

The Importance of Professional Judgment and Professional Skepticism in Conducting a Review Engagement

This article outlines the importance of professional judgment and professional skepticism in planning and performing a review engagement. The new review engagement standard, Canadian Standard on Review Engagements CSRE 2400 – *Engagements to Review Historical Financial Statements*, becomes effective for reviews of financial statements for periods ending on or after December 14, 2017, with no option for early adoption.

PROFESSIONAL JUDGMENT

Professional judgment involves a practitioner applying their training, knowledge and experience in making appropriate decisions relating to procedures required and conclusions reached in a review engagement. Professional judgment is also required in assigning the appropriate levels of staff to a review engagement. Practitioners should be aware that more time will likely be required to supervise and train staff as a result of CSRE 2400 being more rigorous and detailed than Section 8200.

When conducting a review engagement, practitioners and staff working on the review engagement must first obtain a sufficient understanding of the entity, then use their professional judgment to identify areas in the financial statements where material misstatements are likely to arise, and then design procedures accordingly. These designed procedures will help the practitioner or staff either confirm or dispel any matter which they become aware of that may cause the financial statements to be materially misstated. Inappropriately designed procedures could result in the practitioner or staff incorrectly concluding that sufficient appropriate evidence has been obtained.

Professional judgment should be documented. It is important to document procedures completed, considerations taken into account and conclusions reached that required professional judgment in the working paper file.

PROFESSIONAL SKEPTICISM

Professional skepticism is having a questioning attitude, critically assessing evidence obtained and investigating anything that indicates a possible misstatement due to error or fraud throughout the review engagement.

In conducting a review engagement, the practitioner and any employees working under their direction must make inquiries of management and others within the entity involved in financial and accounting matters. The responses received need to be carefully reviewed. This involves using professional judgment and professional skepticism to initially prepare and ask meaningful questions based on the understanding of the entity and then to follow up with additional questions as a result of the responses received.

EXAMPLES OF APPLYING PROFESSIONAL JUDGMENT AND PROFESSIONAL SKEPTICISM

The following examples demonstrate how a practitioner applies both professional judgment and professional skepticism.

Example 1

Scenario: A practitioner is questioning why have sales decreased by over \$40,000 from the prior year. The client explains to the practitioner that sales went down due to fewer customers wanting their product.

Using professional judgment and professional skepticism: The practitioner decides that further clarification is required since accounts receivable went up by more than \$20,000 and inventory went down by over \$50,000, which does not seem to tie into the reduced sales and could also indicate a potential valuation problem. By the practitioner asking the client additional probing questions, the client clarifies that inventory went down because they noted that fewer customers were buying their products and they did not reorder as many items as they have in the past. Accounts receivable went up due to a fraud perpetrated by the previous bookkeeper who stole customer payments. The client further explains that the bookkeeper has been fired and that accounts receivable still needs to be reconciled.

Example 2

Scenario: A practitioner decides to complete a procedure to compare inventory levels from one period to the next and investigate material changes. There was no material difference so the practitioner concludes that there was no material misstatement in inventory.

Using professional judgment and professional skepticism: Had the practitioner decided to complete the comparison at a level other than only reviewing the total amount of inventory, they would have discovered that

one raw material item in inventory had a quantity that exceeded the storage capacity of the silo. Inventory had been miscounted for this item and inventory should have decreased by a material amount.

CONCLUSION

Professional judgment and professional skepticism are important in evaluating the sufficiency and appropriateness of the evidence obtained from the review.

For further guidance please refer to the resources and tools below.

RESOURCES AND TOOLS

Various tools and resources prepared to assist with understanding CSRE 2400 are as follows:

- [Guide to Review Engagements \(CSRE 2400\)](#). In addition to being a useful guide in general, this guide provides examples in Chapter 3.1 that illustrate how professional skepticism and professional judgment can be applied in a review engagement.
- CPA Canada's *Audit & Assurance Alert*, a [Comparison between CSRE 2400 and the 8000 Series](#).
- Professional development courses available through CPA Ontario.
- Canadian Professional Engagement Manual (C-PEM) review engagement checklists for CSRE 2400. Please remember that checklists alone cannot replace the experience needed to complete a review engagement.
- Practice Advisory Services. For further guidance, members are encouraged to contact a Practice Advisor:
 - Phone: 416 962.1841, ext. 4456 or 1 800 387.0735, ext. 4456.
 - Email: practiceadvisory@cpaontario.ca or memberadvisory@cpaontario.ca.