

PROFESSIONAL JUDGMENT

A key requirement in the conduct of an audit

AUDIT TRAINING OF TRAINERS

Vienna

October 2, 2017

PROFESSIONAL JUDGMENT

- **ISA 200**
- **POTENTIAL JUDGMENT TENDENCIES, TRAPS AND BIASES**
- **ELEMENTS OF AN EFFECTIVE JUDGEMENT PROCESS**
- **TIPS TO REDUCE POTENTIAL JUDGMENT TENDENCIES**

ISA 200

Overall objectives of the independent auditor and the conduct of an audit in accordance with ISAs

- In conducting an audit of financial statements, the overall objectives of the auditor are:
- (a) **To obtain reasonable assurance about** whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- (b) **To report on the financial statements**, and communicate as required by the ISAs, in accordance with the auditor's findings.

ISA 200

Overall objectives of the independent auditor and the conduct of an audit in accordance with ISAs

Requirements :

§ 14. Ethical requirements

§ 15. Professional skepticism

§ 16. Professional judgement

§17. Sufficient appropriate Audit Evidence and Audit risk

§ 18. Conduct of an audit in accordance with ISAs

ISA 200

Requirement. Professional skepticism

- The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. (Ref: Para. A18–A22)

Comment:

- —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 evidence. *

ISA 200

Requirement :§ 16. Professional judgement

- The auditor shall exercise professional judgment in planning and performing an audit of financial statements. (Ref: Para. A23–A27)

Comment :

- —The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement

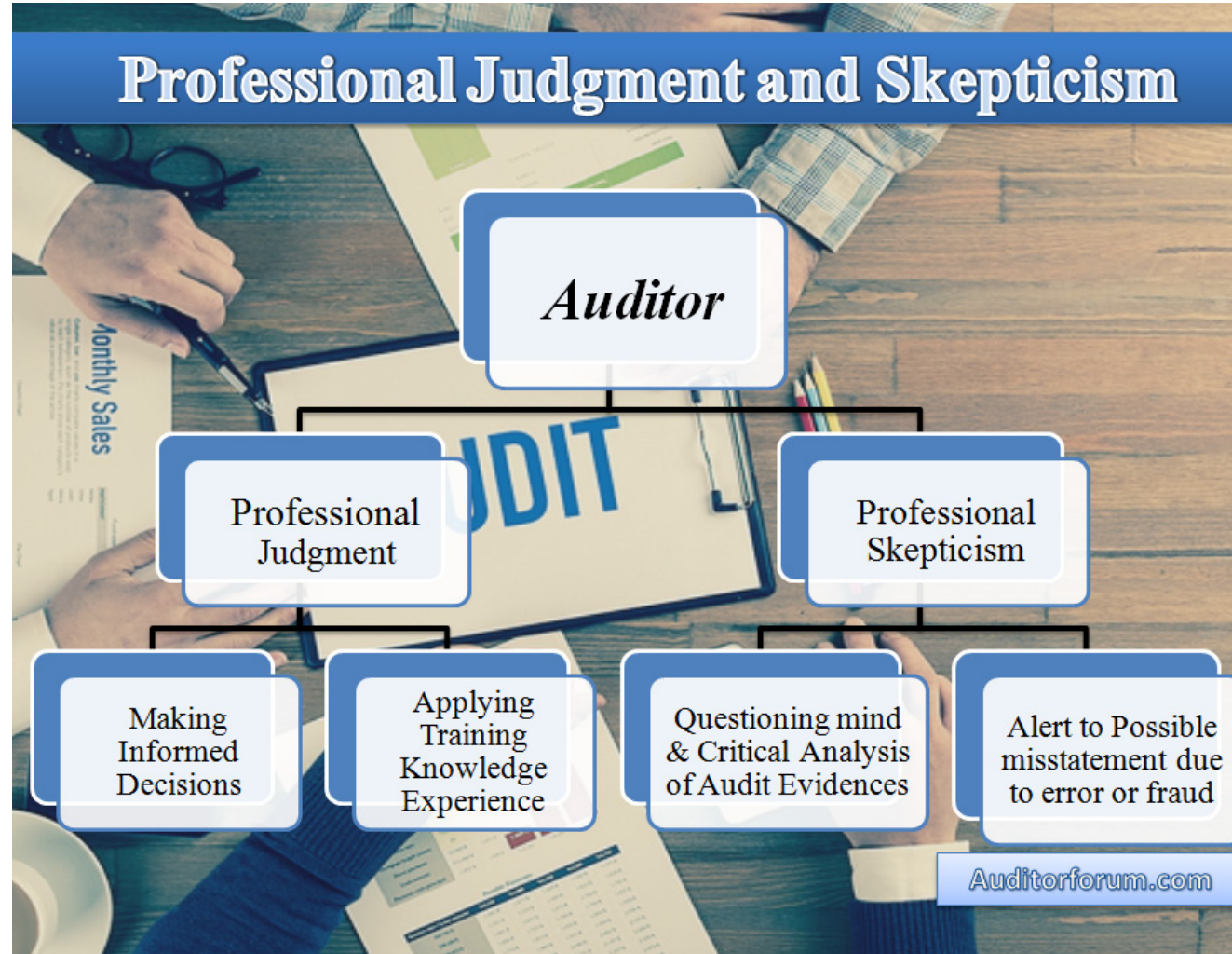
ISA 200

Requirement :§ 16. Professional judgement

Professional judgement is mostly required in the following areas:

- Setting materiality levels
- Nature, timing and extent of audit procedures
- Deciding whether sufficient evidence has been obtained or further procedures are needed
- Evaluation of management's judgments
- The drawing of conclusions based on audit evidence obtained

ISA 200



PROFESSIONAL JUDGMENT

- **ISA 200**
- **POTENTIAL JUDGMENT TENDENCIES, TRAPS AND BIASES**
- **ELEMENTS OF AN EFFECTIVE JUDGEMENT PROCESS**
- **TIPS TO AVOID POTENTIAL JUDGMENT TENDENCIES**

POTENTIAL JUDGMENT TENDENCIES, TRAPS AND BIASES

- **Common potential tendencies**

1. Confirmation
2. Overconfidence
3. Anchoring
4. Availability

POTENTIAL JUDGMENT TENDENCIES, TRAPS AND BIASES

- **Common potential tendencies**

1. Confirmation

- To put more weight on information that are consistent to my initial beliefs or expectations

2. Overconfidence

- To overestimate my ability to perform tasks or make accurate assessments

POTENTIAL JUDGMENT TENDENCIES, TRAPS AND BIASES

- **Common potential tendencies**

3. Anchoring

To make assessment by starting from an initial numerical value and then adjusting insufficiently away from that initial value in forming a final judgment

4. Availability

Potential tendency to consider information that is easily retrievable being more likely, more important for a judgment

ANCHORING : example

- Audit client : A Savings & Loans company
- Loans portfolio : 10 million €
- Audit work :

Assessment of provisions for loans delinquencies in year Y

Audit process :

Year Y-1

Company applied a depreciation rate of 5 % for loans portfolio

Year Y

- Due to increase level of delinquency, Company adjusted rate to 7 %
- Senior Auditor proposed a revised rate of 9 % with reference to his past experience
- Audit manager recommended a rate of 15 % after reviewing industry trends and economics forecasts

Anchoring

- What is 'Anchoring'
- Anchoring is the use of irrelevant information as a reference for evaluating or estimating some unknown value or information.
- When estimating a value, individuals often anchor on a preliminary amount and then make adjustments to arrive at their final estimate; however, they often make insufficient judgments to arrive at the appropriate value.
- For auditors, this type of bias may occur during the risk assessment phase. It may also affect analytical review procedures and sample assessments.
- Auditors are particularly vulnerable to this bias since they typically begin their process with management-provided anchors (i.e., financial statements).

POTENTIAL JUDGMENT TENDENCIES, TRAPS AND BIASES

Examples of potential tendencies, biases

Overreliance on experience

“I know my client” , I know the industry

Overreliance on past practice :

“Same as last year approach”

Judgment shortcuts:

Jumping to a conclusion based on previous cases

Group decision – making :

Tendency to narrow thinking, suppression of divergent views, need to reach a consensus

PROFESSIONAL JUDGMENT

- **ISA 200**
- **POTENTIAL JUDGMENT TENDENCIES, TRAPS AND BIASES**
- **ELEMENTS OF AN EFFECTIVE JUDGEMENT PROCESS**
- **TIPS TO AVOID POTENTIAL JUDGMENT TENDENCIES**

ELEMENTS OF AN EFFECTIVE JUDGEMENT PROCESS

- Professional Judgment Resource



- 1155 F Street NW Suite 450 Washington, DC 20004 202-609-8120
www.thecaq.org

ELEMENTS OF AN EFFECTIVE JUDGEMENT PROCESS

- The exercise of professional judgment should be :
 - Based on the relevant facts and circumstances and available at the time the judgment is made
 - Made after the consideration of reasonable alternatives
 - Sensitive to the degree of uncertainty that may be inherent in the judgement
 - In compliance with the applicable professional standards

ELEMENTS OF AN EFFECTIVE JUDGEMENT PROCESS

1. Identifying the issue
2. Gather the facts
3. Perform the analysis and identify potential alternatives
4. Make the decision
5. Review and complete the documentation

ELEMENTS OF AN EFFECTIVE JUDGEMENT PROCESS

1 - Identifying the issue :

Which issue ? Transaction, event, etc.

This step may be overlooked by judgement tendencies such as *overconfidence or biases*,

Ability of an auditor to consider available audit evidence that contradicts management's assertions

ELEMENTS OF AN EFFECTIVE JUDGEMENT PROCESS

2. Gather the facts

Is evidence gathered sufficient and appropriately reliable ?

Self questioning will help to mitigate potential judgment tendencies and biases

ELEMENTS OF AN EFFECTIVE JUDGEMENT PROCESS

3. Perform the analysis and identify potential alternatives

Compare with prior positions taken in similar situations by the company, the audit firm, the auditor (past experience) and relevant authoritative literature, external specialists,

ELEMENTS OF AN EFFECTIVE JUDGEMENT PROCESS

4. Make the decision

- At that stage, the auditor should consider whether a reliable process has been followed
- Practical consideration:
- Too much reliance on easily available information

ELEMENTS OF AN EFFECTIVE JUDGEMENT PROCESS

5. Review and complete the documentation

- ✓ A written record of the basis for decision made
- ✓ A way to evidence professional skepticism
- ✓ A picture of the existing situation at the time of the audit work

PROFESSIONAL JUDGMENT

- **ISA 200**
- **ELEMENTS OF AN EFFECTIVE JUDGEMENT PROCESS**
- **POTENTIAL JUDGMENT TENDENCIES, TRAPS AND BIASES**
- **TIPS TO AVOID POTENTIAL JUDGMENT TENDENCIES**

TIPS TO AVOID POTENTIAL JUDGMENT TENDENCIES

- For the same audit engagement and every year, we should focus on specific components of ISA 315:

« Understanding the entity and its environment »

« Evaluating internal control »

Check changes in

Market conditions

Staff changes ,

Production process ,

Accounting rules (revenue recognition)

TIPS TO AVOID POTENTIAL JUDGMENT TENDENCIES

- Involve the right people in the judgment process
- Encourage opposing points of view
- Consider disconfirming evidence
- Consider management bias, including the potential for fraud or material misstatements

PROFESSIONAL JUDGMENT

- **THANK YOU**