Introduction

Auditors have been criticized for exercising insufficient skepticism when auditing complex estimates. Regulators have expressed concern that auditors often fail to critically assess the reasonableness of client assumptions by seeking contrary or inconsistent evidence PCAOB (2017) or indicators of management bias (IAASB, 2018). We address these concerns by investigating the following two interventions aimed at enhancing skepticism: perspective-taking and incentives.

In theory, perspective-taking is the process of ascribing other people's mental states (such as beliefs, intents, desires, emotions and knowledge) to oneself and understanding them. When auditing complex estimates, perspective-taking encourages auditors to consider the points of view of other parties. In this paper, we extend the literature by considering how taking one of two perspectives (management vs inspector) affects auditor skepticism when different decisions are being made (i.e. assessing management's assumptions and assessing the need to gather additional evidence). We select management and inspector perspectives because the former guides auditors to focus on the assessment of inputs to the audit process (management's estimates) while the latter guides auditors to focus on the assessment of outputs of the audit process (inspector reports).

We also examine how incentives, a key quality control mechanism (IAASB, 2017), affect demonstrated skepticism. Rewards are motivational, while penalties are based on deterrence. When tasks are complex, unstructured and subjective, rewards exert a larger effect than penalties (Christ et al., 2012). Consistent with these studies, we expect that when auditing a complex estimate, auditors will demonstrate greater skepticism when rewarded than when penalized.

We draw on the perspective-taking and incentive literature to develop our expectations regarding interactions between the two. When assessing management's assumptions, we expect the benefits of rewards over penalties accrue only to auditors adopting an inspector perspective, as auditors adopting a management perspective are already primed to demonstrate greater skepticism. When assessing the need to gather additional evidence, we expect the benefits of rewards over penalties accrue only to auditors adopting a management perspective, as auditors adopting an inspector perspective are already primed to demonstrate greater skepticism.

Hypotheses

Based on the research objective, the theoretical literature and previous studies, the research hypotheses are as follows:

H_1: When assessing management's assumptions, auditors demonstrate greater skepticism when adopting a management perspective than when adopting an inspector perspective.

H_2: When assessing the need to gather additional evidence, auditors demonstrate greater skepticism when adopting an inspector perspective than when adopting a management perspective.

H_3: The positive effect of a reward (over a penalty) in assessing management's assumptions will be greater for auditors taking an inspector perspective than for those taking a management perspective.

H_4: The positive effect of a reward (over a penalty) in gathering additional evidence will be greater for auditors taking a management perspective than for those taking an inspector perspective.

Methods

The statistical population of this research includes all auditors working in trusted audit institutions of Tehran Stock Exchange Organization. The sample of the study consisted of 234 auditors working in trusted audit institutions of Tehran Stock Exchange Organization in 2023 who were selected by random sampling. To investigate hypotheses, an analysis of variance and SPSS software were used.

Results

Results of research showed that in the absence of incentives, adopting a management perspective raises professional skepticism when measuring skepticism as appropriateness of management's fair value estimate while adopting an inspector perspective raises professional skepticism when measuring skepticism as need for more evidence. Evidence has also been obtained that the use of incentives along with the adopting a perspective raises the auditors' professional skepticism.

Discussion and Conclusion

Regulators around the world highlight that auditors fail to exercise sufficient skepticism, particularly when auditing complex estimates (IFIAR, 2017; PCAOB, 2017). Regulatory concerns over the level of skepticism exercised by auditors primarily relate to auditors' failure to critically evaluate management's assumptions and consider all of the available

evidence when auditing complex estimates, such as fair value estimates. Our study addresses these concerns by examining how the combined effect of two interventions, perspective-taking and incentives, may enhance skepticism.

Our study produces two key findings. First, different perspective-taking approaches achieve different skepticism outcomes. Auditors adopting a management perspective are more skeptical when assessing management's assumptions and collect more evidence items contradicting management's estimates than those adopting an inspector perspective. Auditors adopting an inspector perspective are more skeptical when assessing the need to gather additional evidence than those adopting a management perspective. Second, when incentives are provided, auditors taking an inspector perspective not only collect more evidence items but also adopt a questioning mindset when critically assessing management's assumptions. The incentive effect is stronger for rewards than it is for penalties. Also, we detect significant interaction between perspective-taking and incentives that motivates auditors taking a management perspective to collect more necessary evidence. Specifically, we find that the benefits of rewards versus penalties accrues to auditors adopting either a management or an inspector perspective.

Keywords: Perspective-taking, Incentives, Professional skepticism, Auditor judgment.