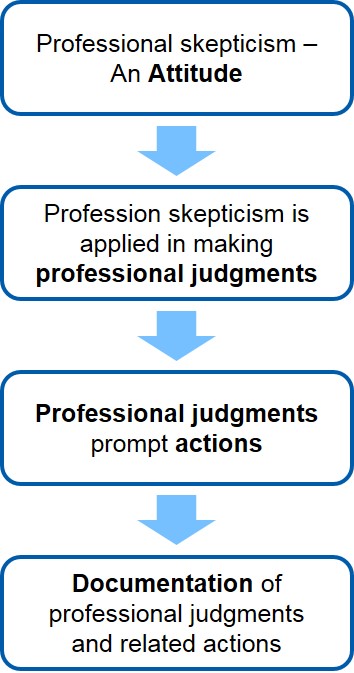
Professional Skepticism –Matrix

**Part I Introduction**

Part I of this document provides background to the matrix and describes the basic concepts of professional skepticism, professional judgment, audit evidence and documentation that form part of this matrix. This paper is not necessarily complete or comprehensive. Its sole purpose was to help the PSWG-IAASB Subgroup structure its thinking and its recommendations to ISA 540. To do so, the analysis needed to cover the audit process (ISA 315/330/450/700) and quality control. Hence, this matrix may be of value to other projects (e.g., ISA 315, Quality Control and Group Audits). There is no intention to publish this matrix as a separate document. The green suggestions relate to ISA 540; the underlined green suggestions are those considered of sufficient importance to address in the agenda paper.

In issuing the Invitation to Comment *Enhancing Audit Quality in the Public Interest, a Focus on Professional Skepticism, Quality Control and Group Audits*, the IAASB agreed that this graphic was an appropriate way to think about the concept of professional skepticism as set forth in the suite of International Standards on Auditing (ISAs).

*Figure: How Professional Skepticism Drives Action*

Professional Skepticism is defined in the ISAs 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.*

In the ITC it was explained that while professional skepticism is an attitude, this attitude is applied in making professional judgments that provide the basis for auditors’ actions. The figure included in the ITC was a simple illustration of how professional skepticism drives action. Other relevant concepts in accounting, auditing and ethical requirements, including independence of mind and objectivity, competence as well as firm-specific and environmental factors may impact the application of profession skepticism. And while the figure was drawn in a way that makes the concepts of professional skepticism, professional judgment and documentation appear to be linear and separate steps, in practice these concepts over lap and working jointly lead to action.

This figure has been the basis for the further thinking on how professional skepticism can be further enhanced within the existing audit model. In that model the auditor exercises professional judgment and maintain professional skepticism throughout the planning and performance of the audit and, among other things:

* Identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity’s internal control.
* Obtain sufficient appropriate audit evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.
* Assessing audit evidence whether it is appropriate and sufficient.
* Form an opinion on the financial statements based on conclusions drawn from the audit evidence obtained.

Each of these steps are captured in the columns of the professional skepticism matrix in section II. In doing so box 2 and 3 have been compiled together and box 4 (documentation) is captured within each of the steps. Since the critical assessment of audit evidence is so elementary rather than including it under the combined box 2 and 3 it is captured as separate column. Staff has identified basic concepts included in the ISAs that in the view of Staff support the boxes in the figure and apply throughout the audit. These concepts have been a relevant basis for further thinking on how to enhance professional skepticism as included in the professional skepticism. The table below includes these basic concepts.

*Basic Concepts in the ISAs and IAPN 1000*

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| **Professional Skepticism is an Attitude** | **Professional skepticism is applied in making professional judgments, which prompt actions (e.g., in relation to risk assessment and response)** | **Critical Assessment of Audit Evidence** |
| Professional skepticism – 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. [ISA 200 Para. 13(l)]  The auditor shall plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. [ISA 200, Para. 15, Ref: Para. A18–A22]  Professional skepticism is necessary to the critical assessment of audit evidence and assists the auditor in remaining alert for possible indications of management bias. This includes questioning contradictory audit evidence and the reliability of documents, responses to inquiries and other information obtained from management and those charged with governance. It also includes being alert to conditions that may indicate possible misstatement due to error or fraud and considering the sufficiency and appropriateness of audit evidence obtained in light of the circumstances. [IAPN 1000, Para.71]  Audit Documentation  [ISA 230 Para. A7] Audit documentation provides evidence that the audit complies with the ISAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document seParately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example...  • In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:  ○ While there may be no single way in which the auditor’s professional skepticism is documented, the audit documentation may nevertheless provide evidence of the auditor’s exercise of professional skepticism in accordance with the ISAs. Such evidence may include specific procedures performed to corroborate management’s responses to the auditor’s inquiries. Additionally, the audit documentation may be a memo that describes how professional skepticism, working in combination with professional judgment critically analyzed an estimate and lead to further audit procedures being performed. | Professional judgment – The application of relevant training, knowledge and experience, within the context provided by auditing, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement. [ISA 200 Para. 13(k)]  The auditor shall exercise professional judgment in planning and performing an audit of financial statements. [ISA 200 Para. 16, Ref: Para. A23–A27]  Audit Documentation  [ISA 230 Para. 8] The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand: (Ref: Para. A2–A5, A16–A17)  (a) The nature, timing and extent of the audit procedures performed to comply with the ISAs and applicable legal and regulatory requirements; (Ref: Para. A6–A7)  (b) The results of the audit procedures performed, and the audit evidence obtained; and  (c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. (Ref: Para. A8–A11)  [ISA 230 Para. A9] An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgment exercised in performing the work and evaluating the results. Documentation of the professional judgments made, where significant, serves to explain the auditor’s conclusions and to reinforce the quality of the judgment. Such matters are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits when reviewing matters of continuing significance (for example, when performing a retrospective review of accounting estimates).  [ISA 230 Para. A10] Some examples of circumstances in which, in accordance with Paragraph 8, it is appropriate to prepare audit documentation relating to the use of professional judgment include, where the matters and judgments are significant:   * The rationale for the auditor’s conclusion when a requirement provides that the auditor “shall consider” certain information or factors, and that consideration is significant in the context of the particular engagement. * The basis for the auditor’s conclusion on the reasonableness of areas of subjective judgments (for example, the reasonableness of significant accounting estimates). * The basis for the auditor’s conclusions about the authenticity of a document when further investigation (such as making appropriate use of an expert or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic. | Audit evidence – Information used by the auditor in arriving at the conclusions on which the auditor’s opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. [ISA 500 Para. 5(c)]  Appropriateness (of audit evidence) – The measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor’s opinion is based. [ISA 500 Para. 5(b)]  Sufficiency (of audit evidence) – The measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor’s assessment of the risks of material misstatement and also by the quality of such audit evidence. [ISA 500 Para. 5(e)]  The auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. [ISA 500 Para. 6, Ref: Para. A1–A25]  ISA 330 requires the auditor to conclude whether sufficient appropriate audit evidence has been obtained. Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor’s opinion, is a matter of professional judgment. ISA 200 contains discussion of such matters as the nature of audit procedures, the timeliness of financial reporting, and the balance between benefit and cost, which are relevant factors when the auditor exercises professional judgment regarding whether sufficient appropriate audit evidence has been obtained. [ISA 200 Para. A6] |

**Part II Professional Skepticism Matrix**

**Objective of this matrix:** To explore how professional skepticism can be more enhanced within the existing model by following the audit process and identifying where:

* Existing material in the ISAs may be elevated from application material to requirements;
* Existing requirements or application material may need to be included earlier in the set of ISAs or reinforced within other ISAs; or
* Further clarification of the concept of professional skepticism or how it is intended to be applied in particular circumstances may be needed (e.g., in relation to contradictory evidence).

**Approach to this matrix**: Each question in the matrix focuses on the three elements of professional skepticism. The extent to which each of these elements of professional skepticism may be relevant to each cell in the matrix may vary. The preliminary recommendations of the Staff are included as “aspirational”, and are meant to explore areas where changes to the standards might be helpful to reinforce the concept of professional skepticism.

| **Implication by audit “phase”, including documentation** | **Attitude: Questioning mind and being alert** | **Professional skepticism is applied in making professional judgments, which prompt actions (e.g., in relation to risk assessment and response)** | **Critical assessment of audit evidence** |
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| **RISK ASSESSMENT PROCEDURES** | | | |
| Identifying and assessing risks of material misstatement through an understanding of the entity and its environment | **REFERENCES TO PROFESSIONAL SKEPTICISM WITHIN THE STANDARDS:**  ISA 315 (Revised) *Understanding the entity and its environment, including the entity’s internal controls and identifying and assessing the risks of material misstatement, A116 The Entity’s Internal Audit Function*  How PS is described: In relation to the monitoring of controls when the entity has an internal audit function the following language relating to the exercise of professional skepticism is used within ISA 315 (Revised): “…ISA 200 discusses the importance of the auditor planning and performing the audit with professional skepticism, including being alert to information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence. Accordingly, communication with the internal audit function throughout the engagement may provide opportunities for internal auditors to bring such information to the auditor’s attention. The auditor is then able to take such information into account in the auditor’s identification and assessment of risks of material misstatement.”  \*\*note: Effective for audits of financial statements for periods ending on or after December 15, 2016 the following sentence is added to ISA 315 (revised) Para. A127 (Process of identifying risks of material misstatement) as a result of conforming amendments related to the Disclosures project and the Auditor Reporting project: “In identifying the risks of material misstatement in the financial statements, the auditor exercises professional skepticism in accordance with ISA 200.”  ISA 540 *Auditing Accounting Estimates, including Fair Value Accounting Estimates, and Related Disclosures, A 40*  How PS is described: The review of prior period accounting estimates may also assist the auditor, in the current period, in identifying circumstances or conditions that increase the susceptibility of accounting estimates to, or indicate the presence of, intentional management bias designed to cause a certain financial result. The auditor’s professional skepticism assists in identifying such circumstances or conditions and in determining the nature, timing and extent of further audit procedures.  Observations:   * Only one reference to “professional skepticism” throughout ISA 315 (revised) and this is in the application material and effective from December 15, 2016, two references * Only one reference in application material to ISA 540 * Only two references in the Staff Q&A (2012) that tie back to requirements in ISA315 (Revised) 1) Professional skepticism should be discussed during the discussion among the engagement team around the risks of material misstatements to the FS as a whole [ISA 315 Para. 10] and 2) Professional skepticism is relevant and necessary throughout the audit, in particular in the revision of risk assessment required by Para. 31 of ISA 315 (revised). | | |
| **ASPIRATIONAL:**  Consideration and Governing ISA Para.:  ISA 315 (Revised) Para. 11  Consider whether to restructure the requirement to promote a greater understanding of the business model in understanding the entity and its environment  ISA 540 Para 8, 10 and 11 are linked to ISA 315 and will be influenced  ISA 240 Para. 32 (b) link with management bias in ISA 540  What does it look like?:   * ISA 315 Para. 11 (d) could be listed first to influence the auditor to compare item (d) against the information it receives from items (a,b,c,e) and determine whether they make sense in light of the objectives and strategies (d). (This would allow the auditor to challenge how they work together and would represent a more logical flow. Would help the auditor remain for opportunities for management to exercise bias and challenging management’s assumptions/judgments.) * Consider restructuring the requirements in Paragraph 8 of ISA 540 to promote greater understanding of the entity’s process for developing the accounting estimate, including whether inconsistencies between information exists.   How do we encourage it?:   * ISA 315 Para. 11(d) by reorganizing the procedures and including a procedure following Para. 11 that directs the auditor to challenge his/her understanding of the items within Para. 11 (i.e., do they make sense). * ISA 315 explicitly being alert to management bias including risk indicators of possible management bias as identified in ISA 540 Para. A128 and apply them more generally to the entire audit. * Include from ISA 315 already the discussion that auditor bias (e.g. anchoring bias) is also a factor that should be considered * Include to document how management bias has been considered in planning the engagement and how it was addressed. Additionally, application guidance to Paragraph 10 (perhaps to A21) could be strengthened to include management bias as an item that could be discussed to focus more attention on where there are greater risks of Risks of Material Misstatement. Auditors could also be reminded during the audit to continue to be alert during the entire audit. * Being alert of auditor’s bias due to previous years’ experience or familiarity and stimulate an open team discussion consider revising ISA 315 Para. 10 by giving more prominence in the required engagement team discussion to potential causes for the susceptibility of the entity’s financial statements to material misstatements such as potential incentives that may exist. * Determining what additional procedures should be performed for significant risks and also why that may create a need to search for disconfirming evidence. * Consider reinforcing the importance of professional skepticism explicitly which can be evidenced through documentation in the audit file. * Consider whether the team composition is such that sufficient competence is available to obtain an understanding of complex accounting estimates that may give rise to a material misstatement * Consider indicators of management bias as in ISA 540 Para. 125 a required engagement team topic of discussions. * Reference in ISA 540 similarly to IAPN 1000 Para. 71 being alert to management bias * Reference in ISA 540 back to ISA 240 Para 32 (b) whether management bias represents a risk of fraud * Consider elevating IAPN 1000 Para. 16 being alert to risks of material misstatement due to insufficient skills and experience within management and those charged with governance   How do auditors evidence it?:   * ISA 315 Para. 32 includes references to audit documentation what to document. This must be read in conjunction with ISA 230. * Through Para. A7 of ISA 230. However, Para. A7 lacks language instructing the auditor to document *how* it has challenged management’s assertions/responses as well as guidance on how the engagement team can demonstrate its internal discussions around being alert and the extent to which the auditor has questioned the evidence provided by management and evaluated it from different perspectives. The audit documentation may be a memo that describes how professional skepticism, working in combination with professional judgment critically analyzed a risk of material misstatement * Documenting the motivation why particular risks have been considered as significant and how that relates to the auditor’s professional skepticism | Consideration and Governing ISA Para.:  ISA 315 (Revised) Para. 11, Para. 32  Consider whether to elevate application material to requirements to emphasize the continuous re-evaluation of understanding the entity and its environment  Consider whether to include in documentation requirements more explicitly how to weigh different types of evidence and to determine whether auditor has sufficiently dealt with any contradictory evidence.  What does it look like?:   * Based on the evaluation of the items in par. 11, the auditor may now identify that an action/management response is not in accordance with the entity’s objectives and strategies and therefore may represent an indicator of management bias affecting the assessments of risk.   How do we encourage it?:   * Include ISA 315 (revised) Para. A1 and Para. A3 as a requirement within the standard. (this would emphasize the continuous re-evaluation of the auditor’s understanding of the entity and its environment throughout the audit).   How do auditors evidence it?:   * Through Para. 32 of ISA 315 (Revised) which requires the auditor to document the discussions among engagement team and conclusions reached, key elements of understanding about the entity, and the identified and assessed risks of material misstatement. * ISA 540 Para. A128 on documenting the indicators of possible management bias and the auditor’s evaluation of whether the risk assessment and related responses remain appropriate, could be applied more generally to the entire audit | Consideration and Governing ISA Para.:  ISA 500 Para. 7-9 on information to be used as audit evidence. ISA 500 Para. 11 on inconsistencies in, or doubts of reliability of, audit evidence. ISA 230 Para. 11, documentation requirements related to inconsistencies in audit evidence.  What does it look like?:   * Retain Para. 11 and Para. A57 of ISA 500 that guide the auditor’s response to identified inconsistencies in audit evidence, or doubts over the reliability of audit evidence. Further ISA 230 Para. 11 indicates that, for significant audit matters, when the auditor identifies information that is inconsistent with the auditor’s final conclusion, the auditor shall document how the inconsistency was addressed.   How do we encourage it?:   * Final evaluation is a product of the evaluations from columns 2 and 3 (attitude and professional judgment).   How do auditors evidence it?   * Final evaluation is a product of the evaluations from column 3 (professional judgments). |
| **RESPONSES TO ASSESSED RISKS** | | | |
| **Designing** audit procedures (both controls and substantive) | **REFERENCES TO PROFESSIONAL SKEPTICISM WITHIN THE STANDARD:**  ISA 330 *The Auditor’s Response to Assessed Risks*, Para. A1 Overall Responses  ISA 540: Para. A 40  How PS is described: ISA 330 Para. A1 In relation to the design and implementation [performance] of the audit responses to address the assessed risks of material misstatement at the financial statement level, the standard suggests that procedures may include, among other items noted, “Emphasizing to the engagement team the need to maintain professional skepticism”.  How PS is described: ISA 540 Para. A 40. The review of prior period accounting estimates may also assist the auditor, in the current period, in identifying circumstances or conditions that increase the susceptibility of accounting estimates to, or indicate the presence of, possible management bias. The auditor’s professional skepticism assists in identifying such circumstances or conditions and in determining the nature, timing and extent of further audit procedures.  Observations:   * Only one reference to “professional skepticism” throughout ISA 330. * Only high level addressed in application material of ISA 540 * PS is only mentioned in the application material. Further, when the concept is mentioned, it refers exclusively to the engagement team maintaining professional skepticism, not specifically in the selection of audit procedures to be performed. | | |
| **ASPIRATIONAL:**  Consideration and Governing ISA Para:  Consider more explicitly aligning risks of material misstatement as addressed in ISA 330 Para. 7a, Para. 10b, and Para. 21 with what can go wrong as addressed in ISA 315 Para. 26  What does it look like?:   * Controls: Testing controls that address the risks identified including indicators of management bias. Selecting controls to test and rely upon, that would address the specific risk(s) identified, including both direct and indirect controls. [ISA 330, Para. 10b] * Substantive: Designing audit procedures that are specifically responsive to the assessed risks of material misstatement as well as identified indicators of management bias.   How do we encourage it?:   * Controls: By linking the “what could go wrong” at the assertion level [ISA 315, Para. 26] to the auditor’s selection of controls to test [ISA 330, Para. 10b]. * Substantive: Linking Para. 21 of ISA 330 back to Para. 26c and Para. 27 of ISA 315 in order to illustrate why the assessed risk is significant and how the audit procedures selected to be performed address the “what could go wrong” when considering the results of tests of controls. * ISA 540 could enhance the application of professional skepticism by requiring that the discussion in the engagement team under ISA 15 also focus on the team identifying instances of possible management bias in accountings estimates, including how audit procedures have been designed to address such matters   How do auditors evidence it?:   * Both: Questioning mind is evidenced through the auditor’s professional judgments. Documenting how the indicators of management bias have been addressed. | Consideration and Governing ISA Para:  Consider to continue to design appropriate procedures to respond to what could go wrong and obtain more persuasive evidence until satisfied with the quality of evidence, ISA 330 Para. 7b, Para. 10, and Para. A19  What does it look like?:   * Controls: Considering whether you have designed and tested controls that meet the requirements in Para. 10 of ISA 330 and addressed the “what could go wrong.” [ISA 315 (revised), Para. 26c] * Substantive: When conditions exist that necessitate a higher assessment of risk, the auditor increases the *quantity* of evidence or the *quality* of evidence (more persuasive). [ISA 330, Para. A19]   How do we encourage it?:   * Both: Strengthen the link between the “what could go wrong” and the controls/substantive procedures selected for testing. * ISA 540 Strengthen the link between the “what could go wrong” and the controls/substantive procedures selected for testing. * Consider more explicit reference in ISA 540 how to increase quantity and quality of evidence to respond to higher risk assessment and link it to the mix of procedures and sources of evidence. * Consider more explicit examples of enquiries to management if inconsistent evidence is obtained.   How do auditors evidence it?   * Audit documentation would include the procedures being performed and the linkage between the risks identified and the audit procedures selected to address those risks. (Potentially in application material to ISA 230). * ISA 540 could draw a link between its application material and that in ISA 230, including how documentation may assist auditors in making judgments requiring professional skepticism | Consideration and Governing ISA Para:  ISA 200, Para. A19 sufficiently addresses maintaining PS throughout the audit, but link to supervision as addressed in ISA 220 Para 15 (a), if applicable 19 (b) and ISQC1 Para.32, 33 and 34 (a)  What does it look like?:   * Supervision and review of the selection of tests of controls and substantive audit procedures (by a more senior engagement team member) to ensure the correct alignment of risks with the “what could go wrong.”   How do we encourage it?:   * Final evaluation is a product of the evaluations from columns 2 and 3 (attitude and professional judgment).   How do auditors evidence it?   * Final evaluation is a product of the evaluations from column 3 (professional judgments). |
| **Performing** audit procedures (both operating effectiveness of controls and substantive testing) | **REFERENCES TO PROFESSIONAL SKEPTICISM WITHIN THE STANDARD:**  See above within “Designing audit procedures (both controls and substantive)” | | |
| **ASPIRATIONAL:**  Consideration and Governing ISA Para:  Considering how promoting an open mind, proper supervision, knowledge and training can enhance PS  ISQC 1 and ISA 220 as basis  Controls: ISA 200 A18 and A22  Substantive: ISA 200 par. A46, ISA 240 par. 32b, ISA 315 par. A47.  What does it look like?:   * Both: Performing the procedures with an open mind, being alert in accordance with ISA 200 par. A18. And also being alert to the potential for management bias.   How do we encourage it?:   * Both: Through engagement team discussion, through supervision, through proper training of team members (industry, regulatory environment, etc.).   How do auditors evidence it?   * Both: Documentation of the list of potential opportunities for management bias, including the ways the team has addressed/considered the potential biases. | Consideration and Governing ISA Para:  Both: ISQC1, ISA 220 and ISA 200 par. A43, ISA 230, Para. A7, A10.  What does it look like?:   * Both: ISQC1/ISA 220 Engagement team members must feel comfortable to bring potential deviations, misstatements, or instances of management bias to the attention of more senior engagement team members. They must also possess the skills necessary to understand the objective of the test originally performed and whether additional testing should now be performed because of the potential misstatements and deviations. * ISA 540 could include matters on how to apply the guidance in ISA 200 Paragraph 43 in the context of accounting estimates   How do we encourage it?:   * Controls: Encourage through ISQC 1 as well as through the language in A43 of ISA 200. * Substantive: Duplicate language from ISA 540 (ex. A80, A124) within ISA 315 and ISA 330 to be more general and applicable to the overall audit.   How do auditors evidence it?   * Both: Evidenced through supervision and review, through documentation of deviations or misstatements. * Through ISA 230 Para A.7 that could also include language that instructs the auditor on how to weigh different types of evidence to reach audit conclusions and determine whether he/she has sufficiently dealt with any contradictory evidence, conditions that may indicate possible fraud, or audit evidence that requires the use of further expertise (a specialist or a more senior engagement team member). * Through ISA 230 Para. A10 which includes examples of circumstances where documentation of significant professional judgments of significant matters is appropriate. | Consideration and Governing ISA Para:  Both: ISA 315 Para. 31, ISA 330 Para. 17, Para. A25 to A28  What does it look like?:   * Both: Challenging the audit evidence, looking for corroboration from management inquiries, challenging management’s assumptions, and critically evaluating audit evidence. Demonstrating (through documentation) that you have considered the effect of the results of controls testing on the audit plan. * Retain Para. 11 and Para. A57 of ISA 500 that guides the auditor’s response to identified inconsistencies in audit evidence, or doubts over the reliability of audit evidence. Further ISA 230 Para. 11 indicates that, for significant audit matters, when the auditor identifies information that is inconsistent with the auditor’s final conclusion, the auditor shall document how the inconsistency was addressed. * ISA 540 could make reference to documenting how inconsistencies in audit evidence were addressed and the implications of deviations from controls where such controls are designed to address indicators of possible management bias and the auditor intends to rely on those controls * ISA 540 could extend the requirement in Paragraph 23 to require the auditor to consider the effect of indicators of possible management bias in performing the auditor’s procedures and whether the auditor has obtained sufficient appropriate audit evidence when reaching conclusions about the results of those procedures   How do we encourage it?:   * Both: Potentially through IQSC 1, in particular via encouragement by “tone at the top”. Also, a link between ISA 330 Para. 17 and ISA 315 Para. 31.   How do auditors evidence it?   * Through audit plan adjustments, risk assessment is a continuous process. |
| **AUDIT CONCLUSION** | | | |
| Forming an opinion (when misstatements are challenged by management) | **REFERENCES TO PROFESSIONAL SKEPTICISM WITHIN THE STANDARD:**  ISQC1  ISA 220  ISA 450 Evaluation of Misstatements Identified During the Audit  ISA 540 Para 18  How PS is described: Not described  \*\*note: Effective for audits of financial statements for periods ending on or after December 15, 2016 the following revisions affect ISA 450 Para. A17 (Evaluating the Effect of Uncorrected Misstatements) as a result of conforming amendments related to the Disclosures project and the Auditor Reporting project:  A17. ISA 240[[1]](#footnote-2) explains how the implications of a misstatement that is, or may be, the result of fraud ought to be considered in relation to other aspects of the audit, even if the size of the misstatement is not material in relation to the financial statements. Depending on the circumstances, misstatements in disclosures could also be indicative of fraud, and, for example, may arise from:   * Misleading disclosures that have resulted from bias in management’s judgments; or * Extensive duplicative or uninformative disclosures that are intended to obscure a proper understanding of matters in the financial statements.   When considering the implications of misstatements in classes of transactions, account balances and disclosures, the auditor exercises professional skepticism in accordance with ISA 200.[[2]](#footnote-3)  Observations:   * ISQC1 and ISA 220 have to create an environment in which the auditor can cultivate appropriate professional skepticism (see section below as well as part of ITC consultation) * In extant ISA 450, there are currently no references to professional skepticism. * ISA 540 includes no reference to PS when evaluating evidence in forming a conclusion. * Within the Staff Q&A there is no specific mention of how professional skepticism should guide the auditor’s evaluation of misstatements identified during the audit. However, the Staff Q&A does state that “Robust dialogue between the auditor and TCWG about areas of higher assessed risk of material misstatement, particularly critical accounting estimates, and how the auditor responded to those assessed risks, may provide TCWG an opportunity to challenge how the auditor applied professional skepticism in the approach to those areas.” | | |
| **ASPIRATIONAL:**  Consideration and Governing ISA:  To consider emphasizing the tone at the top, supporting the fortitude of auditors in critically challenging management via further emphasis in ISQC1 while to auditor is considering identified misstatements as for example identified in ISA 450 Para. 6 and Para. 9 and ISA 540 Para 18, Para 20 and Para 21  What does it look like?:   * The auditor has considered other alternatives/evidence to corroborate management responses. Engagement partner should be pushing back on management when management disagrees with audit conclusions. Tone at the top, creating an environment where employees do the right thing and have fortitude.   How do we encourage it?:   * Through ISQC 1.   How do auditors evidence it?   * Through the audit documentation where the auditor demonstrates that it has obtained sufficient appropriate audit evidence. | Consideration and Governing ISA:  To consider emphasizing the tone at the top, supporting the fortitude of auditors in critically challenging management via further emphasis in ISQC1 while to auditor is considering identified misstatements as for example identified in ISA 450 Para. 6 and Para. 9, Para A10 and ISA 540 Para 18, Para 20 and Para 21  What does it look like?:   * Emphasizing the importance of ethics and fortitude. Being comfortable to stand up to management until the partner is confident that sufficient appropriate audit evidence has been obtained. * With respect to management disagreement with misstatements identified by the auditor ISA 540 could,  1. draw on the content in ISA 450 Paragraphs 9 and A10 and the need to perform audit procedures that corroborate or undermine management’s reasons for not making corrections, with a focus on evaluating whether there are indications of management bias; 2. provide guidance on the application of professional skepticism in ISA 540 Paragraphs A116-A118, for example dealing with whether, based on the audit evidence obtained, the auditor has considered evidence that corroborates or undermines management responses   How do we encourage it?:   * Through ISQC 1.   How do auditors evidence it?   * Through the audit documentation where the auditor demonstrates that it has obtained not only sufficient appropriate audit evidence but that the auditor has applied professional skepticism and in combination with professional judgment, critically analyzed the issue and took action. | Consideration and Governing ISA Para:  ISQC1 and ISA 220  ISA 450 Para. 6 and Para. 9  ISA 540  What does it look like?:   * Final evaluation is a product of the evaluations from columns 2 and 3 (attitude and professional judgment). * Retain Para. 11 and Para. A57 of ISA 500 that guide the auditor’s response to identified inconsistencies in audit evidence, or doubts over the reliability of audit evidence. Further ISA 230 Para. 11 indicates that, for significant audit matters, when the auditor identifies information that is inconsistent with the auditor’s final conclusion, the auditor shall document how the inconsistency was addressed.   How do we encourage it?:   * Final evaluation is a product of the evaluations from columns 2 and 3 (attitude and professional judgment).   How do auditors evidence it?   * Final evaluation is a product of the evaluations from column 3 (professional judgments). |
| Forming an opinion (raising concerns on whether sufficient appropriate audit evidence has been obtained) | **REFERENCES TO PROFESSIONAL SKEPTICISM WITHIN THE STANDARD:**  ISQC1 and ISA 220 have to create an environment in which the auditor can cultivate appropriate professional skepticism when forming an overall opinion (see section below as well as part of ITC consultation)  ISA 700, Forming an Opinion and Reporting on Financial Statements  How PS is described: Not described in the current standard, but referenced  Observations:   * There are currently no references to professional skepticism within ISA 700. For ISA 700 (Revised) effective for audits of financial statements for periods ending on or after December 15, 2016 Para. 38 requires that the Auditor’s Responsibilities for the Audit of the Financial Statements section of the auditor’s report shall further state that, as part of an audit in accordance with ISAs, the auditor exercises professional judgment and maintains professional skepticism throughout the audit * Within the Staff Q&A, two references to ISA 700 is referenced when referring to the importance of exercising professional skepticism throughout the audit both in terms of whether the auditor has 1) obtained sufficient appropriate audit evidence in order to be able to conclude about whether reasonable assurance was obtained [ISA 700, Para. 11] and 2) evaluated whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation [ISA 700, Para. 14]. | | |
| **ASPIRATIONAL:**  Consideration and Governing ISA Para:  ISQC1 and ISA 220 to serve as a basis for applying professional skepticism in the final evaluation of sufficient and appropriate audit evidence to form a conclusion  ISA 700 (revised) Para. 11 through 15 (incl. application material)  What does it look like?:   * The actions of the engagement partner and appropriate messages to the other members of the engagement team emphasize that quality is essential in performing audit engagements and the importance to audit quality of, for example, the engagement team’s ability to raise concerns without fear of reprisals and in issuing auditor’s reports that are appropriate in the circumstances.[ISA 220, Para. A3] Engagement team members feel comfortable to raise issues with the sufficiency of the audit procedures and whether sufficient appropriate audit evidence has been obtained. The QMA approach within the ITC would allow team members to challenge whether sufficient appropriate evidence has been obtained.   How do we encourage it?:   * Through ISQC 1.   How do auditors evidence it?   * Through the audit documentation where the auditor demonstrates that it has obtained sufficient appropriate audit evidence in order to conclude that reasonable assurance has been obtained. [ISA 700, Para. 11] | Consideration and Governing ISA Para:  ISQC1 and ISA 220  ISA 700 (revised) Para. 11 through 15 (incl. application material)  What does it look like?:   * Emphasizing the importance of ethics and fortitude. Being comfortable to stand up to senior engagement team members when evaluating sufficient appropriate evidence.   How do we encourage it?:   * Through ISQC 1.   How do auditors evidence it?   * Through the audit documentation where the auditor demonstrates that it has obtained sufficient appropriate audit evidence in order to conclude that reasonable assurance has been obtained. [ISA 700, Para. 11] | Consideration and Governing ISA Para:  ISQC1 and ISA 220  ISA 700 (revised) Para. 11 through 15 (incl. application material)  What does it look like?:   * Final evaluation is a product of the evaluations from columns 2 and 3 (attitude and professional judgment). * Retain Para. 11 and Para. A57 of ISA 500 that guide the auditor’s response to identified inconsistencies in audit evidence, or doubts over the reliability of audit evidence. Further ISA 230 Para. 11 indicates that, for significant audit matters, when the auditor identifies information that is inconsistent with the auditor’s final conclusion, the auditor shall document how the inconsistency was addressed. * ISA 540 could address the requirements in ISA 540 Paragraphs 18-21 by emphasizing a “stand back” about matters such as: audit evidence obtained, inconsistencies identified, and how they have been resolved, indicators of management bias, etc.   How do we encourage it?:   * ISA 540 could reinforce that evaluating the sufficiency of audit evidence for disclosures in the financial statements involves the application of the same types of considerations as when evaluating the sufficiency of audit evidence for accounting estimates recognized in the financial statements   How do auditors evidence it?   * Through documentation and sign-offs of the final audit file by engagement team members. |
| **Quality Control at Firm and Engagement Level**  *Firm Level:*  ISQC1 has no explicit reference to professional skepticism. However the requirements in ISQC1 form an environment to help create an environment in which the auditor can cultivate appropriate professional skepticism and the responses to the ITC will further highlight where this can be further enhanced.  The Staff Q&A references to the firm’s leadership to influence the internal culture of the firm.[[3]](#footnote-4) Accordingly, the “tone at the top” and continual reinforcement of the importance of professional skepticism on audit engagements are important influences on individuals’ behavior. Opportunities for the firm to set expectations regarding, and to emphasize the importance of, professional skepticism include, for example, when:   * + Establishing policies and procedures designed to promote an internal culture recognizing that quality is essential in performing engagements.[[4]](#footnote-5)   + Promoting a quality-oriented internal culture through clear, consistent and frequent actions and messages from all levels of the firm’s management. This may be communicated by, but not limited to, training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. Such actions and messages encourage a culture that recognizes and rewards high-quality work, and may be incorporated, for example, in the firm’s internal documentation and training materials and in partner and staff appraisal procedures such that they support and reinforce the firm’s view on the importance of quality and how, practically, it is to be achieved.[[5]](#footnote-6)   + Establishing policies and procedures designed to provide the firm with reasonable assurance that it has sufficient personnel with the necessary competence, capabilities and commitment to ethical principles.[[6]](#footnote-7) In this regard, promoting an internal culture based on quality may be achieved through the establishment of policies and procedures that address performance, evaluation, compensation, and promotion (including incentive systems), that give due recognition and reward to the development and maintenance of competence.[[7]](#footnote-8)   + Developing and implementing internal training and continuing education programs for all levels of the firm’s personnel. This may be achieved through, for example, work experience, on the job training, coaching by more experienced staff (for example, other members of the engagement team), and independence education. It is noted that the continuing competence of firm personnel depends to a significant extent on an appropriate level of continuing professional development.[[8]](#footnote-9)   *Engagement level*  ISA 220 includes in Para. A 13 under *Direction, Supervision and Performance* (Ref: Para. 15(a)) a reference to professional skepticism  A13. Direction of the engagement team involves informing the members of the engagement team of matters such as:   * Their responsibilities, including the need to comply with relevant ethical requirements, and to plan and perform an audit with professional skepticism as required by ISA 200.[[9]](#footnote-10) * Responsibilities of respective partners where more than one partner is involved in the conduct of an audit engagement. * The objectives of the work to be performed. * The nature of the entity’s business. * Risk-related issues. * Problems that may arise. * The detailed approach to the performance of the engagement.     Discussion among members of the engagement team allows less experienced team members to raise questions with more experienced team members so that appropriate communication can occur within the engagement team.  The Staff Q&A emphasizes in line with ISA 220 the important of team communication and supervision as follows:   * The actions of the engagement partner and appropriate messages to the other members of the engagement team emphasize that quality is essential in performing audit engagements and the importance to audit quality of, for example, the engagement team’s ability to raise concerns without fear of reprisals and in issuing auditor’s reports that are appropriate in the circumstances.[[10]](#footnote-11) * An ideal opportunity to address and emphasize with the engagement team the importance of maintaining professional skepticism throughout the audit is during the discussion by the engagement partner and other key engagement team members of the susceptibility of the entity’s financial statements to material misstatement. This discussion includes the application of the applicable financial reporting framework to the entity’s facts and circumstances, and places particular emphasis on how and where the financial statements may be susceptible to material misstatement due to fraud, including how fraud might occur (setting aside beliefs that the engagement team members may have that management and TCWG are honest and have integrity). This discussion also provides a basis upon which engagement team members communicate and share new information that may affect risk assessments or the audit procedures performed.[[11]](#footnote-12) * Further opportunities for the engagement partner to set expectations regarding, and to emphasize the importance of, professional skepticism include, for example, when taking responsibility for:   + - * The direction, supervision and performance of the audit engagement.[[12]](#footnote-13)       * Reviews of work performed. In this regard, the engagement partner, in particular, has much knowledge and experience to impart in helping less experienced team members develop a critical and questioning mind through review of, among other matters, critical areas of judgment and significant risks. Timely reviews also allow significant matters (for example, critical areas of judgment, especially those relating to difficult or contentious matters identified during the course of the engagement) to be resolved on or before the date of the auditor’s report.[[13]](#footnote-14)       * The engagement team undertaking appropriate consultation on difficult or contentious matters and that the conclusions reached from such consultations have been implemented.[[14]](#footnote-15) | | | |
| **OTHER CONSIDERATION OF Professional Skepticism**   * Preliminary engagement activities (ISA 300, Appendix in A9) | | | |

**Relevant ISAs referenced throughout this matrix**:

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

ISA 230, Audit Documentation

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

ISA 330, The Auditor’s Responses to Assessed Risks

ISA 450, Evaluation of Misstatements Identified during the Audit

ISA 500, Audit Evidence

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

ISA 700 (Revised), Forming an Opinion and Reporting on Financial Statements

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

1. ISA 240, paragraph 35 [↑](#footnote-ref-2)
2. ISA 200, paragraph 15 [↑](#footnote-ref-3)
3. ISQC 1, paragraph A4 [↑](#footnote-ref-4)
4. ISQC 1, paragraph 18 [↑](#footnote-ref-5)
5. See ISQC 1, paragraph A4. [↑](#footnote-ref-6)
6. See ISQC 1, paragraph 29. [↑](#footnote-ref-7)
7. See ISQC 1, paragraphs A5 and A25-A28. [↑](#footnote-ref-8)
8. See ISQC 1, paragraphs 29 and A25-A26. [↑](#footnote-ref-9)
9. ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 15. [↑](#footnote-ref-10)
10. See ISA 220, paragraph A3. [↑](#footnote-ref-11)
11. See ISA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraphs 10 and A14, and ISA 240, paragraph 15. [↑](#footnote-ref-12)
12. See ISA 220, paragraph 15. [↑](#footnote-ref-13)
13. See ISA 220, paragraphs 16 and A18. [↑](#footnote-ref-14)
14. ISA 220, paragraph 18. [↑](#footnote-ref-15)