referred to as Audit Inspection Unit (AIU).
During the FRC’s AQRs, the inspectors evaluate the UK major audit firms’ policies and procedures supporting audit quality and their audits of listed and other UK major public interest entities, as well as the audits of entities which have securities traded on a regulated market in the European Economic Area (FRC, 2016a). The inspectors adopt a risk-based approach and focus on a small sample of individual audits for each firm review. However, in their reviews of these individual audits, they concentrate on key areas that are specific to each review. When deciding which specific areas to inspect in each review of an individual audit, the inspectors select the areas that are deemed to be of high risk based on auditors’ view, audit committees’ view, their knowledge and expertise of similar entities, and the significance of such areas within the context of the audited FS. After selecting the areas that are subject to inspection, the inspectors assess the audit quality and report their findings by classifying the areas, in terms of quality, as being “good”, “limited improvements required”, improvements required”, or “significant improvements required”. The inspectors tend to exercise judgement in evaluating the significance of the issues identified and reported based on factors such as the materiality of a matter, the level of concern about the sufficiency or quality of the audit evidence, the appropriateness of exercising PS, and the level of non-compliance with standards or a firm’s methodology.

The Review Process
Since the PS literature in auditing has previously shown how US regulators’ inspections (the PCAOB) have criticised auditors’ with reference to the exercise of PS, this review focuses on studying the FRC’s inspection reports. The review began by downloading, collecting, and organising all the firm-specific inspection reports that are available on the FRC website (about 70 reports at the time of this review). These reports cover the audit quality inspections of the Big Four audit firms and non-Big Four firms for ten years (2008-2017). Then, a qualitative content analysis, was conducted focusing on the AQR inspectors’ view of the PS concept and the issues that have been significantly related to the exercise of PS.

An Excel sheet was developed to organise and analyse the issues that have been identified as being linked to the implementation of PS. According to auditing standards,
the PS concept can be pictured as an attitude of collecting persuasive audit evidence and questioning managements’ assertions and explanations (SAS No. 99; ISA 200). Hence, the review of the FRC’s inspection reports focused on the areas where the exercise of PS is discussed explicitly using the “scepticism” term or implicitly using alternative terms such as, challenge of management’s judgement, sufficiency of the audit evidence obtained, quality of the audit evidence obtained, or sufficiency of the audit procedures performed. Additionally, since the inspection reports focus on enhancing audit quality, a greater emphasis is placed on the areas that need further improvements, this is explicitly stated in the reports as that these reports “place greater emphasis on weaknesses identified which require action by the firm than areas of strength” (FRC, 2016a, p. 21). Therefore, the review focused on the areas and issues in which the exercise of PS was reported as lacking.

The content analysis process includes; reviewing all the reports and identifying the issues that have been linked to the practice of PS, counting the number of times that these issues have been referred to in relation to the exercise of PS, and then identifying whether that reference was explicit using “scepticism” word or implicit using alternative words. This simple calculation is employed to help observe the themes (qualities) which arise when a term is mentioned a number of times and repeatedly occurs (Miles et al., 2013). The analysis produced a long list of issues (about 37 issues for the Big Four firms and 36 for the non-Big Four firms) that have been linked to the exercise of PS (see Table A.1 and Table A.2). Then, since the results of the content analysis “may reveal recurrent instances of ‘items’ or themes, or they may reveal broader discourses” (Julien, 2008, p. 120), the content analysis of the FRC’s inspection reports resulted in identifying three general themes that can define all these issues (see Table A.1 and Table A.2).

The identified issues represent the different procedures of auditing engagement from the planning stage (e.g. acceptance procedures) to the formation and finalisation of the audit engagement process (such as going concern assessment). It was also found that these issues cover the interactions that audit firms engage in whether they are internal (e.g. staff and partners’ review appraisal process) or external (such as obtaining external confirmations). The general themes that have been found include auditing areas of
judgement, audit evidence and audit procedures sufficiency and appropriateness, and firms’ internal culture (discussed further in the following sections).

Observations of the AQR Inspectors’ View of PS in the AQR Reports

The PS concept has been conceptualised in a variety of ways (e.g. Hurtt et al., 2013). The varied understanding of PS includes two important areas: (i) whether PS practice should be based on a neutral perspective\(^{15}\) or a presumptive doubt perspective\(^{16}\), and (ii) whether the PS concept should be defined as a state, personal trait or both (Nelson, 2009; Hurtt, 2010; Hurtt et al., 2013). As a response to the findings of the AQR inspectors’ findings that auditors’ exercise of PS is lacking and to the inconsistent understanding of PS in the auditing literature, the Auditing Practice Board (APB) dedicated two papers in 2010 and 2012 to specifically explore the PS concept. The APB explicitly aligned its explanations of the PS concept with the ISA 200 definition of PS through supporting the presumptive doubt perspective, which denotes that auditors should take into consideration the possible occurrence of material misstatements whether due to fraud or error while performing audit procedures (FRC, 2010a, 2012a).

However, the AQR inspectors’ use of terms that are different in strength to suggest the importance of exercising PS may have impaired the clarity of their inclination towards supporting the presumptive doubt perspective. This can be seen in the AQR inspectors’ use of phrases, such as “challenge management’s assumptions” and “corroborate management’s assumptions”. In the current English language, the verb “to challenge” can be defined as “to call in question” or “to dispute”, which is stronger in terms of requiring the exercise of PS and implying the presumptive doubt perspective and the focus on negative evidence which can disconfirm management’s representations (OED, 2017b). Nonetheless, the current English language defines the verb “to corroborate” as “to strengthen (an opinion, statement, argument, etc.) by concurrent or agreeing statements or evidence; to make more sure or certain; to support, or confirm” which apparently does not support the presumptive doubt perspective (OED, 2017c). Therefore, challenging management’s representations might reinforce auditors to take

\(^{15}\) Neutral perspective: AICPA SAS No.1 indicates that sceptical auditors are those, who presume that the management is neither honest nor dishonest

\(^{16}\) Presumptive doubt perspective: auditors should consider the potential existence of material misstatements when performing the audit (Nelson, 2009).
into consideration the likelihood of fraud or error existence (presumptive doubt perspective) while corroborating management’s assumptions might only entail that auditors should confirm (substantiate) the management’s assumptions without necessarily taking into consideration the probable existence of material misstatements. Similarly, Toba (2011), who attempted to define PS through a framework that combines the way of collecting evidence and the doubt perspective that auditors should embrace, argued that auditors’ concentration on collecting evidence that positively confirms management’s assertions can erode their PS behaviour. Thus, the potential difference in strength between the two terms (challenge versus corroborate) may have contributed to the ambiguity associated with the understanding of PS and the insufficient application of PS by influencing auditors’ approach towards evidence.

In the AQR reports, the FRC’s inspectors have shown their inclination toward defining PS as a state. It was implied that this state can be established through training, having effective control policies and procedures, and anchoring audit procedures on an audit quality basis. This inclination can be seen in the AQR inspectors’ consistent emphasis on relating the exercise of PS to aspects such as collecting a sufficient amount of high-quality audit evidence, audit firms’ internal culture, the sufficiency of audit procedures performed, and auditing areas of judgement. Along with the AQR inspectors’ view of PS as a state, it was observed that the firms which were under the FRC’s inspections tend to follow two techniques, which show their appreciation of PS as a state when they respond to the inspectors’ criticism of their practice of PS:

First, the firms respond to the AQR inspectors’ criticism by establishing a new procedure, initiative, or program with the purpose of enhancing audit quality (the exercise of PS is commonly embedded as a core component of the program). For instance, in 2014, E&Y established a program called the Audit Quality Programme which includes the Audit Quality Support Team (AQST) who perform hot reviews on a sample of the firm’s major audits, provide direct feedback and coaching to audit teams and share their observations with the broader audit profession. One of the audit quality related areas that the AQST focuses on is enhancing PS (FRC, 2016b, 2017c). In the AQR annual reports over the period 2011 to 2015, the FRC inspectors have observed an improvement in the exercise of PS. This improvement has been linked to the firms’
different initiatives, including considering the exercise of PS in the performance appraisal process and coaching to develop individuals and encourage critical thinking.

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Table A.1 Issues that were referred in relation to auditors’ lack practice of PS in the FRC AQR reports of the Big Four audit firms
Table A.2 Issues that were referred in relation to auditors’ lack practice of PS in the FRC’s AQR reports of the non-Big Four firms

Second, the firms emphasise the provision of additional training on the exercise of PS and critical thinking to auditors to show their responsiveness to the AQR inspectors’ criticism. The AQR inspectors have addressed that the firms have exhibited an improvement in the exercise of PS because of their emphasis on PS concept in mandatory trainings. This can be observed, for instance, in the AQR reports on PWC
(FRC, 2012b, 2013b, 2014, 2016c, 2017d) and KPMG (FRC, 2011) where the firms responded to the inspectors’ criticism by showing their emphasis on exercising the appropriate level of PS in their mandatory training programs. These programs include training auditors in specific areas, such as challenging client management’s assumptions with regard to asset impairment reviews and valuation models and demonstrating their application of PS in the audit file. However, it should be indicated that the training programs that the firms assign to their auditors are an area of AQR inspectors’ criticism too (e.g. attendance to these training programs is not seriously monitored).

Moreover, it has been observed that the AQR inspectors tend to limit use of the “scepticism” term in the reports compared with their usage of alternative phrases that represent the same meaning. These phrases include: challenging client management’s assertions, assumptions, or estimates, collecting sufficient evidence, performing sufficient audit procedures or obtaining high-quality evidence. Based on the qualitative content analysis conducted on the AQR reports for 10 years (2008-2017), it was found that the terms “scepticism”, “professional scepticism”, or “sceptical mind” were only used 22.5% of the times that the AQR inspectors have referred to auditors’ insufficient exercise of PS (see Table A.3). In some of the AQR reports, the term “scepticism” is only used in the firm’s response to the inspectors’ concerns section, which is separately displayed and titled “Firm Action”. The limited use of the explicit term of PS in the AQR reports may be attributed to the inconsistent understanding of the concept, as has been continually reported in the auditing literature. The AQR inspectors may have chosen to describe the PS concept using alternative phrases that can be more precise in displaying the intended meaning. For instance, “challenging management’s assumptions” may better convey the intended meaning that auditors should not easily accept management’s assumptions.

It was also observed that in addition to the importance of exercising PS while interacting with client management, the AQR inspectors have referred to the need for the further practice of PS inside the audit firms themselves. This kind of PS has been labelled in the
PS literature as “inward PS” (see e.g. Bell et al., 2005). For instance, the AQR inspectors have referred to a lack of PS exercised by the engagement partner while reviewing their subordinates’ work as well as a lack in linking performance appraisal and monetary remuneration to audit quality measures (e.g. the exercise of PS).

### The Main Issues Related to PS in the AQR Reports

This section provides a discussion of the main themes (issues) that have been found related to PS based on the qualitative content analysis of the AQR. These main themes include auditing areas of judgement, audit evidence and audit procedures sufficiency, and audit firms’ internal culture.

#### Auditing Areas of judgment

Several assertions provided in the entities’ FS are determined and disclosed based on the entities managements’ subjective judgements. These assertions can include, for instance,

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17 Inward PS has been defined in the auditing literature as ‘being pre-emptively self-critical in anticipation of various arguments that others could bring against their beliefs or the evidential base they have or have not relied upon to form such beliefs’ (Bell et al., 2005, p. 34).
asset impairments, valuations, revenue recognition, related party transactions, loan loss provisions, going concern assessment, and recognition of deferred accounts. Client management can use their judgement to determine these assertions using certain assumptions, such as discount rate, growth rate, cash generating units, future cash flows, and assets’ useful life. As such assertions are associated with a high level of uncertainty and complexity, it has been argued that auditors are faced with a very difficult challenge to audit these areas (Bratten, Gaynor, McDaniel, Montague & Sierra, 2013; Cannon & Bedard, 2017; Glover, Taylor & Wu, 2017; Martin, Rich & Wilks, 2006). This challenge arises for several reasons, such as management bias or opportunistic behaviour, auditors’ lack of knowledge and expertise (auditors’ confirmation bias), cognitive limitations causing auditors’ over-reliance on managements’ or specialists’ assumptions, and lack of professional guidance on auditing these types of assertions. It has been claimed also that the exercise of PS can be the best method that auditors can use to overcome the high uncertainty and complexity accompanying these areas (Bell & Griffin, 2012; Bratten et al., 2013; Christensen, Glover & Wood, 2012; Martin et al., 2006).

Before discussing the AQR reports’ reference to the deficiencies related to auditing areas of judgment, it should be noted that the inappropriate auditing of these areas can be generated by different factors, such as environmental factors (e.g. economic conditions), task factors (high uncertainty and complexity), auditors’ specific factors (professional judgement), or even the inconsistent (gap) understanding between auditors and inspectors about what constitute audit deficiency (Bratten et al., 2013; Glover, Taylor & Wu, 2019). However, this review of the AQR reports only focused on the issues that relevant to the exercise of PS (professional judgment).

From Table A.4, it can be observed that the AQR inspectors have considered the exercise of PS as significantly lacking in the auditing of accounting issues that are based completely or partially on the management’s judgements. Since the AQR inspectors have criticised the firms’ exercise of PS while auditing areas of judgment, the audit firms have responded to this criticism through appreciating the difficulty associated with auditing these areas. The firms demonstrated that documenting the exercise of PS while auditing these areas in the audit file, which is the basis of the AQR reports, is a significant challenge. Therefore, firms have tried to claim that showing their exercise of
PS in the audit file is the real root cause of this lack of performance that the AQR inspectors are criticising. PWC, for instance, responded to the AQR inspectors’ criticism of their insufficient practice of PS when auditing subjective areas as follows:

“Challenging management is at the core of having a sceptical mindset. Evidencing this challenge of management can be in itself a challenge. Over the last few years, our training programmes have focused on ensuring that challenge made is evident on our audit files, and our use of a specific document to set out particular areas of scepticism has focused engagement teams on their need to capture the work performed appropriately on the audit file” (FRC, 2016c, p. 11).

This example indicates that audit firms recognise the difficulty associated with auditing areas of judgement, so they attempt to show their awareness by contributing a considerable effort to train their auditors into areas, such as maintaining a sceptical mindset, evidencing and documenting professional judgement (PS), accounting estimates, and valuation models. Despite this, the AQR inspectors still find the exercise of PS to be lacking in auditing areas of judgement and continue to demand further improvements in the practice of PS in these areas.

Since the exercise of PS is highly significant when auditing areas of judgement, all of the AQR reports (whether for Big Four firms or non-Big Four firms) have consistently referred to the need for the further exercise of PS in auditing these areas (see Table A.4). The AQR reports also emphasise that the need for the further exercise of PS is not restricted to the auditing of areas of judgement, while the AQR inspectors highlight that audit firms are expected to ensure that their auditors maintain PS behaviour during the whole stages of audit procedures and maintain an internal culture that prioritises audit quality.

**Audit Evidence and Audit Procedures Sufficiency**

Auditing standards require auditors to collect sufficient (quantity) and appropriate (quality) audit evidence. Auditors are not only required to gather evidence, but also to evaluate the evidence obtained in terms of relevancy and reliability (quality) (ISA 500). The type of audit evidence varies based on the method by which it is obtained or the source from which the evidence is obtained. Thus, audit evidence can be obtained from a statement of people, a document, an observation, or an audit procedure (ISA 500; Mautz
The PS concept has been frequently linked in auditing standards to the evidence-based approach in the sense that “auditors should not be satisfied with less than persuasive evidence” (ISA 200.15(a22)). Therefore, auditors who practice the appropriate level of PS are expected to perform additional audit procedures in order to collect additional evidence in terms of quantity (sufficient evidence) and quality (appropriate) (see e.g. Hurtt et al., 2013; Nelson, 2009).

As obtaining sufficient and appropriate audit evidence is at the heart of the appropriate exercise of PS, the insufficient or inappropriate gathering of audit evidence represents a lack of exercising PS. The AQR reports have referred to different cases where there were weaknesses in the firms’ collection and evaluation of audit evidence to support their conclusions or judgments about different managements’ assertions. The AQR inspectors used, for instance, the phrases “insufficient evidence” or “there is no evidence” to highlight the lack of exercising PS. These phrases were consistently employed to refer to the lack of exercising PS in the different stages of auditing process. This means that the exercise of PS which CAQ, for instance, defines as accepting managements’ assertions only when evidence is available (CAQ, 2010) involves the need to base professional conclusions or judgements on sufficient and appropriate evidence. The lack of competency of auditors can lead to insufficient and inappropriate collection of audit evidence and therefore insufficient PS. Therefore, the AQR inspectors have consistently emphasised that firms should provide additional training for their auditors to help them make sound judgments.

The AQR reports do not only refer to the issues that warrant further gathering of audit evidence, they also point out issues that embrace the need for further consideration of the quality of audit evidence. These issues can include among others obtaining external confirmation, the level of reliance on the work of external or internal specialists, and the physical count of stocks (inventories) (see Table A.4). High-quality audit evidence (such as a confirmation from a third independent party) can help auditors reach the reasonable assurance that they are required to obtain before forming a professional judgement (ISA 500). AQR inspectors have highlighted areas where auditors are expected to specifically consider the quality of audit evidence, such as evaluation of specialists’ work, evaluation of confirmations from banks and investment custodians, and triangulation of audit
evidence (e.g. excessive reliance on analytical procedures). In the AQR reports, audit firms were consistently criticised for heavy reliance on managements’ explanations without appropriate corroboration or challenge of these explanations. The AQR inspectors stressed the importance of maintaining a questioning mind (PS) while evaluating managements’ explanations or the information that is used as the basis for the alternative expectations which auditors develop and use as part of their analytical procedures. Finally, it should be noted that since the appropriate exercise of PS emphasises the gathering of sufficient and appropriate audit evidence, at the same time, any emphasis on the collection of audit evidence is also an emphasis on the exercise of PS.

The AQR cover the complete auditing process. For instance, the AQR reports for 2008 and 2009 were structured in a way that correlates with the audit process stages, which can include acceptance or continuance of a client, risk assessment, audit substantive procedures (e.g. testing controls and specific account balances), finalising the audit process (e.g. going concern assessment), and finally reporting the audit opinion. The exercise of PS has been considered lacking in the application of certain auditing procedures, such as sampling, assessing audit engagement risks, selecting and testing journal entries, evaluating the effectiveness of controls operations (including IT controls), and performing group audit engagement (see Table A.4). Therefore, a failure to appropriately perform an analytical procedure, identify fraud risks or evaluate control operations’ effectiveness can represent a failure to exercise the appropriate level of PS. Similarly, in the auditing literature, it has been argued that “auditors should be hard to convince” (Mautz & Sharaf, 1961. p.117), which implies that auditors’ practice of PS involves conducting additional audit procedures to collect sufficient and appropriate audit evidence to support their assessment and evaluation (see e.g. Nelson, 2009). This highlights the importance of auditors’ competency. Therefore, the AQR inspectors have referred, for instance, to the auditors’ lack of certain knowledge or skills, which are important in order to assist them to appropriately assess the work of specialists (e.g. IT or valuation specialists).
Documenting auditors’ professional judgement (including the exercise of critical thinking (PS)) in the audit file is one of the key auditing procedures that audit firms consider significantly challenging. In the AQR reports, audit firms have often attempted to make the argument that they have applied a sufficient level of PS, but they could not appropriately document (evidence) their practice of PS in the audit file. This allegation can be challenged by referring to the possibility that what is documented on the audit file might be more than the PS practised in reality. Furthermore, documenting auditing procedures can be considered part of the exercise of “inward PS” because audit firms are required to perform internal reviews in order to assure that they provide the appropriate level of audit quality.

Table A.4 General themes and issues related to the practice of PS in the AQR reports

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<td>12</td>
<td>1.94%</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Segmental reporting</td>
<td>2</td>
<td>1</td>
<td>3</td>
<td>0.49%</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Evaluation of assets held as a security of loan loss</td>
<td>12</td>
<td>0</td>
<td>12</td>
<td>1.94%</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Loan loss provisions</td>
<td>5</td>
<td>3</td>
<td>8</td>
<td>1.29%</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Estimations (e.g. assets useful lives)</td>
<td>2</td>
<td>4</td>
<td>6</td>
<td>0.97%</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Testing assets under construction</td>
<td>1</td>
<td>0</td>
<td>1</td>
<td>0.16%</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Capitalisation of development expenses</td>
<td>4</td>
<td>2</td>
<td>6</td>
<td>0.97%</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Loan receivables</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>0.32%</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Deferred taxes and tax provisions</td>
<td>11</td>
<td>5</td>
<td>16</td>
<td>2.59%</td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Pension schemes</td>
<td>4</td>
<td>3</td>
<td>7</td>
<td>1.13%</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Assumptions of future plans</td>
<td>1</td>
<td>3</td>
<td>4</td>
<td>0.65%</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Disclosures/emission of disclosures</td>
<td>16</td>
<td>8</td>
<td>24</td>
<td>3.88%</td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>Maternal consolidation adjustment</td>
<td>5</td>
<td>1</td>
<td>4</td>
<td>0.65%</td>
<td></td>
</tr>
<tr>
<td>17</td>
<td>Inventories testing</td>
<td>8</td>
<td>7</td>
<td>15</td>
<td>2.43%</td>
<td></td>
</tr>
<tr>
<td>18</td>
<td>External confirmation</td>
<td>8</td>
<td>7</td>
<td>15</td>
<td>2.43%</td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>Use of experts (internal or external)</td>
<td>21</td>
<td>14</td>
<td>35</td>
<td>5.66%</td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>Performance of analytical procedures</td>
<td>17</td>
<td>14</td>
<td>31</td>
<td>5.02%</td>
<td></td>
</tr>
<tr>
<td>21</td>
<td>Controls operation</td>
<td>13</td>
<td>11</td>
<td>24</td>
<td>3.88%</td>
<td></td>
</tr>
<tr>
<td>22</td>
<td>Documentation of PS and professional judgement</td>
<td>5</td>
<td>1</td>
<td>6</td>
<td>0.97%</td>
<td></td>
</tr>
<tr>
<td>23</td>
<td>IT controls assessment</td>
<td>15</td>
<td>6</td>
<td>20</td>
<td>3.24%</td>
<td></td>
</tr>
<tr>
<td>24</td>
<td>Evaluation of complex investments' (derivatives) existence and completeness</td>
<td>14</td>
<td>6</td>
<td>20</td>
<td>3.24%</td>
<td></td>
</tr>
<tr>
<td>25</td>
<td>Journals selection and testing</td>
<td>9</td>
<td>9</td>
<td>18</td>
<td>2.91%</td>
<td></td>
</tr>
<tr>
<td>26</td>
<td>Evaluating the appropriateness of certain assets</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>0.32%</td>
<td></td>
</tr>
<tr>
<td>27</td>
<td>Work of group auditor (component auditors)</td>
<td>12</td>
<td>9</td>
<td>21</td>
<td>3.40%</td>
<td></td>
</tr>
<tr>
<td>28</td>
<td>Sampling</td>
<td>6</td>
<td>5</td>
<td>11</td>
<td>1.78%</td>
<td></td>
</tr>
<tr>
<td>29</td>
<td>Audit engagement acceptance and continuance procedures</td>
<td>8</td>
<td>11</td>
<td>19</td>
<td>3.07%</td>
<td></td>
</tr>
<tr>
<td>30</td>
<td>Communication with audit committee regarding management's judgement</td>
<td>12</td>
<td>10</td>
<td>22</td>
<td>3.56%</td>
<td></td>
</tr>
<tr>
<td>31</td>
<td>Risks assessment</td>
<td>20</td>
<td>8</td>
<td>28</td>
<td>4.53%</td>
<td></td>
</tr>
<tr>
<td>32</td>
<td>Going concern assessment</td>
<td>8</td>
<td>10</td>
<td>18</td>
<td>2.91%</td>
<td></td>
</tr>
<tr>
<td>33</td>
<td>Lack of audit quality focus in the appraisal reviews</td>
<td>15</td>
<td>10</td>
<td>25</td>
<td>4.05%</td>
<td></td>
</tr>
<tr>
<td>34</td>
<td>Training on PS</td>
<td>13</td>
<td>4</td>
<td>17</td>
<td>2.75%</td>
<td></td>
</tr>
<tr>
<td>35</td>
<td>Inward PS/controls and review within the firm</td>
<td>25</td>
<td>11</td>
<td>36</td>
<td>5.83%</td>
<td></td>
</tr>
<tr>
<td>36</td>
<td>Lack of training (not attending mandatory training)</td>
<td>11</td>
<td>13</td>
<td>24</td>
<td>3.88%</td>
<td></td>
</tr>
<tr>
<td>37</td>
<td>Efficiency vs. effectiveness</td>
<td>10</td>
<td>4</td>
<td>14</td>
<td>2.27%</td>
<td></td>
</tr>
</tbody>
</table>

Table A.4 General themes and issues related to the practice of PS in the AQR reports
Audit Firms’ Internal Culture

It has been argued in the auditing literature that audit firms’ internal culture can have a positive or negative influence on audit quality (see e.g. Jenkins, Deis, Bedard & Curtis, 2008; Svanberg & Ohman, 2013; Svanberg & Ohman, 2016). For instance, an increased commercialisation focus, which prioritises efficiency over effectiveness has been claimed to have a negative influence on audit quality (specifically the insufficient exercise of PS) (see e.g. Carpenter & Reimers, 2013; Hurtt et al., 2013; Jenkins et al., 2008; Sweeney & Pierce, 2004; Nelson, 2009). AQR inspectors have placed specific focus on the firms’ internal policies and procedures in order to investigate whether or not firms’ culture prioritises audit quality objectives.

The AQR reports have linked a number of culture issues to the exercise of PS (see Table A.4). These issues include the emphasis on auditors’ technical development, communication of auditors’ scepticism about management’s assertions to the audit committee, links between performance appraisal and audit quality objectives, the practice of inward PS and preference of efficiency goals over audit quality goals. Since audit firms have incentives to maximise their financial interests, which might inspire them to engage in actions which threaten audit quality (see e.g. Duska, 2005; Sims & Brinkmann, 2003), the AQR inspectors aim in their inspections to assure that audit quality objectives (e.g. challenging management and collecting sufficient and appropriate evidence) are at the heart of the firms’ internal culture. In more than one instance, the AQR inspectors reported that further effort is still needed from firms to enhance their exercise of PS and achieve high audit quality. The following quote provides an example of the AQR inspectors’ explicit message to audit firms that additional effort is still needed to instil a culture that prioritises audit quality and encourages the exercise of PS:

“In three audits, we did not agree with the audit team’s view that revenue recognition was not a significant risk. The firm’s repeated training and reminders in this area do not appear to have been effective in dealing with this issue. More needs to be done by the firm to change the behaviour of audit teams and to encourage them to exercise greater scepticism in this area” (FRC, 2010b, p. 7).
Additionally, the AQR reports’ emphasis on audit firms having an internal culture that prioritises audit quality objectives is consistent with the AQR inspectors’ view of PS as a state. The AQR inspectors appear to believe that since firms can have control over their culture, audit firms can facilitate a better exercise of PS (audit quality) through, for example, a leadership style that prioritises audit quality, establishes strong quality controls, and offers training programs and technical guidance, which can strengthen auditors’ capacity to practice PS (see e.g. Svanberg & Ohman, 2016). The AQR reports exhibit a degree of sensitivity towards any procedure or policy that can contribute to the construction of a culture that abandons audit quality objectives. This can be seen, for instance, when the AQR inspectors expressed their concerns about the PWC initiative to reduce audit hours, which they considered a threat to audit quality (FRC, 2009). They have also consistently criticised audit firms for their unclear strategy, which has persuaded some of their auditors to include their efforts to attain or maintain clients as points of good practice (for which they should be rewarded) in their self-assessment forms (part of the quality control procedures). Finally, from the AQR reports, firms’ culture, which primarily focuses on achieving audit quality objectives can encourage auditors to avoid actions which could reduce quality (insufficient exercise of PS).

**Comparison between Audit Firms**

The size of audit firms has been claimed to have a positive relationship with audit quality, which means that the bigger the accounting firm, the higher the audit quality exercised. This positive relationship has been attributed to a number of factors, such as the higher level of expertise and strong human resources (e.g. in-house networking and firm-wide consultancy), higher number of clients, which means less economic dependency on a specific client, higher exposure to risks (e.g. legal liability and reputation loss) and higher audit fee premiums, which give big firms the ability to expand their resources (e.g. advanced technologies). For instance, it has been suggested that since big audit firms often provide their services to a large number of clients, they can be more able to challenge the clients’ managements’ assertions because they are economically less dependent on a specific client as this might not be the case for small firms. This positive relationship between the firm or office size and audit quality has been consistently evidenced in a number of studies regardless of the fact that the audit quality within a firm’s local offices (city or jurisdiction level) might vary (Choi et al.,
2010; DeAngelo, 1981; Francis, 2004; Francis & Yu, 2009; Francis, 2011). Based on this size dichotomy (Big Four firms and non-Big Four firms) which has been associated with the exhibited level of audit quality (including PS), a comparison between the audit firms in relation to the AQR reports’ discussion of the issues pertinent to the exercise of PS was conducted to serve the objective of understanding the state of PS practice in the UK. The discussion of this comparison will be introduced in the following two sections: first, a comparison between the Big Four audit firms (E&Y, Deloitte, PWC, and KPMG), second, a comparison between the Big Four audit firms and non-Big Four firms.

**Comparison between the Big Four Firms**

Figure A.1 shows a comparison between the Big Four audit firms inspected by the AQR inspectors over a ten-year period (2008-2017). Generally, the chart shows that the concern about firms’ insufficient exercise of PS has increasingly grown since 2008. Even though, these firms possess the resources and the expertise needed to deal with accounting issues and auditing procedures, the insufficient exercise of PS is still growingly observed by the AQR inspectors. For instance, the increase in the concern about the exercise of PS in 2011 can be ascribed to the economic downturn, which occurred around that time. The AQR inspectors have prompted the audit firms to be alerted to the economic conditions during that time. Although all the Big Four firms have appropriately responded to the economic conditions at that time when they conducted their audits and assessed their clients’ going concern, the insufficient exercise of PS has been increasingly observed by the AQR inspectors (who might have become more alerted to the need for exercising PS to avoid audit failures during that economic conditions). This may suggest that the AQR inspectors perceive that the exercise of PS can be signified by the external environment conditions, so auditors should exercise a higher level of PS under these conditions. This view goes along with Hurt et al. (2013) model, which pictures the external environment conditions as one of the antecedents that can influence the PS state.
Additionally, Figure A.2 presents a bar chart that provides a detailed comparison between the Big Four audit firms with regard to the different issues that have been addressed in relation to their insufficient exercise of PS in the AQR reports. From Figure A.2, the Big Four firms are apparently consistent in terms of AQR inspectors’ expressed criticism about their insufficient exercise of PS in relation to auditing areas of judgment (e.g. impairment reviews) and internal culture issues (e.g. linking performance appraisal forms to audit quality objectives). However, the AQR inspectors’ criticism of the firms’ practice of PS in relation to the sufficiency and appropriateness of audit evidence and audit procedures were observed inconsistent between the Big Four firms. For instance, in multiple cases, the AQR reports of E&Y referred to the insufficient collection of appropriate audit evidence compared to other firms. Similarly, various instances indicated to the insufficient or inappropriate practice of audit procedures in the AQR reports of Deloitte compared to the other three firms. This variation between the Big Four firms in terms of the audit evidence and the audit procedures sufficiency and appropriateness theme can be attributed to firms’ different pool of clients, human resources and method of doing audit (e.g. using different types of software).
Comparison between the Big Four Firms and Non-Big Four Firms

As opposed to the Big Four audit firms, the non-Big Four firms are considered to have less access to engage with large clients, recruit the most talented accountants and establish robust expertise internal networks. Along with these characteristics, the non-Big Four firms are expected to be exposed to the risk of being economically dependent on one large client, which can influence them to focus on pleasing that client and consequently be less sceptical while providing auditing services to that client. However, these firms are expected to have lower audit risks than the risks (e.g. legal liability) to which the Big Four firms have exposure (e.g. Choi, et al., 2010; DeAngelo, 1981).

Therefore, it should be taken into account that the characteristics of the audit firms’ themselves are not the only factor that can enhance or impair the firms’ practice of PS. Other factors, such as clients’ characteristics, evidential characteristics and environment characteristics may influence the practice of PS (see e.g. Hurtt et al., 2013). For example, even though the Big Four firms have the resources and expertise needed to provide higher audit quality, the AQR reports considered that the Big Four firms’ exercise of PS significantly lacking in auditing areas of judgement (e.g. assets’ impairment reviews and valuation models). Likewise, while the AQR reports criticised some of the non-Big Four firms for the inappropriate consideration of the economic conditions while they audit their clients during the time of economic downturn (2008-2012), the AQR inspectors underlined the Big Four firms’ appropriate response to that economic downturn.

Since the Big Four firms ordinarily audit large clients, which more likely invest in sophisticated financial instruments, have various subsidiaries, recognise different types
of intangible assets, or specialised in different industries, the AQR inspectors have referred in a greater number of instances to the Big Four firms’ insufficient practice of PS in auditing areas of judgement, applying audit procedures and collecting audit evidence compared to the smaller firms (see Figure A.3). This significant difference between the Big Four firms and smaller firms can be attributed to various matters, which can include firms’ type of clients, access to resources, and exposure to risks. These differences between the two different sizes of audit firms correlate with the AQR inspectors’ view of PS as being a state as it can be influenced by the clients’ characteristics, firms’ characteristics, evidence characteristics (e.g. sophistication of accounting issues).

Finally, it should be noted that the AQR inspectors have consistently conducted annual quality inspections on the practices of the Big Four firms for the whole period of our review (2008-2017). The Big Four firms’ clients characteristics indicate the role that these firms play in the audit profession and the country-level economy (through financial market) as they ordinarily audit a greater number of publicly held companies than the non-Big Four firms do (see e.g. Francis, 2011; Samsonova-Taddei & Humphrey, 2014). These companies, which are listed on the London Stock Exchange market, regularly have a large portfolio of interested parties (which expand their financial reporting influence) and are legally bound to have their FS audited by external auditors (which increases the audit firms’ legal liability). Thus, the AQR team places a greater consideration on the practices of the Big Four firms compared to the smaller firms, which have not been inspected every year within our review time frame (2008-2017). Therefore, this difference of consideration that the AQR team places on the two types of firms (Big Four firms versus non-Big Four firms) might have contributed to the differences between them in terms of the main issues (general themes) that the AQR inspectors have criticised in their AQR reports.
Figure A.3 Comparison between the Big Four firms and non-Big Four firms in terms of the issues related to the exercise of PS in the AQR reports

Conclusion

This detailed review of the AQR is conducted to develop an understanding of the status of PS in the audit practice in the UK. The review is conducted with the purpose of satisfying two main objectives: identifying the AQR inspectors’ view of PS and the issues that have been linked to the practice of PS in the AQR reports. The findings of the qualitative content analysis indicate that the AQR inspectors are inclined to view PS as a state and more related to the presumptive doubt perspective. Based on this view of PS, the AQR reports have discussed the audit firms’ insufficient practice of PS in relation to three general themes (areas): auditing areas of judgment, audit evidence and audit procedures sufficiency and the culture of audit firms.

The findings of this qualitative analysis of the AQR reports point to the significance of exploring the practical meaning of PS as the AQR reports have shown a growing concern about auditors’ insufficient exercise of PS and the vagueness associated with the PS concept. Since most of prior auditing studies, in particular those concerned with PS have been conducted in the US context, this review should contribute to the auditing literature by exhibiting the current state of PS in the UK audit practice, and explaining and highlighting the regulators’ (FRC in specific) perception of PS as expressed in the AQR reports.

Finally, it should be noted that the findings of this review are restricted to a number of limitations. First, since this review focused on the FRC’s reports, the FRC has explicitly explained that the findings of its AQRs are constrained by certain limitations, such as the
small samples of individual audits that they inspect, the limited oral explanations and audit files that they obtain and the limited areas of audit procedures and policies that they focus on. Additionally, this review is restricted to the AQR reports that are made available on the FRC’s website and to which the researcher have access. This review is also restricted to the limitations of the qualitative content analysis method, which can include among others the subjective interpretation of the qualitative data. This subjective interpretation can be regarded slightly risky since the researcher might miss some important themes (issues) as (s)he decides what should be coded or not (Marshall & Rossman, 2006; Marvasti, 2003). However, certain efforts were made to reduce this limitation by developing a systematic process into applying the qualitative content analysis and supervising our interpretations of the data by the auditing literature.
## Appendix 2: Interview Guide

The Four Accounting Scenarios (Examples) Used in the Interviews

<table>
<thead>
<tr>
<th>Four Accounting Scenarios</th>
</tr>
</thead>
<tbody>
<tr>
<td>Based on your preference, please choose one of the following scenarios:</td>
</tr>
</tbody>
</table>

### First Scenario: Accounting Estimate:

You are responsible for a year-end auditing of a continuing client (K manufacturing company). As a new audit member of the audit engagement team, you learned that the company has always received an unqualified audit opinion. However, as you were auditing the client’s account receivables, you learned that the client has estimated a new percentage figure to calculate bad debt expense and the related Allowance for Doubtful Accounts. The rate is significantly less than the rate used over the last five years. The percentage rate that the client has used in the past is 40% higher than the rate they are using this year. In prior audits, documentation has shown no indication for management to manipulate income by decreasing the company’s expenses.

### Second Scenario: Fair Value Valuation:

You are responsible for auditing a continuing client (bank B). As a new audit member of the audit engagement team, you were informed that the bank has always received an unqualified audit opinion. While auditing the client’s investments, which are one of the high-risk areas in the client’s financial statements, you learned that the bank has significant investments in financial instruments, which are not traded in an active market. Additionally, you learned that the bank has valued its financial instruments at fair value using a price quote that is gained from a third party (a broker firm).

### Third Scenario: Going Concern:

You are responsible for auditing a continuing client (Sun Shine manufacturing company) which is a publicly traded company, which has always received an unqualified audit opinion. As you were auditing the client’s liabilities, you found that the client has been sued by another company over copyright infringement claim. The amount claimed in the lawsuit is £5 million, which can significantly impact client’s financial position, but the client’s management made their judgment that they do not need to disclose this contingent liability and told you that “we have a good defence against the claim”.

### Fourth Scenario: Intangible Asset Impairment:

You are responsible for the year-end auditing of a continuing client (G, Inc.) which is a provider of information technology (IT) and professional services. Two years ago, G, Inc. purchased E, Inc. (a global leader in next-generation IT services and solutions) in a large acquisition deal. At the acquisition time, G, Inc. recognised goodwill asset, which represents 40% of the fair value of assets acquired. G, Inc. has consulted the work of a third party valuation specialist (ABC LLP firm) which is a well-respected valuation firm to assist the company with developing the fair value estimates for its annual goodwill impairment testing process. Using the discounted cash flow methodology, ABC estimated that the fair value of the E, Inc. reporting unit exceeded its carrying amount by 25 % for the current year which means that a “step 2” goodwill impairment test was not required.
Appendix 2: Interview Guide, continued

<table>
<thead>
<tr>
<th>Interview beginning stage:</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓ Introducing myself</td>
</tr>
<tr>
<td>✓ Sharing a brief overview of the research project’s nature and endeavours</td>
</tr>
<tr>
<td>✓ Assuring the confidentiality aspects and explaining how the data will be used</td>
</tr>
<tr>
<td>✓ Requesting interviewee’s consent to record the interview</td>
</tr>
<tr>
<td>✓ Collecting some personal information:</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Date</th>
<th>/</th>
<th>Day</th>
<th>Time</th>
<th>Position</th>
</tr>
</thead>
</table>

Interview Questions
[Based on participants’ answers, further prompts and probes are used]

Introduction:
- Can you please briefly describe your experience in auditing profession?
- Which scenario would you like us to use as an example in the interview?
- Please carefully read the scenario [if the participant had not read the scenario before the interview]

| Scenario selected: (3) |

A- Intuitive Judgment (Gut Feeling):
- Q1: What would you do to make your professional judgment about the reasonability of the client’s judgment? Why?
- Q2: If you learned that the client’s net-income has noticeably declined during the current year because of an economic condition that is impacting the client’s industry and several companies have been severely hit by this economic condition, what would you do in this situation? Why?
- Q3: What would you do if you learned that the client’s lawyer has resigned within the current year and a new law firm has been recruited to help with the lawsuit? Why?
- Q4: If this client was a new client to your firm, how would you go about auditing this accounting issue? Why?
- Q5: When do you feel that the client’s judgment is unreasonable? Why?

B- Reasoning Process:
- Q7: If you felt that the client’s judgment is unreasonable, what types of audit procedures would you conduct? Why? Can you give an example
- Q8: What types of audit evidence would you focus on when you feel that the client’s estimate and explanations are unreliable? Why?
- Q9: What makes you feel that your audit procedures are insufficient (sufficient)?
- Q10: When would you feel that the audit evidence collected is insufficient (sufficient)?

C- Rationalisation to Others:
- Q11: If you felt that the client’s judgment is unreasonable, how would you justify your judgment to the client’s management?
- Q12: How would the client’s management react to your concerns? Can you provide an example?
- Q13: What would you do to encourage your audit engagement’s colleagues to accept your judgment?
- Q14: How would your audit team members react to your concerns?

D- Private Reflection and Reasoned Judgment:
- Q15: How would you know that your judgment (feeling) is reasonable?
- Q16: When would you change your judgment about the reliability of the client’s assumptions or explanations? Why? How?
- Q17: What are the issues that can make you rethink your judgment about the audit evidence collected?
- Q18: Would you consider reviewers’ expectations when you make your professional judgment? Why?
- Q19: When do you feel that you have met the reviewers’ expectations? How?
- Q20: What are the aspects that concern you most when you assess your peers’ professional judgment quality? Why?
Appendix 3: Invitation Letters Sent to Participants

Invitation email (message) sent to individual participants:

Hello

Dear Mr./Ms.,

I am writing this email (message) to ask for your kind assistance as an experienced auditing professional to participate into a study that I am conducting as a part of my PhD thesis in the University of Manchester about auditors’ experiences in exercising professional judgement in the practical context of audit engagements. The objective of this study is to provide a practice informed understanding of auditors’ individual real life experiences with making judgmental decision on key financial reporting matters. Since this study mainly focuses on professional auditors’ individual views and experiences in relation to making auditing professional judgment, this study involves speaking with experienced auditors like yourself in an interview setting. Thus, I would like to invite you to participate in an interview which should not last more than 60 - 90 minutes. The interview settings have to be arranged to your likings in terms of time and place. I am very happy to provide further details on the study and interview format should you be able to agree to participate in the study.

I hope you will be willing to assist us with this research project. And please feel free to contact me if you have any inquiries concerning the study or the interview format.

Thank you for your consideration of this approach and your co-operation will be very much appreciated.

Best regards

Yasser Alnafisah
PhD Candidate in the Accounting & Finance Division/ Alliance Manchester Business School
Email: yasser.alnafisah@postgrad.manchester.ac.uk
Phone: 07402681207
Appendix 3: Invitation Letters Sent to Participants, continued

Invitation letter emailed to the Big Four audit firms in the UK:

Dear

I am writing to ask for your assistance with a research project I and colleagues at Manchester Business School are conducting research into the experiences of auditors in exercising professional judgement in the practical context of audit engagements. The objective of this research is to develop a practice informed understanding of auditors’ real life experience of judgemental decisions on key financial reporting matters and so it is important for the conduct of the study to have access to practicing audit personnel. In order to gather evidence from the practice perspective we hope to conduct interviews with a small number of personnel who are of sufficient seniority to be called upon to exercise professional judgement on significant matters and I would like to ask if you could nominate between six and ten engagement partners, or possibly senior managers, to participate in an interview of between 60 and 90 minutes.

I know that as a firm you may receive many requests for assistance with research projects and that it is difficult to respond positively to them all. In that regard, we have sought to restrict this request to access to only a limited number of personnel and, as the topic is one of significance for the profile of the auditing profession, it is critical that the experience of auditors in practice be made visible. In addition, I recognise you may have the natural professional concerns over the confidentiality of information discussed in interview. However, the discussions in interview do not depend on anything that is connected to specific engagements. I am very happy to give undertakings that those discussions will not be disclosed in any way that is attributable to the firm or individual without permission and in over thirty years of conducting research using interviews with members of the auditing profession I have never had any project where a problem of confidentiality has arisen.

This study also involves a senior lecturer at Manchester, Dr Anna Samsonova-Taddei, and a doctoral student, Mr Yasser Alnafisah, who would conduct most of the interviews. We are happy to provide further information on the format of the interviews and the topics we would like to discuss, both to yourself and to the potential interviewees should you be able to agree to participate in the study. I am also happy to try to answer any queries you might have and to discuss any aspect relating to the possible participation by your firm.

Yours sincerely

Prof. Stuart Turley
Professor of Accounting
References


Cushing, B.E. (2000, September). Economic analysis of skepticism in an audit setting In M. E. Peecher (Co-Chair) & I. Solomon(Co-Chair), 14th Symposium on Auditing Research, Urbana, Champaign, IL.


