

Meeting: IESBA

Meeting Location: New York, USA

Meeting Date: June 27–29, 2016

Agenda Item

4

Professional Skepticism

Objectives of Agenda Item

1. To receive an update on the professional skepticism initiative being undertaken jointly by the International Auditing and Assurance Standards Board (IAASB), IESBA and International Accounting Education Standards Board (IAESB).
2. To provide:
 - (a) An overview of the feedback from outreach on the IAASB's Invitation to Comment, [*Enhancing Audit Quality in the Public: A Focus on Professional Skepticism, Quality Control and Group Audits*](#) (ITC), outreach, including roundtables held in Amsterdam (March 2016), Paris (March 2016) and Kuala Lumpur (April 2016).
 - (b) A summary of the high-level feedback from the responses to the ITC.
3. To obtain IESBA's initial views on:
 - (a) The approach to be taken on issues relating to the topic of professional skepticism including, the approach to be taken to the meaning of professional skepticism and its application.
 - (b) Whether, and how the concept of professional skepticism should be addressed in the proposed restructured Code.
4. Depending on the approach to be taken on the definition of professional skepticism, the Board will be asked to consider whether IESBA should undertake an exercise to determine whether there are areas within the IESBA Code of Ethics for Professional Accountants (Code) where there would be benefit in elaborating on, emphasizing or clarifying the role and importance of professional skepticism.

PSWG Members

5. The tripartite Professional Skepticism Working Group (PSWG) comprise of:
 - Annette Köhler, WG Chair, IAASB Member (support to WG Chair: Wolfgang Böhm, IAASB Technical Advisor)
 - Richard Fleck, IESBA Deputy Chair
 - Tone Sakshaug, IESBA Technical Advisor
 - Charles E. Landes, IAASB Vice Chair
 - Susan Jones, IAASB Technical Advisor
 - Eric Turner, IAASB Technical Advisor

- Dave Simko, IAESB Member
- Bernard Agulhas, IAESB Member

Background

Professional Skepticism and International Standards

6. The ISAs define 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.”^{1, 2} The ISAs explicitly require auditors to exercise an appropriate level of professional skepticism throughout the audit – i.e., during engagement acceptance; as part of identifying and assessing risks of material misstatement; in designing the nature, timing and extent of audit procedures; and in forming an opinion on whether the financial statements are prepared in all material respects in accordance with the applicable financial reporting framework.
7. Professional skepticism is necessary to the critical assessment of audit evidence. It is also closely interrelated to the fundamental concepts of auditor independence and professional judgment and contributes to audit quality.
8. Though most prominently dealt with in the ISAs, professional skepticism is addressed in the extant Code and in the (IAESB standards).³ The term professional skepticism appears in four instances in the extant Code as part of the description of “independence” as follows:⁴

Independence comprises:

(a) Independence of Mind

The state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.

(b) Independence in Appearance

The avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and

¹ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 13(l)

² IAASB Staff Publication, [Staff Questions and Answers – Professional Skepticism in an Audit of Financial Statements](#) issued in February 2012, further discusses considerations in the ISAs and ISQC 1, *International Standard on Quality Control (ISQC) 1, Quality Control for Firms that Perform Audit and Reviews of Financial Statements, and Other Assurance and Related Services Engagement* that are relevant to the proper understanding and application of professional skepticism during an audit of financial statements.

³ IES 4, *Initial Professional Development – Professional Values, Ethics, and Attitudes*, prescribes learning outcomes that aspiring professional accountants should achieve in developing professional skepticism and professional judgment. IES 8, *Professional Competence for Engagement Partners Responsible for Audits of Financial Statements*, prescribes the learning outcomes for professional skepticism and professional judgment that engagement partners are expected to develop and maintain through continuing professional development. Both standards emphasize that effective development of professional skepticism needs to include learning methods such as mentoring, reflective activity, and practical experience within the context of a work environment.

⁴ See Part B, *Independence – Audit and Review Engagements* of the extant Code, Sections 290, *A Conceptual Framework Approach to Independence*, paragraph 290.6 and 291, *Independence – Other Assurance Engagements*, paragraph 291.5.

circumstances, that a firm's, or a member of the audit team's, integrity, objectivity or professional skepticism has been compromised.

There is also a perceived connection between professional skepticism and the Fundamental Principles of objectivity, integrity and professional competence and due care - though there is not an explicit reference to this connection in the Code.

Calls for Enhancing Professional Skepticism

9. Audit inspection reports of audit oversight authorities have identified issues about the level, and consistency, of professional skepticism being applied in audits, in particular in areas that require high levels of professional judgment.⁵ These inspection findings are consistent with the findings of the IAASB's ISA Implementation Monitoring project.⁶
10. At the national level, jurisdictions are also undertaking initiatives related to enhancing auditors' application of professional skepticism. Also, within the academic community, there have been suggestions for more initiatives aimed at enhancing professional skepticism. There have been two major syntheses of academic research papers related to professional skepticism released in 2013⁷ and 2009.⁸ At its December 2015, for the purpose of developing its ITC, the IAASB commissioned academics to summarize academic research performed in the area of auditor professional skepticism from the 2013–2015.⁹
11. Whilst these initiatives have arisen against the background of concerns about the way audits have been performed and audit evidence assessed, there have also been instances where regulators have questioned whether the relevant "information", or "evidence" underpinning ethical decisions (usually relating to relationships between individuals within a firm and the entity being audited) were assessed with adequate professional skepticism.

⁵ [IFIAR Report on 2014 Survey of Inspection Findings](#), March 3, 2015. This issue is not new. In their 2012 Report, 17 of the 22 IFIAR members that provided information regarding their inspection of listed public interest entities audit engagements cited the auditor's lack of professional skepticism as a possible cause for audit deficiencies. Also in 2012, the most frequently cited significant challenge and audit quality issue among IFIAR members was a lack of professional skepticism by auditors.

Also, in its publication [Conclusions from the PIOB Public Interest Workshop](#), September 2014, the PIOB noted that "professional skepticism, as a state of the mind and attitude, should govern the performance of auditors, and inspire the attitude of other accountants, e.g., accountants in business. When accountants (practitioners, non-practitioners, accountants in business) do not display proper professional skepticism it is recognized as a barrier to effective performance."

⁶ In July 2013, the IAASB issued a report, [The Clarified ISAs—Findings from the Post-Implementation Review](#), highlighting the findings of its efforts to learn whether the clarified ISAs are being consistently understood and implemented in a way that achieves the IAASB's goals in clarifying and revising them. This report summarizes the feedback from those most directly involved in the audit process in jurisdictions that have implemented the clarified ISAs.

⁷ Kathy Hurr, Helen Brown-Liburd, Christine E. Earley, and Ganesh Krishnamoorthy. [A Journal of Practice & Theory](#) Vol. 32, Supplement 1, [Research on Auditor Professional Skepticism: Literature Synthesis and Opportunities for Future Research](#), 2013.

⁸ Mark W. Nelson. [A Journal of Practice & Theory](#) Vol. 28, No. 2, [A Model and Literature Review of Professional Skepticism in Auditing](#), 2009.

⁹ See December 2015 IAASB Agenda Items 7-A and 7-B, Summary of Academic Research and related IAASB discussion available at: <http://www.iaasb.org/meetings/new-york-usa-11>

IAASB, IESBA, IAESB's Coordinated Response

12. To facilitate a coordinated approach to respond to stakeholders' concerns about professional skepticism, a Joint Working Group of representatives from IAASB, IESBA and IAESB was formed in June 2015. IESBA member Richard Fleck and IESBA Technical Advisor Tone Maren Sakshaug are the IESBA representatives to the PSWG, which is chaired by IAASB member Prof. Annette Köhler.
13. The PSWG discussions to-date have been to:
 - (a) Discuss and agree on a basis for how it should operate and the tentative way forward for its activities; and
 - (b) Contribute to the development of the professional skepticism section of the ITC.
14. **Agenda Item 4-B** is an extract of the professional skepticism section of the IAASB's ITC.
15. **Agenda Item 4-C** is a reference paper that provides relevant background information about how the concept of professional skepticism is currently described and applied in the IAASB Standards; the Code; and the IAESB Standards.

Activities Since the Release of the IAASB's ITC

IESBA

16. At its March 2016 meeting, the IESBA exchanged views in response to an update on the activities of the PSWG since its November/ December 2015 meeting. In particular, the IESBA considered the merits of a suggestion made during the IESBA-IAASB Joint Consultative Advisory Group (IESBA-IAASB CAG) to describe the interaction between professional skepticism and the Code. It was suggested, that the Code clarify that professional skepticism is an important attribute, as is "moral courage," that enables or drives compliance with the fundamental principles.
17. Also, in the context of the Safeguards and Structure of the Code projects, the IESBA-IAASB CAG suggested the need to enhance the description of the linkage between independence and the fundamental principles. This was also a key message received from respondents to the December 2015 Exposure Drafts, Safeguards Exposure Draft (ED), *Proposed Revisions Pertaining to Safeguards in the Code—Phase 1* and Structure of the Code ED, *Improving the Structure of the Code of Ethics for Professional Accountants – Phase 1*.
18. The June 2016 IESBA agenda meeting materials for the Structure and Safeguards sessions include the Structure Task Force proposals that are intended to address the linkage between the independence and the fundamental principles. **Agenda Item 4-A** summarizes issues and the IESBA PSWG Representatives' recommendations for the IESBA's consideration.

IAASB

19. Separately, since the IAASB March 2016 meeting, in order to address the specific areas for consideration raised by the IAASB Board and the ISA 540¹⁰ Task Force, a subgroup of the PSWG was formed. The subgroup consists of the IAASB-related members of the PSWG. This IAASB subgroup plans to put forward its proposals to the IAASB at its June 2016 meeting.

IAESB

20. At its April 2016 meeting, the IAESB considered respondents' feedback on a question to stakeholders about what actions can be undertaken by the IAESB to improve engagement partners' and professional accountants' professional competencies related to the application of professional skepticism, as set out in its December 2015 Consultation Paper, [Consultation Paper, Meeting Future Expectations of Professional Competence: A Consultation on the IAESB's Future Strategy and Priorities](#). The IAESB agreed to defer its detailed professional skepticism discussions, and agreed to consider them jointly with the responses from the IAASB's ITC. The IAESB also established a Task Force, to be chaired by PSWG member, David Simko to develop IAESB specific responses to the issues raised in the response to the IAESB's CP and the IAASB's ITC. Those recommendations will be considered by IAESB at its November 2016 meeting.
21. A forward-looking timetable of planned activities for IESBA, IAASB, and IAESB is included in the appendix to this paper.

Responses to the IAASB's ITC

22. The comment period for the ITC closed on May 16, 2016. As of May 31, 2016, there were 78 comment letters received from respondents with a number of late responses still expected. The comment responses to the ITC can be accessed on the IAASB's [Focus on Audit Quality page](#).
23. The PSWG plans to meet on June 20, 2016 to discuss key themes and high-level issues raised by respondents to the ITC. A meeting is planned for July 6–7, 2016 to discuss the significant issues raised.
24. A summary of the PSWG discussion will be presented to the IAASB on Tuesday June 21, 2016 and to the IESBA on Tuesday June 28, 2016.

Action Requested

25. The IESBA is asked for views regarding the matters raised in **Agenda Item 4-A**.

Material Presented

Agenda Item 4-A	Professional Skepticism – Issues
Agenda Item 4-B	Extract of IAASB ITC, Enhancing Audit Quality in the Public: A Focus on Professional Skepticism, Quality Control and Group Audits
Agenda Item 4-C	Supplement: Current Treatment of the Concept of Professional Skepticism in IAASB and IAESB Standards, the IESBA Code, and the IAASB ITC on Audit (For Reference and Information Only)

Appendix

Professional Skepticism – Forward-Looking Timetable of the IESBA, IAASB and IAESB

Timing	IESBA	IAASB	IAESB
June 2016	Initial IESBA discussion about the concept of professional skepticism.	IAASB meeting to discuss and consider recommendations brought forward by the IAASB representatives of the Professional Skepticism Working Group to the ISA 540 TF on ways to emphasize professional skepticism within ISA 540.	N/A
Sept 2016	IESBA meeting to review and discuss the analysis of the responses to the IAASB's ITC and recommendations from the Professional Skepticism Working Group.	IAASB meeting to review and discuss the analysis of the responses to the ITC and recommendations from the Professional Skepticism Working Group.	IAESB CAG meeting to review and discuss the analysis of the responses to the IAESB's CP and IAASB's ITC and recommendations relating to the development of skills and professional competence from the Professional Skepticism Working Group.
Nov 2016	N/A	N/A	IAESB meeting to review and discuss the analysis of the responses to the IAESB's CP and IAASB's ITC and recommendations relating to the development of skills and professional competence from the Professional Skepticism Working Group.
Dec 2016	TBD	IAASB meeting to review and consider a draft of an ITC Feedback Statement.	N/A