

Launching the Longer-Term Professional Skepticism Initiative**Introduction**

1. The August 2017 Joint Professional Skepticism Working Group (PSWG) publication, [Toward Enhanced Professional Skepticism](#), noted the IESBA's commitment "to clarifying the behavior that is expected of all professional accountants (PAs) in the public interest." The document notes that:
 - With respect to auditors and assurance practitioners, as an initial step, the IESBA's May 2017 Exposure Draft (ED), [Proposed Application Material Related to Professional Skepticism and Professional Judgment](#), proposed application material that clarifies how compliance with the fundamental principles embodied in the Code supports the exercise of professional skepticism in the context of audits, reviews, and other assurance engagements.
 - More broadly, the ED also proposed guidance that emphasizes the importance of PAs obtaining sufficient understanding of the facts and circumstances known to them when exercising professional judgment in the context of complying with the fundamental principles.
 - There is a need for further study about whether and, if so, how aspects of the concepts underlying PS should be relevant and therefore apply more broadly to all PAs – not just auditors.
 - The IESBA intends to consider, as part of a longer term initiative, whether there is a public interest need to develop material to describe the role and expectations of PAs. This material might include consideration about how the work of PAs contributes to enhancing the integrity and reliability of information with which they are associated.
2. This paper outlines the Task Force's (TF's) proposed approach for progressing the longer-term PS initiative. It includes various matters for the Board's consideration that have informed a proposed direction of travel, and seeks the Board's advice on how the proposed approach could be further developed.

Background

3. Over the past few years, there have been continuing calls for the standard-setting boards (SSBs) to enhance the way in which existing material in their standards or the Code addresses PS:
 - In response to the IAASB's December 2015 Invitation to Comment (ITC), [Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits](#), many commentators called for the enhanced exercise of PS in the context of audit and assurance engagements. In addition, a few commentators specifically called for the exercise of PS by all PAs.¹ Others recognizing that the concept of PS applies to all PAs in the IAESB's standards (i.e., IESs 2, 3 and 4), suggested the need for the three SSBs to coordinate their activities in order to ensure a common understanding and consistent approach.²
 - Separately, some stakeholders, in commenting on recent IESBA EDs, suggested that the IESBA consider how the Code should address PS beyond audit and other assurance

¹ CFA, EBA

² AE, CAANZ, GTI, H3C, PAIB, WPK

engagements. Those stakeholders expressed the view that the concept of PS should be relevant to all PAs – not just PAs who perform audit and other assurance engagements.

- The suggestion that all PAs should exercise PS has, independently, been actively promoted by others – in particular, the International Forum of Independent Audit Regulators (IFIAR) – as well as the Public Interest Oversight Board (PIOB), and a number of representatives of the IAASB and IESBA Consultative Advisory Groups (CAGs).³ Some of those stakeholders are of the view that preparers and others in the financial reporting supply chain should also be required to exercise PS because “auditors cannot be expected to detect and resolve all problems as part of the audit and at the very end of the process.”⁴ See the Appendix for approaches to PS taken by some other international and national standard setters.
4. It has also been suggested that a *skeptical mindset* might help address a different concern – namely, the familiarity and self-interest threats that are created by the inherent conflicts of interest arising from the fact that auditors are paid by the entities they audit (and thereby have relationships with the management of those entities).⁵ Those who hold this view suggest that the exercise of PS should be a requirement in the Code.

Task Force’s Response and Recap of Initiatives to Date

5. At the outset, the SSBs considered how to respond to the calls for an enhanced exercise of PS in the context of audit and other assurance engagements. However, the question of whether PS should be exercised more broadly, i.e., by all PAs, became increasingly prominent in the discussions of the PSWG and the SSBs’ respective CAGs. This is reflected in the summary of the [PSWG's September 2016 Preliminary Recommendations](#).
6. In the shorter term, the PSWG recommended that each SSB pursue specific initiatives. The IESBA responded by forming the PSTF, which developed the application material that was the subject of the May 2017 ED and which will be considered by the IESBA at its December 2017 meeting for final approval.
7. Given the public interest responsibilities of those organizations that suggested that the Code should address the exercise of PS by all PAs, as well as the IESBA’s remit as the SSB responsible for setting standards governing the behavior of all PAs, the TF believed that the IESBA should address whether PS – or something like it – should be required of all PAs when performing professional activities. In developing the application material to explain how compliance with the Code’s fundamental principles supports the exercise of PS in the context of audit and other assurance engagements, the IESBA considered two different proposals designed to respond to the calls for the concept of PS to apply to all PAs – one based on the existing concept and definition of PS in IAASB standards; the other based on the concept of a “critical mind-set.”

³ For example, International Accounting Standards Board, International Corporate Governance Network, and Basel Committee on Banking Supervision. See also, the September 2016 minutes of the joint IAASB and IESBA CAGs relating to the topic of PS, available at: www.ethicsboard.org/system/files/meetings/files/20160913-IESBA-IAASB-CAG-Final-Minutes-of-September-2016-Joint-Session-Minutes.pdf.

⁴ See minutes of [IESBA CAG meeting, March 2017](#).

⁵ EBA

8. Both proposals encountered considerable opposition, in particular from a number of members of the IAASB. The principal concerns raised were that:
 - The exercise of PS by all PAs would dilute or otherwise adversely affect the understanding and exercise of PS in the context of audit and other assurance engagements. It was argued that this would be to the detriment of the public interest in financial reporting. Those raising this concern focused on:
 - The fact that the existing definition of PS in IAASB standards is designed for use in audit and other assurance engagements only – referring, as it does, to concepts or terms defined in ISAs such as “misstatement due to error or fraud” and “evidence.” Such concepts and terms would not necessarily be appropriate for more general application to all PAs.
 - The risk that different 'levels' of PS might be necessary in order for the application of PS to all PAs to be proportionate and appropriate for the professional activity performed.
 - Terms such as “critical mind-set” or “critical thinking”⁶ were:
 - Too close in substance to the concept of PS, potentially confusing PAs and undermining the understanding and application of the concept of PS in the context of audit and other assurance engagements.
 - A subset of objectivity, professional competence and due care, or professional judgment which are already addressed in the Code.
 - The requirement to exercise PS might affect the nature and extent of the work effort involved in the provision of professional services other than assurance services by PAs in public practice – for example, the work effort in financial statement compilation or tax return preparation might increase.
 - Inadequate research had been undertaken to assess the implications of the extension of the concept of PS to all PAs and, therefore, there might be significant unintended consequences from such an initiative.
9. Some representatives on the joint CAGs of the IAASB and the IESBA recognized the risks that had been identified and urged caution against unintended consequences.
10. Given stakeholder exhortations for the SSBs to coordinate their initiatives, the IESBA did not consider it appropriate to pursue either of the two proposals noted in paragraph 7 above in the May 2017 ED. The IESBA agreed instead to consider a longer term initiative through which further stakeholder input could be obtained and if supported, proposed changes to the Code could be developed.

Determining an Approach to Address the Issues

11. In reflecting on the issues raised by stakeholders in relation to PS summarized in paragraphs 3-4 above, the TF believes that PS has become a “catch all” jargon term that is perceived and used inconsistently to capture attributes the public expects PAs to demonstrate when performing professional activities. Accepting that such disparity cannot be controlled, the TF instead focused on

⁶ A composite definition for critical thinking was used by the TF, as follows: Recognizes assumptions and biases, considers and challenges evidence, and applies independent judgment to ideas based on observation and experience.

the likely root causes of many of the concerns about PS. For instance, the TF believes that the outcomes that stakeholders who advocate for extending the applicability of PS to all PAs are seeking to achieve are:

- To establish a clear expectation for how PAs are required to act (i.e., PAs should be required to act in a manner that promotes public trust in the profession); and
 - To have a consistent level of trust and credibility that the information with which a PA is associated is reliable for the purpose and intended use of the information.
12. The TF also discussed and tentatively agreed on certain overarching stakeholder expectations of PAs which could provide a basis for further developing the issues:
- Being a PA means delivering a higher level work product than would be delivered by a non-PA.
 - Being a PA carries an expectation that independent judgement and an informed thought process will be applied by the PA to be satisfied that information with which a PA is associated is reliable for its intended purpose.
 - Being a PA means actively demonstrating compliance with the fundamental principles when carrying out any type of professional activity, including audits and assurance engagements where compliance with the fundamental principles supports the exercise of PS.
13. With these outcomes and expectations in mind, the TF believes it is appropriate in the context of the Code to pursue an approach to address the issues identified that:
- Leaves PS as currently defined and understood in the context of audit and assurance engagements. At this juncture, the TF believes the definition of PS for audit and assurance should remain the domain of the IAASB.
 - Does not include the development of a “new” definition of PS, or a new concept – such as critical thinking – for application by all PAs. The TF believes that developing a separate, single defined term would not address the root causes of why public expectations of PAs are not being met, and that to attempt to encapsulate such overarching expectations of a PA described above would be ineffective.
 - Addresses the need for a better understanding of what it means to be a PA and how to comply with the fundamental principles
 - Addresses the behavioral characteristics expected of a PA and that would reinforce that message through appropriate supplemental application material in the Code.
14. Given the existing responsibility of all PAs to act in the public interest,⁷ and calls for the exercise of PS by all PAs, the TF debated the characteristics expected of all PAs and concluded that they should include:
- Obtaining and understanding the information necessary to make a reliable judgment on the facts and circumstances known to the PA.

⁷ Part 1, Section 100, “Complying with the Code”, General - Paragraph 100.1 reads: “A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. A professional accountant’s responsibility is not exclusively to satisfy the needs of an individual client or employing organization. Therefore, the Code contains requirements and application material to enable accountants to meet their responsibility to act in the public interest.”

- Making informed challenges of views developed by others.
 - Being sensitive to the integrity of information.
 - Withholding judgment pending thoughtful consideration of all relevant information.
 - Being alert to potential bias or other impediments to the proper exercise of professional judgment.
 - Ability and willingness of the PAs to stand their ground when facing pressure to do otherwise.
15. The TF discussed these characteristics and determined that they are already embedded in the fundamental principles – concluding that those PAs who properly understand and adhere to the Code will need no additional work effort to remain in compliance.

Characteristic	Relationship to Fundamental Principles
Obtaining and understanding the information necessary for reliable judgments	Professional Competence and Due Care
Making informed challenges of views developed by others	Professional Competence and Due Care
Being sensitive to the integrity of Information	Integrity
Withholding judgment pending thoughtful consideration of all relevant information	Professional Competence and Due Care
Being alert to potential bias or other impediments to the proper exercise of professional judgment	Objectivity
Ability and willingness of the PAs to stand their ground	Integrity

Matters for IESBA Consideration

1. Does the Board agree with the TF's views on outcomes and expectations as summarized in paragraphs 11 and 12?
2. Are there:
 - (a) Other outcomes commentators are seeking to achieve in calling for PS to apply to all PAs in addition to those in paragraph 11?
 - (b) Other overarching shareholder expectations of the PA in addition to those in paragraph 12?
3. Does the Board agree with the TF's proposed approach in paragraph 13, specifically:
 - (a) To develop a better understanding of what it means to be a PA?

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| <p>(b) To NOT pursue a route that involves developing a new definition of PS or another term and related definition applicable to all PAs?</p> <p>4. Does the Board agree with the characteristics of a PA listed in paragraph 15? Are there other characteristics that the TF should consider or include?</p> |
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Task Force's Suggested Approach

16. The TF believes that the identified characteristics (paragraph 14) underpin a PA's ability to meet public interest expectations and to apply the conceptual framework and achieve compliance with the fundamental principles. They noted that paragraph 100.1 of the Code could be the catalyst for adding additional application material to the Code.

The box below contains an initial draft of the type of enhancement that might be used to make the linkage to what it means to act in the public interest.

Acting in the public interest is based on a commitment to (1) produce reliable, high-quality, objective outcomes, and (2) act in a manner that will preserve the public's trust in the profession.

17. Additionally, the proposed approach would involve introducing additional application material that develops the understanding of particular FPs – particularly Integrity, Objectivity, and Professional Competence and Due Care – and how compliance with them can be achieved.
18. Inherent in many professional activities is the potential for bias/preferences/partiality/predisposition to influence the weight given to information. This influence or threat could be rooted in any number of factors which may include placing undue reliance on:
- The most recent outcome, or the first outcome observed.
 - The most common/frequent outcome.
 - The most available data set.
 - The most familiar outcome.
 - An outcome that confirms the PAs' expectations.
19. To raise the profile of these influences or threats and other impediments, and provide support to PAs in overcoming them, the TF proposes to develop additional application material in subsection 111 (Integrity), subsection 112 (Objectivity), and subsection 113 (Professional Competence and Due Care).
20. The TF envisages that the proposed consultation paper will include open questions to establish the level of agreement or disagreement with the proposed approach, and ask for additional input.
21. With all this in mind, to consider rebranding the project and to avoid confusion associated with the term PS in this wider context, the TF proposes henceforth to refer to this initiative as *Leveraging the Fundamental Principles to Act in the Public Interest*.

Matters for IESBA consideration:

5. Does the Board support the proposed approach?
6. Does the Board support the change to the title of this project?

Proposed Way Forward

22. Following the December IESBA meeting and subject to the Board's support for the way forward, the TF plans to:
 - (a) Ask the IAASB and IAESB whether anything in the proposed approach conflicts with the remits of those boards, or would be inconsistent with their standards;
 - (b) Develop the consultation paper seeking input from stakeholders on the proposed approach; and
 - (c) Present the draft consultation paper for consideration at the March 2018 IESBA meeting.

Appendix

Approach to “Professional Skepticism” Taken By Various Bodies

Body	Approach to professional skepticism
IAASB	<p>Given its remit, the IAASB defines the term focusing on those who practice in audit and assurance. For example, the International Standards on Auditing define professional scepticism as follows:</p> <p><i>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.</i></p>
IAESB	<p>IES 4, “Initial Professional Development – Professional Values, Ethics, and Attitudes,” identifies “professional skepticism and professional judgment” as a competency area at the intermediate level of proficiency. In doing so, it uses the IAASB definition of professional skepticism, acknowledges that the IAASB definition is limited to audit, assurance and related service engagements, and goes on to state that within IES 4, PS (and professional judgment) are to be interpreted as applying to the broader context of a role as a PA.</p> <p>IES 4 goes on to acknowledge that achieving learning objectives in PS and PJ may extend across several different courses of subjects, none of which may be devoted solely to that competency area.</p>
PCAOB	<p>In its auditing standards, the PCAOB states the following:</p> <p><i>Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. The auditor uses the knowledge, skill, and ability called for by the profession of public accounting to diligently perform, in good faith and with integrity, the gathering and objective evaluation of evidence.</i></p>
UK FRC	<p>The UK FRC has adopted the IAASB’s definition of PS in its ISAs (UK and Ireland). The UK FRC also published a paper in 2012 on PS and its relation to audit quality. The paper examines the Greek roots of skepticism, discussing doubt and how doubt stimulates challenge and inquiry, and withholds judgment about the truth. It compares PS with scientific skepticism, noting that scientific skepticism is typically not subject to external influences, human error, and fraud – as are audits. The paper concludes by suggesting that an appropriately skeptical auditor:</p> <ol style="list-style-type: none"> 1. Applies a critical appraisal of management’s assertions, actively looking for risks of material misstatement. 2. Develops a high degree of knowledge of the entity’s business and its environment.

Body	Approach to professional skepticism
	<ol style="list-style-type: none">3. Makes informed challenge of consensus views and considers the possible incidence of low probability high impact events.4. Considers if there is evidence to contradict management's assertions.5. Has strong skills in making evidence-based judgments.6. Approaches and documents audit judgments and review processes in a manner that facilitates challenge, and demonstrates the rigor of the challenge.7. Documents not only the auditor's conclusions, but also the rationale for the conclusions.