RESEARCH ON PROFESSIONAL RESPONSIBILITY AND ETHICS IN ACCOUNTING

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CHAPTER 1

UNDERSTANDING PROFESSIONAL SKEPTICISM THROUGH AN ETHICS LENS: A RESEARCH NOTE

Michael K. Shaub

ABSTRACT

This chapter examines the relationship between four variables indicating ethical disposition – ethical sensitivity, ethical reasoning, concern for others, and egocentrism – and trait professional skepticism (PS) (Hurtt, 2010) among 119 first-year auditors. While there has been research addressing the link between ethical dispositional factors and state PS in auditors (e.g., Shaub & Lawrence, 1996), there is a lack of research into the link between ethical dispositional factors and trait PS (Hurtt, 2010). The results indicate that trait PS is higher in first-year auditors with higher levels of ethical reasoning, concern for others, and egocentrism. More ethically sensitive auditors do not demonstrate higher levels of trait PS, however. The results provide evidence that auditors' ethical dispositions influence their ability to have the mindset necessary to carry out the investor protection role that requires adequate PS.

Keywords: Professional skepticism; ethical sensitivity; ethical reasoning; concern for others; egocentrism; ethical disposition

INTRODUCTION

While professional skepticism (PS) is often discussed as a necessary characteristic for auditors, there has been some disagreement about its nature, and its appropriate use in the audit. However, two basic approaches have been taken to understanding

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it, the neutral approach and the presumptive doubt approach. Nelson (2009, p. 1) defines PS using a presumptive doubt approach 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…. This definition reflects more of a "presumptive doubt" than a "neutral" view of PS, implying that auditors who exhibit high PS are auditors who need relatively more persuasive evidence (in terms of quality and/or quantity) to be convinced that an assertion is correct. Depending on how an auditor's decisions are evaluated, it is possible under this definition for an auditor to exhibit too much PS, in that they could design overly inefficient and expensive audits.

Presenting the contrasting neutral view, Hurtt (2010, p. 151) defines 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." Through a rigorous process of scale development described in Hurtt (2010), she identifies six sub-constructs that make up this "neutral" PS: a questioning mind, suspension of judgment, a search for knowledge, interpersonal understanding, autonomy, and self-esteem.

Nelson (2009) develops a conceptual framework for understanding PS (see Fig. 1) that indicates, in part, that skeptical judgment and subsequent skeptical

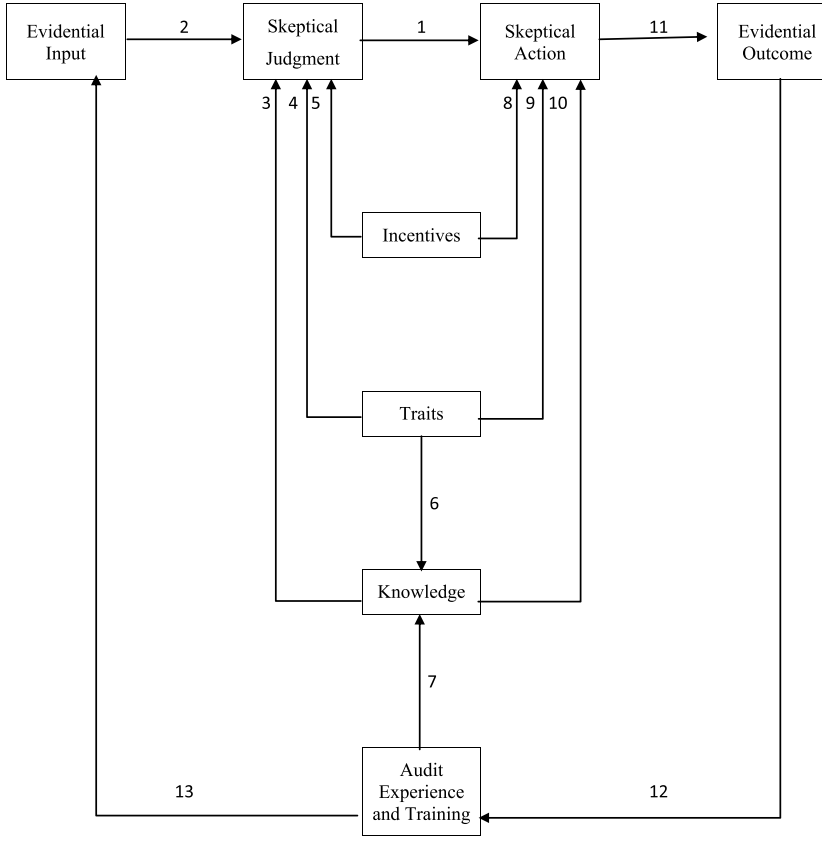

Fig. 1. Model of Determinants of PS in Audit Performance. *Source*: Nelson (2009, p. 5).

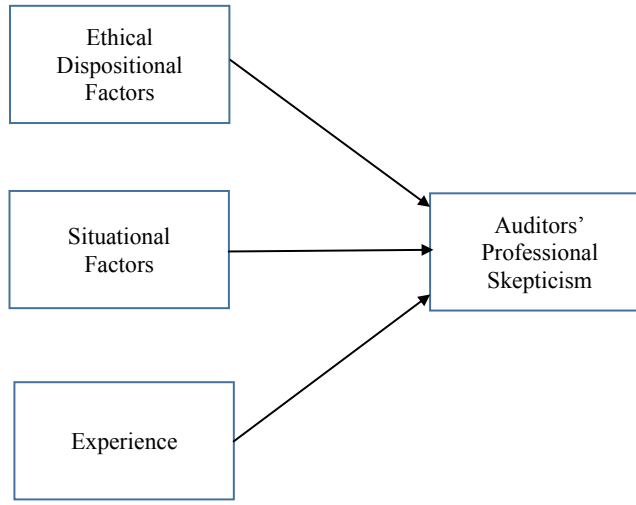

Fig. 2. Model of Auditors' PS. *Source*: Shaub and Lawrence (1996, p. 127).

actions are a function of pre-existing knowledge, traits, and incentives in the context of evidence gathering. He indicates that research related to the traits falls into three categories: ethics/moral reasoning, problem-solving ability, and skepticism (Nelson 2009, pp. 8–11; Quadackers, Groot, & Wright, 2014, p. 641).

Shaub and Lawrence (1996) propose a model (see Fig. 2) based on Kee and Knox (1970) that hypothesizes PS as a function of ethical dispositional factors, situational factors, and experience. However, Hurtt's measure of trait PS may not be influenced by situational factors if it is indeed inherent to the individual. Trait PS would be another dispositional factor that could potentially be linked to state PS, or the experienced state of skepticism in a given situation that results in skeptical thinking and skeptical action. It could, however, be influenced by other traits, and this might particularly be important if trait skepticism evolves over time, or if other traits temporally precede the development of trait skepticism.

The presumptive doubt approach to PS presumes that the auditor's primary responsibility is an ethical one: to protect the public from harm. This requires the auditor to assume somewhat of a defensive posture that arises from a duty to prevent damage, rather than a purely neutral approach that reflects simply cognitive complexity. It implies that PS is ethical in nature. Thus, in testing the theory, an examination of the relationship between ethical disposition and PS is warranted.

This chapter examines the impact of four variables indicating ethical disposition – ethical sensitivity, ethical reasoning, concern for others, and egocentrism – on trait PS (Hurtt, 2010), among 119 first-year auditors, consistent with Shaub and Lawrence's (1996) model. While there has been research addressing the link between ethical dispositional factors and state PS in auditors (e.g., Shaub & Lawrence, 1996), there is a lack of research into the link between ethical dispositional factors that likely precede the development of trait PS, and trait PS itself (Hurtt, 2010).

The results indicate that ethical dispositional variables indeed have a significant impact on the trait PS demonstrated by the first-year auditors in this study. Trait PS is higher in first-year auditors with higher levels of ethical reasoning, concern for others, and egocentrism. More ethically sensitive auditors do not demonstrate significantly higher levels of trait PS, however.

The rest of the chapter is organized as follows. The next section reviews the findings of prior research and discusses theory relevant to auditors' PS. The following section elaborates on the research method and discusses the instruments used to measure the theoretical constructs. The next section provides results and the final section discusses those results, and discusses implications, limitations, and suggestions for future research.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Professional Skepticism

Hurtt (2010, p. 150) pictures the skeptical mindset as influenced by both trait and state skepticism. Trait skepticism is inherent to the individual, multi-dimensional, and thought to be stable over time. State skepticism is "a temporary condition aroused by situational variables" (Hurtt, 2010, p. 150). Presumably, this condition is unobservable, but the skeptical mindset can be measured by asking auditors what they think. That thinking is linked to behavior, but behavior can also be influenced by situational variables, including time pressure on the audit, and the opinions of influential others such as firm superiors (Cohen, Dalton, & Harp, 2017) and client management.

Nelson's (2009, p. 5) more complete "Model of Determinants of Professional Skepticism in Audit Performance" proposes that both skeptical judgment and skeptical action are functions of incentives, traits, and knowledge. Knowledge arises from traits, audit experience, and training. Skeptical judgment is also state-based, a result of evidential input. Incentives are largely state-based as well, though some incentives are similar across many clients, and even across auditors within a firm. Finally, skeptical judgment influences skeptical action.

Nelson (2009) identifies two primary approaches to PS, neutrality and presumptive doubt, which have been subject to recent research and used to characterize skepticism in professional practice. The neutrality view of PS is characterized as "… the propensity of an individual to defer concluding until the evidence provides sufficient support for one alternative/explanation over others" (Hurtt, 2010, p. 151). Hurtt rigorously designed a 30-item instrument that uses a multidimensional approach to measure PS, and identifies the following six sub-constructs that define neutrality trait PS: questioning mind, suspension of judgment, search for knowledge, interpersonal understanding (of motives), autonomy, and self-esteem (Hurtt, 2010). This approach to PS is consistent with US and international standard setting (Nelson, 2009, pp. 2–3).

The presumptive doubt form of PS has been characterized by Cohen et al. (2017, p. 3) as assuming "… that some level of dishonesty or bias is inherent

in management's assertions." This approach is consistent with prior research (McMillan & White, 1993; Shaub, 1996; Shaub & Lawrence, 1996), auditing standards directed toward fraud detection, and the views of regulators, including the Securities and Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB) (Nelson, 2009, p. 3). Society expects presumptive doubt out of auditors (Bell, Peecher, & Solomon, 2005; Quadackers et al., 2014).

Quadackers et al. (2014) examine the relationship between auditors' skeptical perspective (meaning, their endorsement of either the neutrality or presumptive doubt approach) and their planning judgments in high and low risk control environments for an analytical procedures task. They measure neutrality using Hurtt's (2010) instrument and measure presumptive doubt as the negative of responses to Rotter's (1967) Interpersonal Trust Scale. Quadackers et al. find that the presumptive doubt measure is more predictive of skeptical judgments and decisions than Hurtt's measure across risk environments, and particularly so in the high-risk environment.

Carpenter and Reimers (2013) provide evidence that partners' emphasis on PS influences audit managers' identification of fraud risk factors and the appropriate audit procedures to perform. Auditors, in the high partner emphasis on PS condition, provide higher fraud risk assessments, while those in the lower condition are not impacted by fraud risk factors in their assessment of fraud risk or their procedure selection.

Schmitt, Hageman, and Radtke (2014) test the relationship between Hurtt's (2010) neutrality PS and client advocacy in auditors and tax professionals in light of the perception that these two constructs are opposing. They find no correlation between advocacy and five of Hurtt's six sub-constructs of trait PS, indicating that the two are distinct constructs. While Schmitt et al.'s tax professionals were higher on client advocacy, there was no difference in the level of PS between tax professionals and auditors.

Cohen et al. (2017) examine the impact of the two competing views of PS (neutrality and presumptive doubt) on organizational citizenship behaviors and turnover intentions. They find that neutral skeptics' alignment with partner priorities (through more focus on client relationships and audit efficiency) causes them to perceive greater partner support, and results in more organizational citizenship behaviors and a lower intent to turnover. This finding aligns with Shaub and Lawrence (2002), who note that over 30% of new staff in their sample are classified as aggressive skeptics in their taxonomy of PS, while fewer than 10% of auditors at all other levels in the firm are classified that way.

According to Hurtt:

> It is possible that the difference between the neutral and presumptive doubt perspectives on professional skepticism identified by Nelson (2009) will be explained by a trait and state view of professional skepticism. Trait skepticism may relate to the neutral perspective and the six characteristics identified here; however, when an auditor's state skepticism is aroused, it may be that he or she moves to a position of presumptive doubt. (Hurtt, 2010, p. 167)

Therefore, in Hurtt's view, the same auditor could use both the neutral and presumptive doubt approaches to PS, depending on the client circumstances.

Understanding the relative importance of dispositional and situational factors is central to much auditing research (Anderson & Marchant, 1989).

Therefore, while the current study focuses on dispositional (or trait) skepticism, the study of situational (or state) skepticism is important as well. The extent to which state PS is manifested in auditors' thinking and their decisions about actions they would take, as well as its predictors, is examined by Shaub (1996) and Shaub and Lawrence (1996). Shaub (1996), measuring PS as low trust, finds limited support for a measure of client trust negatively impacting state PS, and no evidence for the ability of low scores on Wrightsman's (1974) measures of trustworthiness and independence to predict subjective trust/state skepticism. In general, Shaub and Lawrence (1996) find that auditors' concern with professional ethics positively affects state PS, while principled ethical reasoning using Rest's (1986a) Defining Issues Test (DIT) and the endorsement of situation ethics reduce state PS. Both Shaub (1996) and Shaub and Lawrence (1996) provide evidence that situational factors that make fraud likelihood higher trigger state PS in auditors.

Shaub and Lawrence (2002) seek to infer auditor trait skepticism by identifying a pattern of skeptical choices across a variety of scenarios, including both low risk and high risk of fraud. They calculate normalized scores for the auditors in their sample for each scenario by comparing the auditor's response to the mean response for all auditors receiving that version of the scenario and dividing by the mean. This gives each auditor a series of scores between -1 and 1 on a series of skeptical thoughts and actions. Using the results, Shaub and Lawrence categorize the auditors in a 2×2 taxonomy as measured skeptics (watchdogs), aggressive skeptics, reluctant skeptics, and conflicted skeptics. The axes of the taxonomy are the tendency to think skeptically (high/low) and the tendency to act skeptically (high/low) across situations. They find the measured skeptics most concerned with professional ethics, the aggressive skeptics least experienced, the reluctant skeptics the oldest auditors, and the conflicted skeptics the least idealistic, or most pragmatic.

Ethical Sensitivity

Ethical sensitivity (Shaub, Finn, & Munter, 1993) is a measure of an auditor's ability to recognize an ethical issue imbedded in a technical, professional situation. Shaub (1989) originally developed his ethical sensitivity measure based on Bebeau, Rest, and Yamoor's (1985) Dental Ethical Sensitivity Test. Shaub's work is based on the observation in the helping professions that professionals who are preoccupied with technical issues or the demands of the profession may tend to overlook ethical issues. This is true in counseling (Volker, 1984) and even in a seminary setting (Darley & Batson, 1973). Bebeau et al.'s (1985) work, like Volker's, was based on professionals listening to audio tapes, while Darley and Batson (1973) used confederates to create a realistic setting that forced seminary students to choose between helping someone in need or walking past them to deliver a sermon on The Good Samaritan.

Shaub et al. (1993) use a written instrument and ask 207 auditors to identify significant issues in an auditing scenario that includes a number of professional issues, as well as three imbedded ethical issues – eating hours (under-reporting time), the personal use of firm time to correspond with a prospective employer, and subordination of judgment over a generally accepted accounting principles (GAAP) issue.

Ethical orientation (Forsyth, 1980) is measured by two orthogonal concepts, idealism and relativism. An idealist generally believes that doing the right thing will result in the right outcomes; a low idealist is a pragmatist. Relativists reject absolutes and rules that define ethical behavior. Shaub et al. (1993) find that ethical orientation is related to ethical sensitivity; auditors high on idealism and those high on relativism are both less ethically sensitive. Shaub (1989, p. 139) reports that auditors' ethical reasoning using Rest's (1986a) DIT is uncorrelated with ethical sensitivity.

Karcher (1996) varies the level of each of her three scenarios, presenting a moderate level and severe level to determine differences in ethical sensitivity to each setting across levels in the firm and other demographics. In general, demographics do not explain either ethical sensitivity or the importance ratings assigned to the scenarios across levels of severity.

Patterson (2001) uses Karcher's (1992) measure of ethical sensitivity in her study of causal effects of ethical sensitivity. Based on the Hunt and Vitell (1986) model, she predicts that ethical sensitivity will be a function of industry environment, organizational environment, and personal experiences. Industry environment includes codes of conduct, licensing requirements, and judicial oversight. Peer and management relations, corporate ethics policies, and competition would be included in organizational environment, and personal experiences include motivation, self-concept, and ethical development. Patterson finds no support for any of the three constructs affecting ethical sensitivity.

An auditor who is more sensitive to ethical issues in a professional context would be expected to be more likely to be able to evaluate potential motives of management to misstate financial statements or not fully disclose. Thus, a positive relationship is expected between ethical sensitivity and trait PS in the current study. In the alternative form, then:

H1. Trait PS is higher for those auditors with higher ethical sensitivity.

Ethical Reasoning

Substantial research in auditors' ethical reasoning has been conducted over the last three decades, since Armstrong (1987) reported that certified public accountants (CPAs) had significantly lower levels of ethical reasoning than college students did. Her statement struck a nerve in the profession:

> These results indicate that the CPA respondents appear to have reached the moral maturation level of adults in general, instead of maturing even to the level of college students, much less to the level of college graduates. In other words, their college education may not have fostered continued moral growth. (Armstrong, 1987, p. 33)

Her work gave rise to a cadre of researchers interested in understanding accountants' and auditors' ethical reasoning.

Ponemon (1992), using cross-sectional, longitudinal, and experimental approaches, finds that there is an ethical socialization process by which those promoted to the manager and partner levels in accounting firms tend to show lower and more homogeneous levels of ethical reasoning as measured by Rest's (1986a) DIT *P*-score. Shaub (1994) reveals a similar trend in moral reasoning scores, with

increasing scores to the experienced staff level and then declining scores thereafter. Thorne, Massey, and Magnan (2003) report similar results for both US and Canadian auditors. Jones, Massey, and Thorne (2003) provide a thorough summary of insights from ethical reasoning research in accounting.

Thorne (2000) develops an accounting-specific instrument, the Accounting Ethical Dilemma Instrument (AEDI), measuring ethical reasoning using accounting case scenarios. Two versions of this instrument measure prescriptive reasoning (cognitive capacity) and deliberative reasoning. The results of Thorne's (2000) study using her instruments include the inference "… that accountants respond to social factors when formulating their ideal professional judgment and respond to self-interest in the exercise of professional judgment" (p. 154). Therefore, both measures are potentially important in understanding accountants' ethical decision making, since "… short-term contextual factors may adversely affect accountants' propensity to formulate and exercise professional judgment according to their cognitive moral capacity" (Thorne, 2000, p. 154). The prescriptive measure more nearly matches Rest's (1986a) DIT, though Thorne (2000) reports lower *P*-scores for her prescriptive measure than for Rest's, and even lower for the deliberative measure. Massey (2002) develops her own adaptation of Rest's DIT she calls the audit-specific DIT and similarly finds *P*-scores that are higher in generic contexts than in an auditing context. However, she finds auditors more rule-based than principles-based in both contexts.

Several accounting studies use Thorne's measure of ethical reasoning. Thorne (2001) finds that cooperative accounting students use more principled reasoning in addressing hypothetical moral dilemmas like those in the DIT than in accounting-specific dilemmas like those in the AEDI. When split into two sub-samples, subjects' prescriptive reasoning scores are also higher than the deliberative reasoning scores. Thorne et al. (2003) compare US and Canadian auditors' moral reasoning using both the DIT and the AEDI. They find US auditors marginally higher in deliberative reasoning, but similar in both moral development using the DIT and in prescriptive reasoning. Earley and Kelly (2004) study the impact of educational interventions in an undergraduate auditing course, assessing pre- and post-course moral reasoning using both Thorne's and Rest's measures, both pre- and post-Enron. AEDI scores increase in both semesters tested, while DIT scores do not (consistent with prior DIT research).

In general, it is expected that there will be a positive relationship between ethical reasoning and trait PS based on measures designed around cognitive moral developmental theory. The theory of cognitive moral development (Kohlberg, 1976) predicts that cognitive development must take place prior to moral development; moral development is capped at the level of cognitive development because of the inability to attend to more principled moral arguments rather than simply following rules.

Four of the six sub-constructs under Hurtt's (2010) measure of trait PS are clearly cognitive in nature: questioning mind, suspension of judgment, search for knowledge, and interpersonal understanding (of motives). Only autonomy and self-esteem appear to be affective in nature, but autonomy is also cognitive in that it is a measure of the ability to self-determine. It includes items like, "I usually