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## **PROFESSIONAL SKEPTICISM OF AUDITORS AND RISK OF FRAUDULENT FINANCIAL REPORTING**

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### **ABSTRACT**

Fraudulent financial reporting refers to the deliberate misstatements, omissions or significant disclosures in the financial statements in order to deceive users of financial statements. The frequency of fraudulent financial reporting is increasing and the auditor should perform an audit with an attitude of professional skepticism and a questioning mind, a critical assessment of the audit evidence and to be alert, especially when considering and assessing fraud risk in order to provide reasonable assurance that the financial statements are free from material misstatements caused by fraud. Skepticism depends on the individual characteristics of the auditor, but skepticism will be also affected by the professional knowledge, training and experience with the significant audit firm's role in the creation and implementation of policies and procedures that promote the importance of skepticism during the audit process. The auditor is not responsible for the prevention and detection of fraud, but it is the responsibility of the management, which must establish appropriate fraud risk management program. The auditor is expected that with an attitude of professional skepticism implements procedures to identify and estimate the risk of fraud, performs appropriate procedures in response to the assessed risk of fraud, particularly in the evaluation of the collected evidence, and to communicate identified risks and express an opinion on the financial statements. Results of the research indicate, that the auditors, although recognizing the importance of skepticism, do not demonstrate the appropriate level of skepticism when assessing the risk of fraud. Therefore, there is need of continuous education about fraud and emphasizing the importance of skepticism at the audit firm level.

*Keywords: professional skepticism of auditors, risk assessment, audit, fraud, fraudulent financial reporting*

## 1. INTRODUCTION

As a research problem is considered whether the auditor during the audit, as required by professional standards, expresses attitude of professional skepticism, with an emphasis on determining the relationship, the role and impact of skepticism on the review and assessment of the risk of fraudulent financial reporting. So far, in the Republic of Croatia research has not been conducted, while in the countries with most developed accounting and auditing profession more and more attention is paid to the stated problem, especially after many global corporate scandals caused by fraud.

The research objectives are defined as follows: **C1:** *To determine whether the estimated risk of fraud in the audit planning phase affects the degree of auditor's professional skepticism in subsequent phases of the audit.* **C2:** *To determine whether the impact of professional skepticism on the assessment of the fraud risk is in relation to the experience of the auditor.* **C3:** *To determine whether the length of engagement with a client affects the auditor's professional skepticism.*

With regard to the research objectives the following hypotheses are defined: **H1:** *Assesment of low fraud risk in the planning phase will impact on the decrease of auditor's professional skepticism in subsequent phases of the audit.* **H2:** *Auditor's experience affects the professional skepticism and the ability to assess the risk of fraud.* **H3:** *A longer period of conducting an audit at one client affects reduction of auditor's professional skepticism.*

For research purposes a combination of several scientific – research methods was used: induction and deduction method, the method of analysis and synthesis, the historical method, description method, method of compilation, deductive – logical methods, empirical – inductive method and statistical method. As a data source were used foreign and domestic literature and books, scientific and professional journals published in electronic databases, a variety of publications, laws and standards relating to the subject of research.

## 2. DEFINITION OF ACCOUNTING FRAUD

The concept of fraud is complex and there is no single definition. Generally, fraud includes a wide range of irregularities and illegal acts that could broadly be defined as deliberate deception or misrepresentation that aims to gain benefits in an unlawful manner. International Standard on Auditing (ISA) 240 – The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements defines fraud as, "...an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage."<sup>1</sup>

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<sup>1</sup> Međunarodni revizijski standardi, Međunarodni standardi kontrole kvalitete, Međunarodne smjernice revizijske prakse, prijevod s engleskog jezika, Hrvatska revizorska komora, Zagreb, 2010, MRevS 240, point 11

Further, Association of Certified Fraud Examiners (ACFE) states that fraud is „intentional, deliberate, misstatement or omission of material facts, or accounting data which is misleading and, when considered with all the information made available, would cause the reader to change or alter his or her judgment or decision.“<sup>2</sup>

Usually, basic categories of fraud are:<sup>3</sup> (1) financial statement fraud, (2) asset misappropriations and (3) corruption. ISA 240 defines scope of auditor's work and the auditor's responsibilities relating to fraud in an audit of financial statements, so the auditor will consider the possibility of occurrence of only two types of misstatements, which are fraudulent financial reporting and misappropriation of assets. This paper discusses the fraud focusing on *fraudulent financial reporting*, which refers to the deliberate misstatements, omissions of amounts or financial statements disclosures to deceive users of financial statements. Financial statement fraud may involve these schemes:<sup>4</sup> (a) falsification (including forgery), alteration or manipulation of financial records, supporting documents or business transactions, (b) material intentional omissions or misrepresentations of events, transactions or other significant information from which financial statements are prepared, (c) deliberate misapplication of accounting principles, policies, and procedures used to measure, recognize, report and disclose economic events and (d) intentional omissions of disclosures or presentation of inadequate disclosures regarding accounting principles and policies.

Criminologist Cressey developed the basic concept for fraud consideration, the so-called „Fraud Triangle“ and found three elements are present in each fraud occurrence, which are: *pressure (motive)*, *opportunity and rationalization (justification)*. Although the fraud perpetrators can be management or employees, all perpetrators demonstrate features different from normal behavior or warning signs of fraud, the so-called. „Red Flags“. Each company is exposed to fraud risk and the management responsibility is to establish a fraud risk management program, periodically evaluate risk exposure, implement preventive and detective controls to prevent and detect fraud, and to establish corrective mechanisms and reporting process on the identified risks. The most common victims of fraud are those companies that do not have implemented internal controls, and the most common risk areas or financial statements ele-

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<sup>2</sup> Association of Certified Fraud Examiners, *Cooking the Books: What Every Accountant Should Know about Fraud*, No. 92-5401, Self-Study Workbook, (Austin, TX: Author, 1995), page 12, according to Rezaee, Z., Riley, R.: *Financial Statement Fraud: Prevention and Detection*, 2nd ed., John Wiley&Sons, Inc., Hoboken, New Jersey, 2010, page 5

<sup>3</sup> ACFE, *Report to the Nation on Occupational Fraud and Abuse*, 2010 Global Fraud Study, page 10, available at: [http://www.acfe.com/uploadedFiles/ACFE\\_Website/content/documents/rtnn\\_2010.pdf](http://www.acfe.com/uploadedFiles/ACFE_Website/content/documents/rtnn_2010.pdf), 5.1.2012

<sup>4</sup> Rezaee, Z., Riley, R.: *Financial Statement Fraud: Prevention and Detection*, 2nd ed., op.cit., page 7

ments subject to a considerable incorrect expression due to fraud are overstatement of revenues and assets, understatement of costs and liabilities and inaccurate, inappropriate or omitted presentation.

### **3. DEFINITION AND CHARACTERISTICS OF PROFESSIONAL SKEPTICISM**

The term skepticism derives from the Greek word skepticism and is defined generally as the propensity for doubt, suspicion, mistrust, distrust.<sup>5</sup> Recent corporate scandals (eg. Enron, WorldCom, Parmalat), failure of auditors during the auditing process and the global financial crisis affected the growing importance of expressing auditor's skepticism with the aim of increasing audit quality. ISA 200 – *Overall Objective of the Independent Auditor, and the Conduct of an Audit in Accordance with International Standards on Auditing* requires that the auditor uses professional judgment and maintain professional skepticism throughout the planning and performing the audit due to circumstances which could cause the financial statements to be material misstated and defines professional skepticism 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.”<sup>6</sup> Further, ISA 240 defines professional skepticism as „...an attitude that includes a questioning mind and critical assessment of audit evidence.”<sup>7</sup>

Accordingly, it is necessary to retain the attitude of professional skepticism even when there is previous experience on the honesty and integrity of management, since the circumstances could change, so the auditor must collect convincing evidence in order to be still confident in that. The auditor must continuously examine the reliability and whether obtained information and evidence indicate existence of significant misstatement due to fraud.

Characteristics and factors of professional skepticism and influence of skepticism on the auditor's behaviour can be shown with Hurtt model (picture 1.).

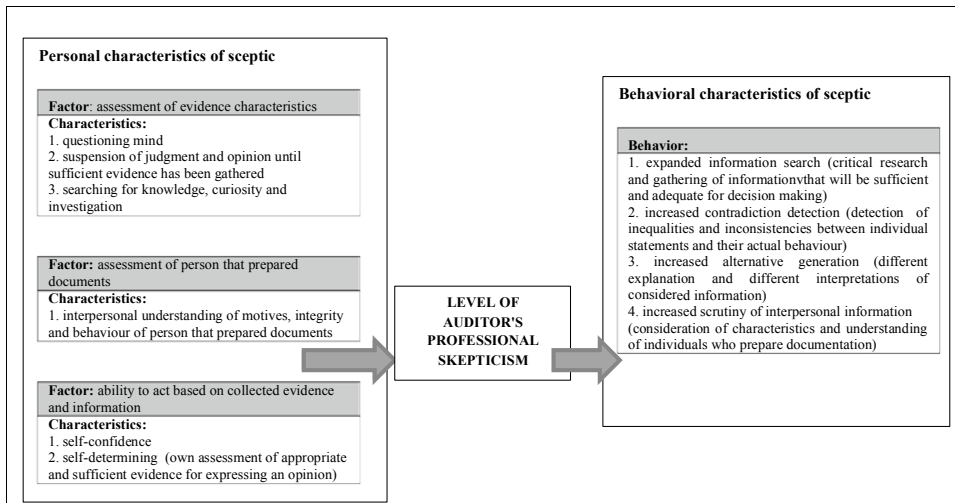
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<sup>5</sup> Klaić, B.: Rječnik stranih riječi, Nakladni zavod Matice Hrvatske, Zagreb, 1982, page 1238

<sup>6</sup> Međunarodni revizijski standardi, Međunarodni standardi kontrole kvalitete, Međunarodne smjernice revizijske prakse, prijevod s engleskog jezika, op.cit., MReVS 200, point 13.(I)

<sup>7</sup> Ibid., MReVS 240, point A7

**Picture 1.** Model of professional skepticism



Source: Adjusted according Hurtt, K.R.: *Development of an Instrument to Measure Professional Skepticism*, University of Wisconsin-Madison, November 2001, page 18, available at: [https://docs.google.com/viewer?a=v&q=cache:gM9268YDrqMJ:home.business.utah.edu/actdp/Acttg%25207000/Instrument.doc+&hl=en&gl=hr&pid=bl&srcid=ADGEESibRcvM M040Zu6YyjzeR0fSRfk4SzT\\_apGCzIFoenEuorJJa3FZZQENq3ETT8vc2Z0Rx3vkqm6MaQt-4BLQk1YH3IVuK4nCNJd8to-5sOLU3NH5aIE99UPN1EkdZf3Z336aTRUU2&sig=AHIEtbQY1PR-CsCTqBMzvXeTw1DsDt90Q, 19.12.2011](https://docs.google.com/viewer?a=v&q=cache:gM9268YDrqMJ:home.business.utah.edu/actdp/Acttg%25207000/Instrument.doc+&hl=en&gl=hr&pid=bl&srcid=ADGEESibRcvM M040Zu6YyjzeR0fSRfk4SzT_apGCzIFoenEuorJJa3FZZQENq3ETT8vc2Z0Rx3vkqm6MaQt-4BLQk1YH3IVuK4nCNJd8to-5sOLU3NH5aIE99UPN1EkdZf3Z336aTRUU2&sig=AHIEtbQY1PR-CsCTqBMzvXeTw1DsDt90Q, 19.12.2011)

Also, apart from personal characteristics, auditor’s skepticism is influenced by auditor’s knowledge, experience and training, as well as the audit firm by establishing certain procedures, work methodology, quality control of work and rules of conduct, but also with education that promotes the importance of skepticism during the audit process.

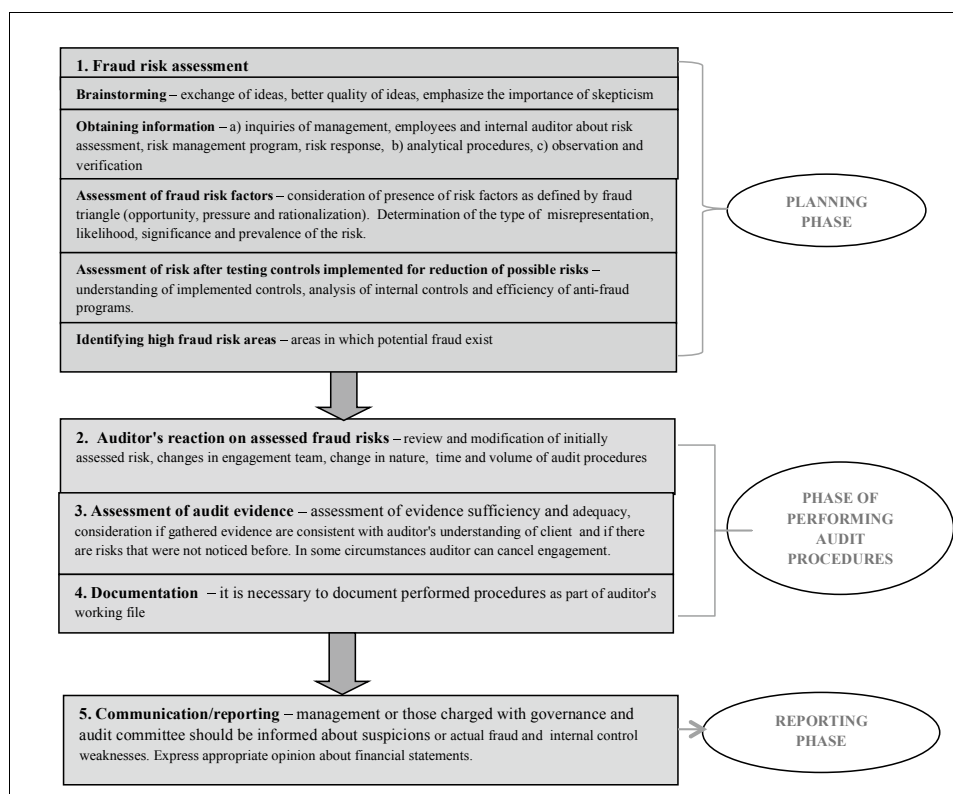
#### 4. AUDITOR’S FRAUD RISK ASSESSMENT PROCEDURES IN DETECTING FRAUDULENT FINANCIAL REPORTING

In general, risk represents the uncertainty of event occurrence, which could have detrimental effect on the achievement of objectives and is measured as a combination of the probability of an event and its consequences. With an attitude of professional skepticism and due professional care, the auditor has to assess inherent risk, control risk, audit and fraud risk and materiality. The fraud risk represents the probability fraud will occur or potential severity and consequences for the company when it comes to fraud.<sup>8</sup>

<sup>8</sup> Fondacija za istraživanje Instituta internih revizora (IIA), Okvir profesionalnog djelovanja, Hrvatski institut internih revizora, Zagreb, March 2007, page 102

As already mentioned, ISA 240 provides guidance on the auditor’s responsibilities in respect of fraud in the audit of financial statements, when it is estimated that the risk of fraudulent financial reporting is increased. Fraud risk assessment is carried out in three basic steps, namely: (1) *in the planning phase* auditor carries out procedures to identify and estimate the fraud risk, (2) *in the phase of performing further audit procedures* the auditor performs audit procedures in response to assessed fraud risk and considers the risk of fraud when evaluating the evidence collected, and (3) *in the reporting phase* auditor communicates recognized risks and express opinion on the financial statements.

**Picture 2.** Overview of the auditor procedures when assessing fraud risk by individual phases of audit



Source: Adjusted according ASOSAI, Session 3.1. Overview of Fraud and Corruption Detection Process, page 3, available at: <http://audit.bhutanaudit.gov.bt/contents/papers/asosai-pakistan/Overview%20of%20Fraud%20and%20Corruption%20Detection%20Process.pdf>, 14.3.2012

## **5. RESULTS OF RESEARCH ABOUT ROLE OF AUDITOR'S PROFESSIONAL SKEPTICISM IN ASSESSMENT OF RISK OF FRAUDULENT FINANCIAL REPORTING**

### **5.1. BASIC INFORMATION ABOUT EMPIRICAL RESEARCH**

The research was conducted in the Republic of Croatia during August 2012, using the method of a random sample of the target population of subjects relating to active certified auditors. According to the Register of the Croatian Audit Chamber, as of 1.8.2012 there were 544 active certified auditors. The survey was conducted by distributing questionnaires via e-mail to 235 active certified auditors, and since Snowball method has been used, answers from unauthorized auditors were also collected. 77 questionnaires were collected (distribution according to different criteria was provided: age, sex, years of working experience, positions in the auditing company, experience with fraud, etc.) and the rate of return was 33%. The rate of return is satisfactory, the results of research were formed based on significant data and research requirements were met.

Survey questions are defined as follows: (1) open type questions - respondents can formulate a response alone, (2) closed type questions - the possibility to choose one or more predefined responses and (3) closed type questions - expressing agreement with the default assertions using a Likert scale.

Data entry and processing of collected data was performed using statistical program SPSS 19.0. The methods of descriptive statistics of each variable were used and testing of differences between subsamples is performed. Closed type questions were analyzed using frequency analysis, measures of central tendency and dispersion measures. The hypothesis of categorical variables were tested using chi-square test of independence of characteristics in the contingency table, that checked the statistical significance of differences in the frequency of specific responses to a particular question, while differences between subsamples on continuous variables were tested using t-test. The selected level of statistical significance was 5%.

### **5.2. PRESENTATION OF EMPIRICAL RESEARCH RESULTS**

Research was conducted among auditors on a sample of 77 participants of which 53% were women and 47% men. The average age of the respondents was 35.4 years with an average deviation of 9.30 years, i.e. 26% and the average number of years of experience in audit practice was 9.5 years with an average deviation of 6.46 years, i.e. 68 %. According to the current position in the audit company, most respondents are at the position of manager (53%), 22% at the

position of partners, while an equal number of respondents are at the position of senior manager (13%) and assistants (12%). 86% of respondents passed an exam for certified auditors, i.e. 14% did not. 60% of respondents had experiences with financial statements fraud, while 40% did not, i.e. each respondent met with fraud during work experience on average 1.40 times, of which 54% auditor met with fraud 1-5 times, 35 % between 5-10 times and more than 10 times 11% of auditors.

The auditors are aware of the importance and the role of skepticism when conducting the audit procedures and while considering the risk of fraudulent financial reporting (99% of respondents) and believe that skepticism has a significant impact on the professional judgments of the auditor (88% of respondents) depending on the individual characteristics of auditors (72% of respondents), primarily on self-confidence (97% of respondents), questioning mind (96% of respondents) and suspension of judgment (93% of respondents). On the other hand, auditors find that during the audit they do not express a sufficient level of skepticism to assess the risk of fraud and to identify fraudulent financial reporting (65% of respondents), and the cause of this behavior is the lack of experience and knowledge necessary to recognize the significant indicators of fraud (64% of respondents).

The most common areas of fraudulent financial reporting relate to revenue 30.4%, inventories 17.9%, trade receivables 16.1%, then non-current assets with 14.3%, expenses and liabilities with 12.5%, 8.9% respectively, while as the most common perpetrators of fraud 63% respondents state management, followed by the owners with 23% and employees with 14%.

When assessing the risk of fraud, following procedures are most often carried out: inquiries of management, internal audit and employees (73% of respondents), checking the adequacy of the implemented internal controls for preventing and detecting fraud (69% of respondents) and analytical procedures (62% of respondents).

The results of tested hypothesis are presented below.

**The first hypothesis** examines whether the estimated risk of fraud in the audit planning phase affects the degree of auditor's professional skepticism in subsequent phases of the audit and is as follows: **H1: Assessment of low fraud risk in the planning phase will impact on the decrease of auditor's professional skepticism in subsequent phases of the audit.**

*The hypothesis will be confirmed only if the average grade for more than 50% of assertions is higher than the median. Median = 3.*

This hypothesis was tested in a way that the participants are asked to rate on the Likert scale from 1 to 5 (1-strongly disagree, 2-disagree, 3-neither agree



nor disagree, 4-agree, 5-strongly agree) the extent to which they agree with each assertion.

Furthermore, additional analysis is performed in a way that the total population of 77 respondents was divided in two groups, based on the assertion they represented. *Group 1* - 75% of respondents believe that the assessment of obtained audit evidence affects the level of initially estimated fraud risk in the planning phase, and *group 2* - 25% of respondents believe that the initially estimated fraud risk level in the planning phase does not change in the subsequent phases of the audit. These responses indicate that initially estimated low level of fraud risk in the planning phase should not affect the skepticism and auditor's behaviour, and that the auditors will express an appropriate level of skepticism during all audit phases, adjusting the size of the estimated risk to new circumstances. To test whether there are statistically significant differences between the two groups the chi-square test was used.

**Table 1.:** The frequency of agreement, the average grade of agreement and the results of the chi-square test for the impact of the assessed low level fraud risk in the planning phase at the professional skepticism and auditor's behaviour in subsequent stages of the audit

Assertion	1 (%)	2 (%)	3 (%)	4 (%)	5 (%)	Average	chi-square	p-value
1. Conduction of simple auditing procedures by applying a general audit program without introducing elements of unpredictability in the audit procedures or significant program modifications.	5.2	14.3	23.4	45.5	11.7	3.44	2.303	.680
2. Collection of less evidence and reduced scope of documents collected from independent third sources.	3.9	31.2	26.0	35.1	3.9	3.04	2.201	.699
3. Reliance on statements and accepting management statements with reduced caution and less critical assessment.	3.9	32.5	22.1	32.5	9.1	3.10	1.789	.774
4. Audit teams are often formed of less experienced auditors with occasional and not detailed monitoring and review of working papers by the responsible person.	10.4	23.4	15.6	35.1	15.6	3.22	1.801	.772
5. No changes in methods of conducting and the type of audit procedures, ie. conducting the same audit procedures as in previous years.	3.9	28.6	24.7	28.6	14.3	3.21	4.277	.370
6. Reliance on the tests of controls carried out in previous years without testing of controls in the current year.	18.2	23.4	18.2	29.9	10.4	2.91	4.425	.352

Assertion	1 (%)	2 (%)	3 (%)	4 (%)	5 (%)	Average	chi-square	p-value
7. Level of trust in management responses is high.	13.0	27.3	24.7	32.5	2.6	2.84	1.631	.803
8. Inconsistency in the gathered evidence is often explained as a result of errors, not as a fraud.	7.8	27.3	26.0	31.2	7.8	3.05	3.554	.470
9. Acceptance of company's accounting policies and estimates made by management without significant assessment of appropriateness of their implementation.	7.8	32.5	16.9	32.5	10.4	3.05	3.201	.525
10. Acceptance of review into photocopied documentation as a credible basis for recording business transactions.	1.3	27.3	26.0	37.7	7.8	3.23	5.977	.201

Source: Pretnar Abičič, S.: *Profesionalni skepticizam revizora i rizik prijevernog financijskog izvještavanja, magistarski rad, Ekonomski fakultet Zagreb, Zagreb, 2012*

The average score of answers for eight out of ten assertion, ie. for 80% of all assertions was above the median, so it can be concluded that the assessment of low level fraud risk in the planning phase impacts on decrease of auditor's professional skepticism in subsequent stages of the audit.

Furthermore, the results of chi-square tests indicate that with 5% probability there are no statistically significant differences between the two groups, ie. auditor's professional skepticism is decreasing due to the impact of the low level risk of fraud assessed in the planning stage on auditor's behaviour in subsequent stages of audit. This means that in practice the respondents from group 1 are acting contrary to their beliefs, ie. skepticism and their actions during the audit will be affected by initially estimated low risk in the planning phase. *The first hypothesis is in fully confirmed.*

**The second hypothesis** examines whether the level of professional skepticism and fraud risk assessment depend on the auditor's experience and is as follows: **H2: Auditor's experience affects the professional skepticism and the ability to assess the risk of fraud.**

In order to determine the relationship between auditor's experience, professional skepticism and fraud risk assessment, respondents are asked, based on past experience, to assess on the Likert scale from 1 to 5 (1-no impact, 2-weak impact, 3-moderate impact, 4-strong impact, 5-very strong impact on the increase) the extent to which certain factors identified during the audit, and related to revenue recognition, affect the expression of auditor's professional skepticism and also fraud risk should be assessed taking into account these factors.

When testing this hypothesis two assumptions were considered and two areas were tested:

*a) previous experience with fraud, regardless of years of work experience in audit practice, affects the higher increase in professional skepticism and the assessment of higher fraud risk level compared to the absence of previous experience with fraud*

*Hypothesis H2a) will be confirmed if for individual assertions  $p < 0.05$ .*

The total sample of 77 respondent is divided into two groups, based on previous experience with fraud. *Group 1* - respondents with fraud experience (60% of respondents), *group 2* - respondents without fraud experience (40% of respondents). The hypothesis is tested in a way to determine whether there is statistically significant difference in frequency of answers between the two respondent groups. Testing was conducted using chi-square test.

*b) longer years of experience in audit practice affects the higher increase in professional skepticism and the assessment of higher fraud risk levels comparing to shorter working experience in audit practice*

*Hypothesis H2b) will be confirmed if for individual assertions  $p < 0.05$ .*

The total sample of 77 respondent is divided into two groups, based on average number of years of work experience which is 9.5 years. *Group 1* - respondents with work experience less than 9.5 years (52% of respondents), *group 2* - respondents with work experience more than 9.5 years (48% of respondents). The hypothesis is tested in a way to determine if there is statistically significant difference in average grade for assertions for which significant difference in answers between the two groups of respondents was identified (assertions 8, 11, 13 and 15). Testing was conducted using t-test.

**Table 2.:** Results of chi-square test and t-test for the intensity of influence of factors related to revenue recognition observed during the audit on expression of auditor's professional skepticism attitude and assessment of fraud risk

Factors	Hypothesis H2a		Hypothesis H2b (t-test)				
	chi-square	p-value	t	df	p	Arith. mean difference	Standard error of the difference
1. Results of preliminary analytical procedures showed deviations of revenue in relation to the expectations and the results of the previous year.	2.936	.569	-.101	75	.920	-.01959	.19478
2. Client's management conducts aggressive accounting practice in recording business transactions.	1.083	.897	-1.175	75	.244	-.27095	.23062
3. Occurrence of occasional unusual transactions related to income.	3.226	.358	-.133	75	.895	-.02432	.18344

Factors	Hypothesis H2a		Hypothesis H2b (t-test)				
	chi-square	p-value	t	df	p	Arith. mean difference	Standard error of the difference
4. Rapidly revenue increase or unusual profitability compared to other companies in the same industry.	5.468	.141	.275	75	.784	.05270	.19144
5. Negative operating cash flows or inability to generate cash flows from operations with simultaneously disclosure of earnings and earnings growth	4.116	.390	-1.072	75	.287	-.21824	.20365
6. Pressure on management or employees for achievement of sales targets or profitability.	5.101	.277	-.521	75	.604	-.13176	.25288
7. Management or employee bonuses depend on the achievement of operational results	8.322	.080	.039	75	.969	.01014	.25900
8. Lack of mandatory vacations for the key employees in the sales cycle.	2.953	.566	-2.002	75	.049	-.48919	.24436
9. Frequent changes of key personnel employed in sales department.	5.132	.274	-.574	75	.568	-.14257	.24827
10. Segregation of duties is not appropriate.	2.448	.654	-1.273	75	.207	-.23581	.18521
11. As a basis for recording business transactions, auditors are presented with photocopied documents or documents in electronic form, although there should be original documents.	3.934	.415	-2.331	75	.022	-.51622	.22141
12. Sale is made to customers with whom the company usually does not have business cooperation (unknown buyers).	5.417	.144	-.749	75	.456	-.16689	.22277
13. Certain weaknesses in the functioning of the internal control relevant to the sales cycle are noticed.	.724	.696	-2.240	75	.028	-.39730	.17733
14. Unreconciled differences between the company's balance receivable records and confirmation received from third parties.	4.586	.205	-.726	75	.470	-.14527	.20002
15. Invoicing without sequence invoice numbers.	.140	.987	-2.025	75	.046	-.38446	.18986
Please rate the fraud risk taking into account all the above factors and responses	.029	.865	.227	75	.821	.02432	.10701

Source: Pretnar Abičić, S.: *Profesionalni skepticizam revizora i rizik prijevernog financijskog izvještavanja, magistarski rad, Ekonomski fakultet Zagreb, Zagreb, 2012*

The results of chi-square tests indicate that with a 5% probability there is no statistically significant difference between the two groups of respondents, i.e. that previous experience with fraud, regardless of years of work experience in audit practice, does not affect the higher increase in professional skepticism

and higher fraud risk level estimation compared to the absence of previous experience with fraud, and therefore *the hypothesis H2a) has not been confirmed.*

The results of the t-test indicate that with a 5% probability there is a statistically significant difference for all four statements in favor of group 2, i.e. the observed factors will affect the higher increase of professional skepticism among the respondents with longer years of work experience, and will not have a significant impact on the level of assessed risk of fraud. In addition, analysis of responses on individual assertion between the two groups is performed and was determined that for 13 of the 15 assertion respondents with more years of experience evaluated the risk of fraud at a higher level. Although the differences between the responses of individual groups are insignificant, results suggest that longer years of work experience also influences the assessment of the fraud risk at a higher level, and *the hypothesis H2b) is confirmed.*

**The third hypothesis** tested whether the length of engagement with a client affects the auditor's professional skepticism and is as follows: **H3: A longer period of conducting an audit at one client affects reduction of auditor's professional skepticism.**

*The hypothesis will be confirmed only if the average grade for more than 50% of assertions is higher than the median. Median = 3.*

This hypothesis was tested in a way that the participants are asked to assess on the Likert scale from 1 to 5 (1-strongly disagree, 2-disagree, 3-neither agree nor disagree, 4-agree, 5-strongly agree) the extent to which they agree with each assertion.

**Table 3.:** Respondents' opinions about relationship between the number of years of repeatedly audit work for the same client and auditor's behavior with the expression of professional skepticism attitude - the frequency of agreement and average grade

Assertion	1 (%)	2 (%)	3 (%)	4 (%)	5 (%)	Average grade
1 Auditor's professional skepticism is usually highest in the first year of the audit due to unknown client.	2.6	1.3	6.5	35.1	54.5	4.38
2. Many years of audit performance develops trust and relationship between the auditor and the client, and therefore the auditor is too much relying on the information gathered from the client and reduces critical assessment of management assertions and management estimations of significant transactions.	3.9	7.7	35.1	44.2	9.1	3.47

Assertion	1 (%)	2 (%)	3 (%)	4 (%)	5 (%)	Average grade
3. Years of performing audits of the same client jeopardizes the independence and objectivity of the auditor due to the frequent impact of management on auditor's decisions and behaviour.	9.1	26.0	24.7	33.8	6.5	3.03
4. If the frequency of disagreements with the management is low, the auditor's experience with the client is positive which affects the lower auditor's alertness when evaluating the collected evidence and acceptance of poor client explanations.	7.8	13.0	37.7	39.0	2.6	3.16
5. Emphasis of partner on a cost-effective audit performance affects the reduction of volume and quality of audit procedures below the level that is necessary for the conclusion of the audit program	6.5	19.5	22.0	32.5	19.5	3.39

Source: Pretnar Abičić, S.: *Profesionalni skepticizam revizora i rizik prijevernog financijskog izvještavanja, magistarski rad, Ekonomski fakultet Zagreb, Zagreb, 2012*

Average rating of respondents' answers for each assertion is above the median, therefore it is concluded that the longer period of the audit performance with one client impacts on the decrease of auditor's professional skepticism. *Therefore, the third hypothesis is fully confirmed.*

## 6. CONCLUSION

It is important that during the audit auditors express skepticism and caution when using professional judgment, especially when considering and assessing risk of fraudulent financial reporting. Results of research in the Republic of Croatia indicate that auditors have experience with fraudulent reporting and believe that it is very important to perform the audit with an attitude of skepticism, especially when considering the fraudulent financial reporting. But, on the other hand they do not show a sufficient level of skepticism when considering the fraud risk, because of the lack of experience and knowledge to identify fraud risk factors or because the auditing standards do not provide sufficient guidelines related to the expression of an appropriate skepticism attitude. Also, the auditor's behaviour and skepticism are influenced by information on estimated low level risk in the planning phase and the number of years of the audit work for the same client, which impact on decrease of auditor's skepticism. Previous experience with fraud does not impact, while a longer auditor's work experience in certain situations impacts the increase of auditor's skepticism and the ability to assess risk. The results point to certain problems in the auditing profession and the deviation from the requirements of professional standards, and the possibility that the auditor when expressing

opinion on the financial statements does not provide users with confidence in the quality and reliability of the information presented. Therefore, it is important to note that the audit companies could influence the increase of auditor's skepticism by conducting trainings, in order to gain more experience on how to identify and better assess the risk of fraud, and by creating an environment that will recognize and emphasize the importance of skepticism when assessing the risk of fraud and when performing audit procedures.

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## PROFESIONALNI SKEPTICIZAM REVIZORA I RIZIK PRIJEVARNOG FINANCIJSKOG IZVJEŠTAVANJA

### SAŽETAK RADA

Prijevarno financijsko izvještavanje odnosi se na namjerna pogrešna prikazivanja, značajne propuste ili objave u financijskim izvještajima sa ciljem obmane korisnika izvještaja. Učestalost prijevarnog izvještavanja je sve veća, te revizor tijekom revizije mora iskazivati skepticizam, odnosno imati ispitivački um, kritički pogled na revizijski dokaz i biti oprezan, a naročito kad razmatra i procjenjuje rizik prijevare, kako bi mogao pružiti razumno uvjerenje da izvještaji ne sadrže značajne pogrešne prikaze nastale uslijed prijevare. Skepticizam ovisi o individualnim karakteristikama revizora, ali na njega utječu i profesionalno znanje, edukacija i iskustvo, uz važnu ulogu revizorskog društva u kreiranju i implementaciji politika i procedura koje promiču važnost skepticizma u reviziji. Revizor nije odgovoran za sprječavanje i otkrivanje prijevara, već je odgovornost na menadžmentu koji mora uspostaviti program upravljanja rizicima prijevare. Od revizora se očekuje da sa stavom skepticizma provede postupke prepoznavanja i procjene rizika prijevare, reagira na procijenjeni rizik, a naročito prilikom ocjene prikupljenih dokaza te da komunicira prepoznate rizike i izrazi mišljenje o financijskim izvještajima. Rezultati istraživanja ukazuju da revizori, iako prepoznaju važnost skepticizma, ne iskazuju odgovarajuće razine skepticizma kod procjene rizika prijevare. Stoga je potrebna kontinuirana edukacija o prijevari i isticanje važnosti skepticizma na razini revizorskog društva.

*Ključne riječi:* profesionalni skepticizam revizora, procjena rizika, revizija, prijevara, prijevarno financijsko izvještavanje