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## LIABILITY LESSONS

**"The wise auditor considers an adverse reaction to skepticism in advance and plans for it."**



### The Wise Auditor's Approach to Skepticism

By Jonathan S. Ziss, JD

*Insightful lessons can be learned by reviewing professional liability issues. With this in mind, Bollinger Inc. provides this column for your review. For more information about liability issues, contact Bollinger at robert.connolly@bollingerinsurance.com.*

Professional skepticism is a central tenet of audit work, its very spirit. Professional standards help to define due skepticism, and published commentary provides guidance as to its exercise throughout an audit plan. For many clients, though, the expression of skepticism is not easily received.

After all, professional skepticism requires an auditor to voice his or her doubts through a "questioning mind" and a "critical assessment of audit evidence." Perhaps most prominent is the need to "corroborate management's representations." To some clients, this can seem like a reproach, an implicit negative assessment of their integrity. This, in turn, can trigger an adverse reaction in the client.

The wise auditor considers this situation in advance and plans for it. Based on a view of litigated cases, not all auditors are so wise.

#### Don't Back Down

Without knowing that they are doing so, some auditors find a way to "back down" from valued clients to some extent. Perhaps they do not press for as probing or as time-consuming an inquiry about fraud risks as they might have liked. Perhaps they accept peculiar journal entries, with insufficient explanations, without seeking corroboration elsewhere once a client begins to squawk.

This is unhealthy in audit work. It is inimical to quality control, and it can lead an auditor astray. It can also increase expo-

sure to a professional liability claim. The necessary blend of poise, tact, and confidence to survive these encounters is not covered in any professional how-to texts, and it does not appear, as such, on any checklist. It is gained through experience. As you gain experience, learn how to recognize the circumstances in which professional skepticism will likely be met with personal affront.

#### Where Skepticism Is Unwelcome

In less formal, less hierarchical organizations, such as family businesses and many not-for-profits, the auditor may find a culture of trust based on personalities and relationships, a greater reliance on tenure and reputation, and a porous sense of rank. In these environments, the exercise of professional skepticism can really rock the boat.

Consider the example of a not-for-profit run by a professional executive who is supported by a largely unskilled accounting staff. The executive is backed by a board of volunteer directors who essentially received their directorships in exchange for loyal charitable support.

In this example, the road of professional skepticism leads right to the executive director. The auditor needs to approach board leadership with questions regarding the executive's management. Should the executive also serve in a leadership position on the board, the wise auditor will find an alternate path to gain the board's insight. The direct approach is to explain to both the executive and the board that professional skepticism demands nothing less. This may be harder than it seems if the board is weak and the executive is not inclined to be second-guessed. Since the executive might also be the client origination contact, considerable tact must be

brought to bear during the planning and field work so as not to offend. How to do this won't be mentioned in GAAS, but it is something a wise auditor knows must be done and knows how to do.

For the client, the benefit will be a more effective audit process. For the auditor, the benefit is compliance with the standard of due care and a diminution in the risk of an error or omission.

Another example of unwanted skepticism could be in a family business in which the founder is beginning to play an ever-diminishing role, and his children and their spouses are now occupying positions of authority. Here, the auditor may encounter a blur of horizontal management with overlapping duties and a functionally absent oversight scheme. The obligation to communicate "with management and those charged with governance" is not easily met in this instance.

If the oldest son is more or less the marketing guy, his sister (who is "better with numbers") is more or less the finance person, and a family friend and former salesman is more or less the CFO, determining who is governing is almost impossible. The wise auditor will communicate this fact to the client at the outset, and will explain and document the challenge. This may cause the client to play up to the auditor's standards, and what might have been seen as a reproachful attitude on the part of the auditor may instead be welcomed by the client.

When it comes to the exercise of professional skepticism, the audit client deserves nothing less than the wise auditor. ■

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