

Professional Skepticism – Issues**Introduction**

1. **Agenda Item 4** provides background information about the professional skepticism initiative being undertaken jointly by the International Auditing and Assurance Standards Board (IAASB), IESBA and International Accounting Education Standards Board (IAESB), including a discussion how the concept of professional skepticism is used in their respective suites of international standards.
2. Because the IESBA's current Structure of the Code and Safeguards projects address related issues, careful consideration with respect to the nature and timing of activities related to professional skepticism is needed. It is also important the IESBA's activities are coordinated with that of the IAASB and the IAESB.
3. The purpose of this paper is to describe current issues, in advance of the PSWG's considerations of the significant matters raised by respondents to the IAASB's [Invitation to Comment, *Enhancing Audit Quality in the Public: A Focus on Professional Skepticism, Quality Control and Group Audits*](#) (ITC), with a view to obtaining the IESBA's initial reactions to the matters identified in this paper.

Issues*Description of Professional Skepticism*

4. A November 2013 academic paper notes that the word skepticism, rooted from the word "skeptic," comes from the Greek word "skeptikos," which means "inquiring or reflective." The paper further explains that to inquire is "to seek information by questioning; or to ask."¹ The paper also notes that the characteristics commonly associated with being a skeptic include "questioning and careful observation, probing reflection, looking beyond the obvious, and suspension of belief."
5. The concept of "professional skepticism" is used extensively in the IAASB's standards and applies only to assurance engagements. As noted in **Agenda Item 4-C**, it is defined 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."² Explicit reference to the concept of professional skepticism in the extant Code is made only in the context of describing independence.³

Is there a Need to Change the Description of Professional Skepticism?

6. **Agenda Item 4-B**, 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 at 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 that exist between the concept of professional skepticism and other concepts (such as professional judgement,

¹ Glover, Stephen and Prawitt, Doug, [Enhancing Auditor Professional Skepticism](#), November 2013.

² ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 13(l)

³ 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.

integrity, independence of mind, objectivity, and sufficient appropriate audit evidence) are clear and well-understood.

7. The PSWG IESBA Representatives note that there are varying views about what is meant by the concept of professional skepticism and who the concept should apply to. They note, for example, that a respondent to the IESBA's Part C Phase 1 ED suggested emphasizing in Section 320⁴ the need for professional accountants in business (PAIBs) to exercise an adequate level of professional skepticism throughout the process of preparing, presenting and/or filing information. The respondent felt that with the increasing complexity of business transactions and the increasing need for judgment and estimates in the PAIB's work, there is an increasing need for the PAIB to consider the integrity of the information that is being utilized.
8. The IESBA's March 2016 Close-off document, *Changes to Part C of the Code Addressing Preparation and Presentation of Information and Pressure to Breach the Fundamental Principles* (Part C Phase 1 close-off document) includes new guidance to help deal with pressure from superiors. It also includes enhanced guidance to better explain what is meant by "constructive challenge".⁵ There is a view that this new guidance, as well as some of the proposals in the IESBA's December 2015 Safeguards Exposure Draft essentially describe what is commonly understood to be behavior exhibiting professional skepticism, and might be relevant to the appropriate application of professional skepticism.
9. Preliminary review of the feedback from some respondents to the IAASB's ITC indicate that some stakeholders are of the view that the IAASB, IESBA and IAESB should coordinate their efforts towards clarifying the definition of professional skepticism across their respective suites of international standards.

Should the Definition Continue to be Relevant to Assurance Engagements Only?

10. Initial IESBA discussions on the topic indicate that some IESBA members are of the view that the concept of professional skepticism as it is referenced in the extant Code is relevant to audit engagements only. Those members expressed the need for cautious consideration of the practical implications of extending the concept of "professional skepticism" as it is currently understood, to professional accountants undertaking professional activities other than audits, reviews and other assurance engagements. Others, including some representatives of the IAASB CAG and IESBA CAG, are of the view that there is no conceptual reason why professional skepticism should not apply to all professional accountants. They have suggested that the description of professional skepticism in the international standards promulgated by the IESBA, IAASB and IAESB should be focused on explaining a "mindset" rather than a "specific action". An illustration of, and a discussion of the possible implications of moving forward with such an approach is included below.

Consideration of Way Forward – Description

11. As noted in **Agenda Item 4-C**, the way the concept of professional skepticism is used in the IAASB's standards and the Code is consistent. However, the concept is used differently in the IAESB's standards. Should the IAASB, IESBA and IAESB determine it necessary to establish a common definition for use across their respective suites of international standards, consideration should be given to:
 - (a) Whether that definition of professional skepticism should be specific and relevant to assurance

⁴ Revised Section 320, *Preparation and Presentation of Information*

⁵ See Section 370, *Pressure to Breach the Fundamental Principles*

engagements only, or whether the definition should be generic so that it can accommodate the individual remit of each board.

- (b) Whether such a change would impact:
- (i) The scope of non-assurance engagements (e.g., whether there would be an expansion of the level of work effort involved).
 - (ii) The robustness of a non-specific definition for assurance engagements.
 - (iii) The definitions of other related and widely used terms and concepts in the IAASB's standards (e.g., the definition of evidence, and misstatement). See Agenda Item 4-C for a discussion of how those terms are used in the IAASB's standards.

Illustration 1 – Using a specific definition

12. The status quo is illustrative of the first approach whereby specific definitions of professional skepticism are prescribed in the context of assurance engagements. The IAASB's standards describe professional skepticism:
- For assurance engagements as “an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement, and a critical assessment of evidence”⁶
 - For audits of financial statements 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 evidence”.⁷

Illustration 2 – Using a generic definition

13. An alternative, generic approach, might see a description of professional skepticism along the lines of the following:
- "An attitude that includes a questioning mind, a critical assessment of [evidence] and being alert to conditions that may indicate [possible misstatement due to error or fraud]."
14. One merit to this approach is that it allows the key elements of the definition of professional skepticism to be consistent across all three Standard Setting Boards, while allowing each Board the flexibility to further tailor the definition in a manner that specifies the purpose for which the concept should be applied.
15. Such an approach requires careful planning and coordination among the three Standard Setting Boards to avoid practical challenges. For example, as noted in paragraph 11(b) (iii), the term “evidence” is defined in the IAASB's standards and is not applicable to non-assurance engagements, such as compilations. Some stakeholders have expressed concerns about broadening the applicability of terms and concepts that have historically been associated with assurance engagements (e.g., professional skepticism, evidence, and misstatement). Those stakeholders are of the view that using the same terms differently across Standard Setting Boards would be confusing for auditors, assurance practitioners and others. They

⁶ International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*

⁷ 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*

also are of the view that deviating from the extant approach to defining those terms might reduce the robustness of the assurance engagements.

16. However, if one takes the view that the key elements of a definition of professional skepticism are those that address the mindset to be applied – namely "*a questioning mind*", "*a critical assessment*" and "*being alert*", the concerns arising from the use of the term "evidence" differently across the Standard Setting Boards could be addressed by using the term "evidence" where appropriate in IAASB assurance standards and a formulation such as 'the available information' elsewhere.
17. It has also been suggested that IESBA and IAESB should use the concept of "skepticism" rather than "professional skepticism" in those standards that do not address assurance engagements. However, questions have been raised about whether the application of "skepticism" versus what is understood as "professional skepticism" would instill the same level of confidence in the judgments and conclusions reached by professional accountants. It is noted that the use of the word "professional" carries with it an understanding that the professional accountant has benefited from appropriate professional training, qualifications and experience – all of which enhances the quality of the professional accountant's assessment of "information" or "evidence" in a manner that goes beyond that of the average person.

Matter for IESBA Consideration

1. Taking into account the matters raised in paragraphs 4-17 above, and the material in **Agenda Items 4-B and 4-C**, IESBA members are asked for their views about:
 - (a) What, if anything, should be done within the Code to emphasize the meaning of professional skepticism and its applicability.
 - (b) Whether the IESBA, IAASB and IAESB should adopt a consistent approach to defining professional skepticism across their respective suites of international standards. If yes, should the definition of professional skepticism be along the lines of:
 - (i) The extant IAASB definition and applicable to only assurance engagements (see Illustration 1); or
 - (ii) The generic description and applicable to all professional accountants (see Illustration 2).
 - (c) What actions, if any, should be taken now in relation to professional skepticism in the context of IESBA's current projects (e.g., Structure of the Code).

Relationship Between Professional Skepticism and the Fundamental Principles

18. At its March 2016 meeting, the IESBA generally agreed to consider how to clarify the description of the interaction between professional skepticism and the fundamental principles, a suggestion made by representatives of the IESBA and IAASB Consultative Advisory Group (CAGs). There are different views among PSWG members regarding how that interaction should be described.
19. On one hand, some PSWG members accept the suggestion that the Code should clarify that "professional skepticism" is an important attribute, as are "independence" and "moral courage," that *enables* or *drives* compliance with the fundamental principles. On the other hand, some IAASB PSWG members are of the view that the IESBA should consider describing objectivity, integrity, and professional competence and due care as being "enablers" of professional skepticism. It is noted that some national initiatives have

made explicit reference to the connection between professional skepticism, auditor independence and objectivity.⁸

20. Questions have also been raised about whether there are other enablers that assist professional accountants comply with the fundamental principles.

Matters for IESBA Consideration

2. IESBA members are asked whether they believe that:
 - (a) Professional skepticism is an “enabler” to the professional accountant’s compliance with the Fundamental Principles; or
 - (b) The Fundamental Principles are “enablers” of professional skepticism.
3. IESBA members are asked for views about whether there are other “enablers” to compliance with the fundamental principles that should be considered and acknowledged in the Code at this time (e.g., “moral courage”).

Interaction with IESBA’s Current Projects

21. The Structure of the Code project is intended to enhance the clarity of the Code. This might involve changing the placement of certain material. For example, the December 2015 Structure Exposure Draft includes proposals to clarify the link between independence and the fundamental principle of objectivity in the Guide to the proposed restructured Code;⁹ Section 112 as part of the description of objectivity;¹⁰ and Section 400 as part of the introduction.¹¹ Paragraphs 400.1 and 400.2 of Structure ED-1 state:

400.1 Independence is a measure of objectivity, both in mind and appearance, which is applied to audit engagements.¹² It enables a firm to express, and be seen to express, an objective conclusion when performing such engagements. It is in the public interest and required by the Code that members of audit teams,¹³ firms and network firms be independent of audit clients.¹⁴ C1 sets out requirements and application material on maintaining independence when performing audit engagements. (See also paragraph 400.7 regarding references to “firm.”)

400.2 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.

⁸ For example, in August 2011, the US Public Company Accounting Oversight Board (PCAOB) issued a [Concept Release](#) to solicit views about ways that auditor independence, objectivity and professional skepticism could be enhanced.

⁹ See Structure ED-1, paragraph 3 of the Guide.

¹⁰ See Structure ED-1, Subsection 112, *Objectivity*, paragraph 112.A1.

¹¹ See Structure ED-1, Section 400, *Application of Conceptual Framework to Independence for Audits and Reviews*, paragraphs 400.1 and 400.2.

¹² In C1, “audit engagement” includes “review engagement.”

¹³ In C1, “audit team” includes “review team.”

¹⁴ In C1, “audit client” includes “review client” and related entities of the audit client – see Glossary for more detail.

- (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 circumstances, that a firm's, or a member of the audit or assurance team's, integrity, objectivity or professional skepticism has been compromised.
22. Some note that the placement of the description of independence in a more prominent location (e.g., Section 120) might raise questions about the applicability of the concept of “professional skepticism”. This is because historically the conceptual framework has been relevant to, and applied by all professional accountants, in contrast to the concepts of independence and professional skepticism that are relevant to assurance practitioners only.
23. Further consideration should also be given to whether there is a need to have, as part of the next Structure of the Code exposure draft, (e.g., in close proximity to paragraph 120.11 A1 of Section 120 in **Agenda Item 3-A**:
- (a) A description of the interaction between professional skepticism and the fundamental principles; or
 - (b) Additional information about the concept of professional skepticism in the context of the Code.

Matters Relevant to the IESBA's Consideration of Way Forward

24. Exploration of the approach to respond to the issues set out in this paper, would require close coordination internally, with the Structure and Safeguards Task Forces, as well as agreement on the definition and the applicability of professional skepticism on a coordinated basis with the IAASB and the IAESB. Consideration would also need to be given to the fact that the Structure of the Code and Safeguards projects are well on the way with established timelines, while the joint professional skepticism initiative is in its exploratory stages.
25. It is important that the IESBA's decide on an approach to respond to the concerns that have been raised with respect to professional skepticism in the short-run, given:
- The importance that stakeholders, including regulators, investors and others have attached to the topic.
 - The need to progress this initiative in a coordinated manner with the IAASB and IAESB. For example, agreement among the Standards Setting Boards for a common definition of professional skepticism, would enable the IESBA to seek public feedback as part of its Structure of the Code Phase 2 exposure draft (ED). The planned timing for the IESBA's Structure of the Code Phase 2 ED coincides with the IAASB's planned timing for a feedback on its ITC.

Matters for IESBA Consideration

- 4. IESBA members are asked for preliminary views about whether there is a need for clarification of the concept of professional skepticism in Code, in light of the proposed change in the positioning of the concept in the Code (See the Structure Task Force's proposal pertaining to the linkage between independence and the fundamental principles).
- 5. IESBA members are asked to share any other comments or suggestions with respect to the joint professional skepticism initiative.