

Supplemental Reference Material – For IESBA Information

Current Treatment of the Concept of Professional Skepticism in IAASB and IAESB Standards, the IESBA Code, and the IAASB ITC on Audit Quality

I. Purpose of this Paper

1. This paper describes how the concept of professional skepticism is currently defined and used in:
 - (i) IAASB Engagement Standards;
 - (ii) The IESBA Code; and
 - (iii) The IAESB Standards;
 which are collectively referred to in this paper as “the International Standards”.
2. The purpose of this paper is to facilitate an understanding of the IAASB, IAESB and IESBA about the concept of professional skepticism as it is currently defined and used, the logical implications of related definitions and their application, and thereby aid in coordination. The paper describes “how things are,” not how they might be changed in future work. Because the potential implications of changes to the concept of professional skepticism may have an impact on IAASB engagements standards other than those for audits (e.g., compilation engagements and agreed-upon procedures engagements) and on other activities of professional accountants, this paper also deals with the current use, or non-use, of the concept for engagements and activities other than audit.
3. This paper also summarizes how the concept is dealt with in the IAASB Invitation to Comment [*Enhancing Audit Quality in the Public Interest, a Focus on Professional Skepticism, Quality Control and Group Audits*](#) (the IAASB ITC).

II. IAASB Engagement Standards

Analysis of Definition of Professional Skepticism in IAASB Engagement Standards

4. Paragraph 12 (u) of ISAE 3000 (Revised)¹ defines professional skepticism as follows:

“An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement, and a critical assessment of evidence”.
5. Paragraph 13 (l) of ISA 200² expands this for audits of financial statements as follows:

“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”.
6. The use of the word “includes” implies that the concept of professional skepticism as an attitude may include matters beyond
 - A questioning mind,
 - Being alert to conditions which may indicate possible misstatement (due to fraud or error, if applicable), and

¹ International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

² International Standard on Auditing (ISA) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*

- A critical assessment of evidence.

The use of the word “includes” also implies that unless each of these three elements are present, the concept in question is not “professional skepticism” as defined. Accordingly, both the concepts “misstatement” AND “evidence” need to be covered when the concept of “professional skepticism” is used. These specific aspects are further analyzed below.

Analysis of Definition of Term “Misstatement” and Its Use in IAASB Engagement Standards

7. Paragraph 12 (o) of ISAE 3000 (Revised) defines the term “misstatement” as follows:
“The difference between the subject matter information and the appropriate measurement or evaluation of the underlying subject matter in accordance with the criteria.”
8. Paragraph 13 (i) of ISA 200 essentially defines the term “misstatement” in similar terms:
“The difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for that item to be in accordance with the applicable financial reporting framework.”
9. Currently the term “misstatement” (without “of the other information” or “of fact”) is used only in assurance engagements and compilation engagements that require the measurement or evaluation of underlying subject matter using suitable criteria.
10. The only other use of the term “misstatement” in IAASB engagement standards relates to the use of the terms “misstatement of the other information” in ISA 720 (Revised)³ and of “misstatement of fact” in ISAE 3000 (Revised). This is further described in detail below, for information:
 - Prior to the issuance of ISA 720 (Revised), the only other use of the term “misstatement” in IAASB engagement standards was within the term “misstatement of fact”. The term “misstatement of fact” as defined in ISA 720.5 (c) (Redrafted) and ISAE 3000.12 (p) (Revised) referred to situations in which information OUTSIDE of the outcome of evaluation or measurement of the underlying subject matter using suitable criteria (that is, the subject matter information) is factually incorrectly stated or presented. The determination of “facts” does not require the application of suitable criteria: this is consistent with the determination of factual findings under ISRS 4400 in agreed-upon-procedures-engagements, for which the application of suitable criteria is not relevant. Hence there was no inconsistency between the usage of the terms “misstatement” and “misstatement of fact” in IAASB engagement standards.
 - In line with these definitions, the use of the word “misstatement” (without “of fact”) was limited to engagements for which there are suitable criteria (including an applicable financial reporting framework, which by definition is acceptable – see ISA 200.13 (a)) as a basis for measurement or evaluation and hence for an assurance conclusion under IAASB engagement standards relating to assurance or for compiling financial information in accordance with a financial reporting framework under ISRS 4410⁴ (both extant and revised). The concept “misstatement” (without “of fact”) was therefore used in all IAASB engagement standards (that is, the ISAs, ISREs, ISRSs, and ISAEs) with the exception of ISRS 4400 Engagements to Perform Agreed-Upon-Procedures Regarding Financial Information, for which the concept of suitable criteria is not relevant.

³ ISA 720 (Revised), *The Auditor’s Responsibilities Relating to Other Information in Documents Containing Audited Financial Statements*

⁴ International Standard on Related Services (ISRE) 4410, *Compilation Engagements*

- The introduction of the use of the term “misstatement of the other information” in ISA 720 (Revised), which appears inconsistent with the usage noted above, should be seen as the further development and broadening of the term “misstatement of fact”, rather than a change to the meaning of “misstatement” otherwise, even if there are different views about how users might understand the term “misstatement of the other information”. Hence, the term “misstatement of the other information” in ISA 720 (Revised) is not inconsistent with the restriction of the term “misstatement” without “of fact” or “of the other information” to assurance and compilation engagements as noted above.

Analysis of Definition of Term “Evidence” and Its Use in IAASB Engagement Standards

11. Paragraph 12 (i) of ISAE 3000 (Revised) essentially defines the term “evidence” as follows:
“Information used by the practitioner in arriving at the practitioner’s conclusion.”
12. In this context, the “practitioner’s conclusion” refers to the “assurance conclusion” formed by the practitioner (which is indicated by the use of the article “the” and the reference to the sufficiency and appropriateness of evidence in the sub-points (i) and (ii) of the definition thereafter).
13. Paragraph 13 (b) of ISA 200 essentially defines the term “audit evidence” similarly, but refers to the conclusions upon which the opinion is based:
“Information used by the auditor in arriving at the conclusions on which the auditor’s opinion is based.”
14. Consistent with these definitions, the term “evidence” is used throughout the IAASB engagement standards relating to assurance (ISAs, ISREs and ISAEs). Even ISA 720 (Revised) is careful to use the term “evidence” or “audit evidence” only in relation to the audit evidence used to form the audit opinion, and not in relation to the reporting by the auditor on the other information. Paragraph 2 of ISA 720 (Revised) also clarifies that the auditor does not obtain audit evidence in relation to the other information.
15. When the IAASB revised ISRS 4410 Compilation Engagements a few years ago, in line with extant ISRS 4410, the IAASB was very careful not to use the term “evidence” in that standard because the practitioner does not gather any evidence to support a conclusion with respect to the financial information being compiled: rather the practitioner compiles the financial information based on information provided by management. Paragraph 6 and the practitioner’s report in ISRS 4410 (Revised) clarify that no evidence is obtained to support an assurance conclusion.
16. The only use in IAASB engagement standards of the term “evidence” beyond assurance conclusions that would be inconsistent with the definitions noted above is in ISRS 4400 Engagements to Perform Agreed-Upon-Procedures Regarding Financial Information, where, pursuant to paragraph 14, documentation provides evidence support the report of factual findings and that the engagement was carried out in accordance with the Standard. Furthermore, paragraph 15 of ISRS 4400 links the performance of procedures to obtaining evidence. It should be noted that ISRS 4400 was written in 1994/1995, is not in clarity format, and the inconsistency of the Standard with other IAASB engagement standards is one reason why the IAASB has commenced a project to revise that Standard. The question arises whether the concept of evidence is necessary in relation to the determination of factual findings at all, but this is an issue that the task force charged with revising the ISRS 4400 may need to address.
17. In any case, the usage in ISRS 4400 would not detract from a conclusion that currently the concept of evidence is used only in assurance engagements and agreed-upon-procedures engagements, and is therefore not used in engagements where neither assurance conclusions are formed nor factual findings based on the performance of agreed-upon-procedures are determined.

Use of the Term “Professional Skepticism” in IAASB Engagement Standards

18. The concept of professional skepticism is used in the ISAs (see, for example, paragraph 15 of ISA 200), in the ISREs (see, for example, paragraph 22 of ISRE 2400 and paragraph 6 of ISRE 2410), and in the ISAEs (see, for example paragraph 37 of ISAE 3000 (Revised); it is not mentioned in all of the other ISAEs, but since ISAE 3000 applies to these, mention in each ISAE is not necessary). The concept of professional skepticism was NOT mentioned in ISRS 4400 for agreed-upon-procedures engagements or in ISRS 4410 (extant) for compilation engagements. This is consistent with the definition of professional skepticism, and in particular, its reference to “misstatement” AND “evidence”. When the IAASB revised ISRS 4410 a few years ago, the IAASB took this into consideration and, in line with extant ISRS 4410, chose not to include the concept of professional skepticism in ISRS 4410 (Revised).
19. There is only one case in IAASB engagement standards in which the use of the concept of professional skepticism is inconsistent with the definition of professional skepticism: in paragraph A23 of ISA 720 (Revised). This usage is a change from ISA 720 (Redrafted), which did not refer to professional skepticism. In paragraph A23 of ISA 720 (Revised), professional skepticism is used in relation to the auditor's treatment of other information, even though neither the concept of evidence (for obtaining assurance or determining a factual finding) nor misstatement (involving the use of suitable criteria for measurement or evaluation) as defined in ISAE 3000 (Revised) or ISA 200 is directly relevant to other information.⁵ This inconsistency may be due to the distinction between the concept of “professional skepticism” as used elsewhere in IAASB engagement standards and the concept of skepticism without “professional” (commonly understood as a questioning mind), which is what appears to be addressed in paragraph A23.
20. **In summary, with the one noted exception (relating to the distinction noted above between “professional skepticism” with the more general concept of “skepticism”), the concept of professional skepticism is used only in IAASB engagement standards relating to assurance engagements for which both the concepts of misstatements and evidence as defined in ISAE 3000 (Revised) or ISA 200 are relevant.**
21. In this context, professional skepticism assists the exercise of professional judgment about whether sufficient appropriate evidence has been obtained, and is therefore critical for evidence-based decisions in assurance engagements.

⁵ A23. The auditor is required by ISA 200.19 to plan and perform the audit with professional skepticism. Maintaining professional skepticism when reading and considering the other information includes, for example, recognizing that management may be overly optimistic about the success of its plans, and being alert to information that may be inconsistent with:

- (a) The financial statements; or
- (b) The auditor's knowledge obtained in the audit.

III. IESBA Code

References to Professional Skepticism in the IESBA Code

22. The extant IESBA Code refers to the concept of “professional skepticism” in the following four paragraphs:⁶

In Section 290 Independence – Audit and Review Engagements

290.6 (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.

290.6 (b) Independence in Appearance

The avoidance of facts and circumstances that are so significant that a reasonable informed third party would be likely to conclude, weighting all the specific facts and circumstances, that a firm’s, or a member of the audit team’s integrity, objectivity or professional skepticism has been compromised.

290.196 When a firm accepts an engagement to provide internal audit services to an audit client, and the results of those services will be used in conducting the external audit, as self-review threat is created because of the possibility that the audit team will use the results of the internal audit service without appropriately evaluating those results or exercising the same level of professional skepticism as would be exercised when the internal audit work is performed by individuals who are not members of the firm.

In Section 291 Independence – Other Assurance Engagements

291.5 (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.

291.5 (b) Independence in Appearance

The avoidance of facts and circumstances that are so significant that a reasonable informed third party would be likely to conclude, weighting all the specific facts and circumstances, that a firm’s, or a member of the assurance team’s integrity, objectivity or professional skepticism has been compromised.

Analysis of References to Professional Skepticism, Misstatements and Evidence in the IESBA Code

23. In line with the analysis of the use of professional skepticism in IAASB engagement standards, the IESBA Code currently uses the concept of professional skepticism only in relation to assurance engagements.
24. Of interest is the use of professional skepticism in relation to independence in appearance. Within this concept, the IESBA Code addresses the position where a reasonable and informed third party concludes that professional skepticism has been compromised.

⁶ 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.

25. The definition of independence of mind in 291.5 (a) of the IESBA Code implies that independence of mind is an enabler of integrity, objectivity and professional skepticism, rather than professional skepticism being an enabler of independence of mind.
26. The International Standards, including the IESBA Code do not otherwise explain the relationship between the fundamental principles of ethics, independence of mind, and professional skepticism. It is noted that the IESBA plans to consider this matter which was also raised during the Joint IAASB-IESBA Consultative Advisory Group professional skepticism session in March 2016. In doing so, the IESBA plans to coordinate with the IAASB.
27. In accordance with the current IESBA Code, the fundamental principles of ethics apply to all professional activities of professional accountants, and not just to assurance engagements. However, in alignment with current IAASB engagement standards, references to the concept of professional skepticism in the current IESBA Code are used only in relation to assurance engagements, because the IESBA Code only refers to the concept of professional skepticism in defining independence, a concept that is relevant only to assurance engagements.
28. In the presentation provided by PSWG Chair and IAASB Member Prof. Annette Köhler to the IAASB in September 2015, it was noted that professional skepticism is a necessary but not sufficient condition for obtaining sufficient appropriate evidence in an assurance engagement. Other necessary conditions included the fundamental principles of the Code (except for confidentiality and professional behavior) and independence of mind. The impediments or deficiencies impairing these principles and independence of mind were linked to the ability to exercise professional skepticism and obtain sufficient appropriate evidence.
29. The IESBA Code defines “objectivity” as “*to not allow bias, conflict of interest or undue influence of others to override professional or business judgments*”.⁷ Hence, under the current definition of “objectivity” in the Code, biases of all professional accountants, (including assurance practitioners, to whom the concept of professional skepticism applies) are covered by the concept of objectivity – not by professional skepticism.
30. The IESBA Code uses the term “misstatement” only in paragraph 290.196 in relation to an audit or review engagement, which is not inconsistent with the use of the term in IAASB engagement standards.
31. The IESBA Code uses the term “evidence” in different manner than in current IAASB engagement standards. The references to evidence in paragraphs 147 (b) (i), 220.11 third bullet, 230.1, 290.29, 291.29, and 310.9⁸ relate to evidence supporting or undermining compliance with ethical requirements, rather than the information used to form an assurance conclusion. Where use of the term evidence does not lead to a concomitant use of professional skepticism in this context, there would not be inconsistency with IAASB engagement standards.
32. However, the fact that professional accountants may need to consider “evidence” as used in the Code in a broader context than only assurance engagements does mean that the concept of “skepticism” (without “*professional*”), which is commonly understood as a questioning state of mind, may be a relevant concept for the Code.

⁷ Section 100, *Introduction and the Fundamental Principles*

⁸ Section 310, *Conflict of Interest*

IV. IAESB Standards

References to Professional Skepticism, Skepticism, Misstatement and Evidence

33. The IAESB's standards refer to the concept of "professional skepticism" whereas, the IAESB's Framework for International Education Standards for Professional Accountants and Aspiring Professional Accountants (2015) (the Framework) (non-authoritative publication) refers to the concept of "skepticism", and the former term is used in ways that conveys a different meaning to what is defined in the IAASB engagement standards.

Reference to Professional Skepticism Aligned with IAASB Engagement Standards

34. International Education Standard (IES) 8, *Professional Competence for Engagement Partners Responsible for Audits of Financial Statements* refers to professional skepticism in the context of audit engagements. Consequently, these references are consistent with those in IAASB engagement standards. Accordingly, no further analysis of IES 8 is required.

Other References to "Skepticism" And "Professional Skepticism"

35. Paragraph 28 of the Framework notes that "general education helps professional accountants integrate technical competence, professional skills, professional values, ethics, and attitudes developed through professional accounting education." The Framework further notes that general education "supports the development of decision making skills, judgment and skepticism". Without the use of the word "professional" in connection with "skepticism" in paragraph 28 of the Framework, it is unclear whether the term "skepticism" as used in the IAESB's Framework is intended to have the same meaning as the concept of "professional skepticism" as defined in the IAASB engagement standards, or whether "skepticism" as commonly defined (a questioning mind) is meant.
36. IES 3, *Initial Professional Development – Professional Skills* (2015) establishes the professional skills that aspiring professional accountants are required to demonstrate by the end of Initial Professional Development (IPD) in order to perform a role as a professional accountant. Paragraph 7 (c) (ii) of IES 3 includes as a learning outcome for professional skills "apply professional skepticism through questioning and critically assessing all information." As IES 3 applies to all professional accountants, this requirement extends the concept of professional skepticism to all types of professional activities, and goes beyond just assurance engagements. This approach is not consistent with the definition and use of the concept of professional skepticism in IAASB engagement standards.
37. IES 4, *Initial Professional Development – Professional Values, Ethics and Attitudes* (2015) establishes the professional values, ethics and attitudes that aspiring professional accountants need to develop and demonstrate by the end of IPD in order to perform a role as a professional accountant. Paragraph 11 (a) (i) of IES 4 includes a competency area for professional values, ethics and attitudes "professional skepticism and professional judgment". It also described the related learning outcome as:
- "Apply a questioning mindset critically to assess financial information and other relevant data; and
 - Identify and evaluate reasonable alternatives to reach well-reasoned conclusions based on all relevant facts and circumstances."
38. As IES 4 applies to all professional accountants, the IAASB's definition of professional skepticism is acknowledged in paragraph A2 of IES 4, which also notes that the terms "professional skepticism" and "professional judgment" within IES 4 are to be interpreted as applying to the broader

context of a role as a professional accountant. Accordingly, the concept of professional skepticism is used in IES 4 in a manner that is inconsistent with IAASB Engagement Standards. In this case, alignment is needed in how the concept of professional skepticism is expected to be defined and used in the current IAASB and IAESB standards.

Misstatement and Evidence

39. The use in IAESB standards of the term “misstatement” is confined to audits of financial statements, which is not inconsistent with IAASB engagement standards. Other than the use of the term “evidence” in relation to audit engagements, which is not inconsistent with the usage in IAASB engagement standards, the IAESB also uses the term “evidence” in relation to support for competence achieved or demonstrated in an education program. This different usage, however, has no impact on the usage in IAASB engagement standards.

V. Use of the Terms Professional Skepticism, Misstatement and Evidence in the IAASB ITC

40. The professional skepticism section of the IAASB's ITC sought feedback on the issues relating to professional skepticism as well a number of areas being explored by the Joint Working Group of representatives from the IAASB, IESBA and IAESB. Those areas, noted in paragraph 37 of the ITC, include for example, whether it is clear what is meant by “professional skepticism” and whether the concept is consistently described across the ISAs, IESs and IESBA Code – for example, whether the links between the concept of professional skepticism and other concepts (such as professional judgement, integrity, independence of mind, objectivity, and sufficient appropriate audit evidence) are clear and well-understood.
41. However, the focus within the IAASB's ITC is on the improvement of the application of professional skepticism in support of audit quality, rather than on conceptual issues. Accordingly, throughout the IAASB ITC reference to the concepts of “professional skepticism,” “misstatement” and “evidence” are in line with their definition and use in IAASB Engagement Standards.
42. The IAASB ITC does allude to the fact that the concept of professional skepticism is described differently. For example, the IAASB ITC includes a quote from a PIOB workshop that suggests professional skepticism may be relevant to professional accountants other than auditors (paragraph 18), and in the ITC notes that in research studies some academics may use the concept of professional skepticism differently than defined in by the IAASB (see paragraph 21).
43. Further, the IAASB ITC draws on relevant concepts in the IESs and on relevant fundamental principles defined in the IESBA Code by noting that these may impact the application of professional skepticism in audits (see paragraph 23), but does not suggest that there may be a reciprocal relationship. The ITC also briefly describes the relationship between the exercise of professional judgment and the exercise of professional skepticism (paragraphs 24 to 26).
44. The IAASB ITC already addresses the potential need to further clarify the concept of professional skepticism (paragraph 22) across the International Standards. It also signals the fact that the PSWG is already exploring the issues relating to professional skepticism, including whether its meaning and its intended use is consistent across the International Standards (i.e., the IAASB Engagement standards, IAESB Standards and the IESBA Code (paragraph 37 first bullet).

Summary

45. The IAASB uses the concept of “professional skepticism” for assurance engagements only; the IESBA Code currently does the same. IAESB standards uses the term “skepticism” without clarification as to what is meant, and uses the concept of “professional skepticism” in a broader context beyond assurance engagements, that is not in line with how the term is defined and used in the

IAASB Engagement Standards. The IAASB's ITC is focused on the application of professional skepticism in the context of audit engagements and uses the term as it is defined and used in the IAASB engagement standards. The IAASB's ITC, acknowledges that a possible area to explore is whether the use of the concept of professional skepticism across the International Standards is aligned and appropriate, or whether there is a need for clarification.

46. While the ITC recognizes that one of the considerations in the project on professional skepticism at the IAASB will be whether the definition of professional skepticism might require amendment, the IAASB's current work efforts in relation to revising ISA 540⁹ and 315 (Revised),¹⁰ and potentially also ISAs 220¹¹ and 600,¹² and ISQC 1¹³ will need to apply the current definition and model for professional skepticism, unless the work streams are re-prioritized.
47. The IAASB, the IESBA and the IAESB have acknowledged the need to coordinate their work in exploring ways to improve application of professional skepticism, including determining whether there is a need amend the definition of professional skepticism.

⁹ ISA 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

¹⁰ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

¹¹ ISA 220, *Quality Control for an Audit of Financial Statements*

¹² ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

¹³ ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*