

IESBA PROJECT PROPOSAL—PROFESSIONAL SKEPTICISM (SHORT TERM) IESBA December 2016 Meeting Agenda Material for Reference

I. Subject

1. This project will explore a short-term measure to emphasize professional skepticism (PS) in the restructured Code, including by:
 - (a) Explaining the linkage between PS and the fundamental principles/ independence in the context of audit and assurance engagements; and
 - (b) Considering whether further clarifications are needed in the Code to explain the expectation that all professional accountants apply a critical mindset when applying the conceptual framework to comply with the fundamental principles.
2. This project will seek to avoid the potential unintended consequences that might arise if the current concept of PS, as defined in the standards of the International Auditing and Assurance Standards Board (IAASB), were to be applied more broadly (i.e., to apply to all professional accountants (PAs)).
3. This project will not preempt future standard-setting activities that the IESBA might undertake in coordination with the IAASB and the International Accounting Education Standards Board (IAESB). This might include for example, a longer-term project to consider how to the description of PS in the standards of IESBA, IAASB and IAESB might be harmonized.

II. Background and Relevant Developments

4. Audit inspection reports have identified issues about the level, and consistency, of PS being applied in audits, in particular in areas that require high levels of professional judgment.¹ To facilitate a holistic and coordinated response to those concerns, a Joint Professional Skepticism Working Group (PSWG) comprising of representatives from IAASB, IESBA and IAESB was formed in June 2015.
5. Separately, there have been calls from certain IESBA stakeholders for enhancement to the application of PS among PAs more broadly in the Code². In particular, some 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 or other matters of compliance with the Code) was assessed with adequate PS.

¹ [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 inspections of listed 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.

² For example:

- Some respondents to the IESBA Part C Phase 1 ED (including Monitoring Group member IOSCO) suggested that:
 - The Code should emphasize the need for PAIBs to exercise an adequate level of professional skepticism throughout the process of preparing, presenting or filing information, because PAIBs’ work typically involves accumulating, distilling, and interpreting information from others, namely colleagues who work at the source (e.g., in operating departments) of an entity’s transactions.
 - PAIBs should always maintain professional skepticism and that the concept of professional skepticism should not be limited to auditors.

6. A 2014 PIOB publication, [Conclusions from the PIOB Public Interest Workshop, September 2014](#), 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.” The publication also noted that “When accountants (practitioners, non-practitioners, accountants in business) do not display proper professional skepticism it is recognized as a barrier to effective performance.”
7. There is a view that there is a linkage between the concept of PS and four of the five fundamental principles (i.e., objectivity, integrity, professional competence and due care, and professional behavior).³ The IAASB CAG and IESBA CAG have suggested that the Code describe that linkage.

Reference to PS in the Code and Definition of PS

8. The extant Code refers to PS 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 circumstances, that a firm’s, or a member of the audit team’s, integrity, objectivity or professional skepticism has been compromised.

9. PS is more prominently dealt with in the ISAs, and is defined there 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.*”⁵ The ISAs note that PS is necessary to the critical assessment of audit evidence.
10. PS is also addressed in the IAESB standards.⁶

³ For example, this view was noted in some responses to the December 2015 IAASB Invitation to Comment (ITC), *Enhancing Audit Quality in the Public Interest*; and the IESBA’s Exposure Drafts, *Proposed Revisions Pertaining to Safeguards in the Code—Phase 1* and *Improving the Structure of the Code of Ethics for Professional Accountants—Phase 1*.

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.

⁵ ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 13(l)

The 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 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.

⁶ IES 4, *Initial Professional Development – Professional Values, Ethics, and Attitudes*, prescribes learning outcomes that aspiring PAs 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

III. Project Objective and Scope, and How They Serve the Public Interest

Project Objective

11. The objective of the project is to explore how PS might be emphasized in the restructured Code without the potential for unintended consequences for the IAASB's standards.

Project Scope

12. The scope of the project encompasses Part 1, *Complying with the Code, Fundamental Principles and Conceptual Framework*, and Section 120, *The Conceptual Framework* and its relationship with other parts of the Code. Consideration will be given as to whether conforming amendments might need to be made to other areas in the restructured Code.

How the Project Serves the Public Interest

13. PS is essential in all aspects of the audit – from planning and risk assessment to the critical assessment of audit evidence in forming the auditor's conclusions. It is in the public interest that an exploration is undertaken to establish the steps that can be taken to re-emphasize PS in audits of financial statements. However, the need for, and use of, a specific description of PS in the IAASB's standards that is applicable to audit and assurance engagements does not mean that the concept of PS is not applicable to all PAs.
14. It is also in the public interest to consider whether interim steps can be taken to clarify the importance of evaluating, with appropriate rigor, the "information" or "evidence" that underpins ethical decisions (usually relating to relationships between individuals within a firm and the entity being audited or other matters relating to compliance with the Code).
15. The project also serves the public interest because it is responsive to concerns raised by regulators and audit oversight authorities, investors and others.

IV. Outline of the Project

Issues that Will be Addressed and Approach to Project

16. The short-term project will include a study of the restructured Code to determine whether, and where in the restructured Code, it would be beneficial to:
 - (a) Explore whether a requirement should be established for all PAs, when applying the conceptual framework, to apply a critical mindset in order to understand facts and circumstances being considered and their implications with respect to compliance with the fundamental principles; and
 - (b) Explain the interaction between PS, independence and certain fundamental principles in the context of audit and assurance engagements in the Code. Such explanation would be based on the current definition of PS in the ISAs.

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.

Impact Analysis Considerations

17. The changes to Section 120 of the Code relating to the application of a critical mindset are expected to enhance PAs' application of the conceptual framework to comply with the fundamental principles and independence requirements, thereby making the restructured Code even more robust.
18. It is expected that regulators and audit oversight authorities and investors will welcome this change because of its actual and perceived benefits for improving PAs' compliance with the fundamental principles and therefore, with respect to auditors, audit quality.
19. It is not envisioned that the proposals would result in implementation costs at the national or accounting firm levels. Though individual PAs, including PAIBs, may be impacted by the proposals, the changes do not represent a significant change in what PAs are expected to do under the extant Code.
20. It is also anticipated that the impact of the proposals will be positive as they are responsive to calls for more guidance about how complying with the fundamental principles enhances the application of PS among PAs who perform audits, reviews and other assurance engagements.
21. Further consideration of the impact of these proposals will be an important part of the IESBA's evaluation of the responses received following exposure of these proposals.

V. Implications for any Specific Persons or Groups

22. The project has particular implications for jurisdictions and IFAC member bodies that have adopted the Code, or use it as a basis or a benchmark for their own ethical standards.
23. There may be implications for the all PAs, including auditors and PAIBs working in all sizes of businesses, including PAs in the public sector. The IAASB, IAESB, the IFAC PAIB Committee, the International Public Sector Accounting Standards Board (IPSASB) and the IFAC Small and Medium Practices (SMP) Committee will be kept apprised of developments to ensure appropriate input is received at key stages of the project.
24. When considering the provisions of the Code that apply to the preparation and reporting of information, consideration will be given to liaison with the accounting standard setters as appropriate, such as IASB and IPSASB, to build on, but not overlap, with their work.
25. Consideration will also be given to reaching out to regulators, audit oversight authorities and investors to solicit their input on proposed revisions to the Code, given their interest in and concern for enhancing audit quality.

VI. Development Process, Project Timetable and Project Output

Development Process

26. It is anticipated that the project will follow the normal development process of the IESBA if it concludes that changes to the Code are required.
27. The project approach will include appropriate dialogue with regulators and audit oversight authorities, investors and other users, national standards setters, firms, IFAC member bodies and others able to influence ethical standards in this area. Such dialogue will, to the extent possible, facilitate the development of consistent requirements and application material.

Project Timetable

28. Subject to the IESBA's approval of the project proposal, this project will commence immediately. The specific project milestones and outputs will be dependent on the matters that the project Task Force ultimately determines are appropriate to address as part of the project, and the priorities assigned to those matters. The project milestones and outputs are intended to align with the finalization of the Structure of the Code project.

Indicative Timing	Milestone
December 2016/ January 2017	<ul style="list-style-type: none"> Approve short-term project proposal Consider the proposed text for exposure Approve exposure draft (ED)
December 2016 – April 2017	<ul style="list-style-type: none"> Dialogue with stakeholders on key issues and proposals⁷
April – September 2017	<ul style="list-style-type: none"> Consideration of issues raised by respondents to the ED and revisions to the proposed text
December 2017	<ul style="list-style-type: none"> Approval of final PS short-term text

Project Output

29. The output of the project may take the form of additional or revised requirements and application material in the restructured Code.

VII. Resources Required

30. A project Task Force will be established, consisting of three individuals, including an IESBA member as Chair.
31. The PSWG has an important role in providing input to the project as a means of contributing to coordination of the efforts of the IESBA, IAASB and IAESB on the topic. The input of the PSWG is also critical to the IESBA's consideration of the potential implications of its proposals for the IAASB's and IAESB's standards.
32. Consideration will also be given as to how best to obtain appropriate input from the IAASB, IAESB and other stakeholders who have similar projects, or initiatives aimed at enhancing PS.
33. IESBA Staff will provide support to the project Task Force.

VIII. Relevant Sources of Information that Address the Matter Being Proposed

34. Relevant sources of information include:
- Ethical requirements for PAs established by IFAC member bodies and similar.
 - Professional standards for PAs who perform audits, reviews and other assurance engagements (e.g., the IAASB's standards).
 - Educational standards for the profession, particularly the IAESB's standards.

⁷ To include discussion with the IESBA CAG