

## Professional Skepticism

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Agenda Item 8

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# Objectives of the Discussion

- To summarize the responses to the IAASB's Invitation to Comment (ITC)
- To highlight discussions of the IESBA and IAESB relevant to the work of the Professional Skepticism Working Group (PSWG)
- To present the PSWG's *preliminary recommendations* on the actions that could be taken by the three standard-setting boards (SSBs), individually and in coordination, to enhance the application of PS and solicit views on these actions from a public interest standpoint, in particular to:
  - Consider next steps for the IAASB
  - Discuss a “straw man” developed by IESBA Representatives
  - Highlight potential actions of a longer-term nature and consider their implications

# Overview of Feedback to Date – IAASB ITC

- PS is about the appropriate **mindset** of the auditor
  - Concerns over a lack of PS in audits cannot be fixed in isolation by changes to the definition or within the IAASB's International Standards
  - Mixed views over whether the definition needs to be changed or whether the IAASB could instead be more clear how it expects PS to be demonstrated
- PS is about **behavior**—how can auditors be encouraged to act as critical challengers?
  - Can changes to certain auditing standards more effectively direct auditors to what is expected?
  - How does the culture of the firm influence and encourage skeptical behavior?
  - Additional guidance on exercising PS in particular circumstances (e.g., when auditing highly judgmental areas) would be helpful to enhance practice – linkage to IAASB's ISA 540 project
- Auditors need a sufficient **knowledge of the business** to more effectively challenge management, and better consider evidence obtained – PS relevant throughout the audit
  - Linkage to the IAASB's ISA 315 (Revised) project

# Overview of Feedback to Date – IAASB ITC (cont.)

- Strong link between PS and the role of the “tone at the top” and the “tone at the middle”
  - Audit firm, the engagement partner, senior staff, and the engagement quality control (EQC) reviewer (where applicable) all have a role – communication and mentoring particularly important
  - Linkage to the IAASB’s Quality Control project
- Training and education is important to infuse a professional skeptical attitude into the “DNA” of auditors
  - Raise awareness for auditors of their (and management’s) potential biases, including within the standards
- Support for a joint approach by the IAASB, IESBA, and IAESB, with a focus on
  - Consistency between the SSBs on the concept/definition of PS
  - The analysis in Agenda 8B suggests that the various impediments are closely linked to the fundamental principles in the IESBA Code, i.e. lack of due care, objectivity, or professional competence
- Planned actions should match the impediments they are designed to address – at the individual level, engagement level, firm level, and profession levels

# Overview of Feedback to Date – IESBA

## Feedback from ITC

- Great support for clarifying the interactions between PS and the fundamental principles (FPs) and independence
- PSWG conclusion: Drivers and impediments to PS related to the compliance with the FPs

A few stakeholders expressed the following to IESBA

- Relevant “information” underpinning ethical decisions should be assessed with adequate PS
- Code should emphasize PS in much the same way as it does auditor independence
- Code should address how the concept of PS applies to PAIBs

# Overview of Feedback to Date – IAESB Consultation Paper on Its Future Strategy

- IAESB's International Education Standards (or IESs) prescribe learning outcomes that assist professional accountants – not just auditors – to demonstrate effective PS and professional judgment
- IAESB exploring what actions it could take to improve professional competence related to the appropriate exercise of PS and professional judgment
  - Respondents offered a range of suggestions for IAESB, but also urged coordination with the other SSBs
- A separate IAESB PS Task Force is in the process of considering specific matters, e.g., a potential separate behavioral competence category in the IESs aimed at addressing the risks of auditor bias
  - Decision on next steps to be made in November 2016 when IAESB finalizes its strategy and work plan

# Nature and Structure of PSWG Preliminary Recommendations to the SSBs

- Stakeholders desire a coordinated approach among three SSBs, but the three SSBs develop their work plans and standards independently
- PSWG serves as a means of coordinating efforts across SSBs—including the consideration of potential implications of their individual approaches
  - This becomes more important as individual Boards move forward, and the timing of various actions by those Boards should take into account the need for this coordination
- PSWG continues to deliberate a number of key issues where a consensus has not been reached; preliminary recommendations not yet considered by the SSBs
- Some actions needed in the short term by SSBs individually to demonstrate responsiveness to key questions, while other preliminary recommendations will need to be considered over a longer term, in particular to understand implications

# Specific Matters that Could Be Addressed by the IAASB: Interaction with Current IAASB Projects

IAASB Project	Opportunity to Emphasize PS within the IAASB's Standards
<u>Quality Control</u>	Focus on risks to quality (including auditor bias); establishing an appropriate culture whereby PS is encouraged and rewarded; and appropriately staffing engagements with the requisite experience and expertise
<u>Risk Assessment (ISA 315 (Revised))</u>	Clarify the relationship between PS and professional judgment, including the relationship between the auditor's judgments about risks of material misstatements and consideration of appropriate responses to those risks (e.g., the importance of applying PS when dealing with higher risks of material misstatement)
<u>Group Audits</u>	Focus on impediments to professional skepticism that may arise when using others to support a group audit engagement (e.g., the effects of culture, dealing with accounting firms outside of the network)
<u>ISA 540</u>	Focus on suggesting that auditors take a challenging mindset as it relates to accounting estimates that involve greater management judgment and where there is an increased risk of unintentional and intentional management bias; highlight the need to consider the effect of contradictory audit evidence that comes to the auditor's attention, rather than an approach overly focused on corroboration

# Specific Matters that Could Be Addressed by the IAASB: New Efforts

- Many ITC respondents focused on how the definition and appropriate application of PS could be better demonstrated in audits
  - ISA 200 defines PS 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.”
- PSWG recommends IAASB commence with information gathering and initial discussions on the topics of **evidence** and **documentation**, with a focus on
  - Elaborating what “a critical assessment of evidence” entails by seeking to enhance ISA 500, *Audit Evidence*, and other ISAs)
  - Reconsidering requirements related to the auditor’s documentation in accordance with ISA 230, *Audit Documentation*, in particular in relation to significant professional judgments made in planning and performing the audit
- IAASB should also contribute to the debates if preliminary recommendations for longer-term considerations by all three SSBs are pursued

# Matter for IAASB Consideration

1. Does the IAASB support the preliminary recommendations of the PSWG with respect to the IAASB in relation to:
  - A focus on professional skepticism in the current projects;
  - A new project related to evidence and documentation; and
  - The need for IAASB involvement in longer-term considerations of the PSWG?If not, why not or what other activities do you believe are necessary by the IAASB in response to the feedback received to date?

## **CAG Feedback**

- Supportive of focusing on how professional skepticism is expected to be demonstrated through current projects, specifically ISA 315 and ISA 540
- Supportive of exploring issues related to evidence and documentation, but some concern about timing and resources needed to do so and whether work on ISA 200 may also be needed
- Support for the separation of LT vs. ST activities of the PSWG, and IAASB involvement in those activities

# PSWG Preliminary Recommendations to the SSBs in the Longer Term

The PSWG has tabled the possibility of the SSBs jointly exploring:

- a) Whether it may be appropriate to extend the concept of professional skepticism beyond audit and assurance engagements (e.g., beyond how it is currently defined in the ISAs).
- b) Whether a common description explaining the interrelationships among key concepts in the SSB's standards and the IESBA Code should be developed and, if so, how this description could be articulated.
- c) The potential standard-setting implications of a) and b), including providing views about whether this might result in changes to the SSBs' standards and the IESBA Code or whether a common description of professional skepticism could be promulgated in another way.
- d) Whether a fundamental change to the concept of professional skepticism is needed.

*Feedback from the CAGs and SSBs will enable the PSWG to further consider the feasibility of exploring these issues and their implications to the individual SSBs, with the PSWG to continue to act as a central point for discussion of these and other issues that require coordination.*

# IESBA Activities

- IESBA June 2016 discussion provided indicative direction to IESBA PSWG Representatives
- At its September 2016 meeting, IESBA will consider what, if any, additional PS material should be included in the forthcoming restructured Code
- **Agenda Item 8-C**, PS Strawman includes *preliminary wording* to facilitate Board discussion about how the Code might approach PS
- Aim of session is to obtain views about how IESBA should move forward

# Context in Which PS is Addressed in the Extant Standards

- PS is defined in IAASB's standards
  - Applies to PAs who perform audits and other assurance engagements only
- Code only refers to PS as part of the description of independence
  - Independence applies to audits and other assurance engagements only
- IAESB standards refer to the concept of PS as defined in the IAASB's standards
  - Applies to all PAs, including those who prepare financial statements (PAIBs)

**Agenda Item 8-D** includes a discussion about how the concept of PS is addressed in the IAASB, IESBA and IAESB extant standards

# IESBA PS Strawman

The Strawman includes the following:

- Description
- Linkage between PS and the FPs [and independence]
- Understanding when PS is applicable
- Considerations for applying PS
- Documentation

# Views Expressed by All IAASB PSWG Members About the PS Strawman

- Prejudges a longer-term discussion about whether the concept of PS should apply to all PAs, and whether the IAASB definition of PS should be changed
- Inclusion of certain material (gray paragraphs) should either be deferred and explored as part of a longer-term project, or omitted
- More thorough analysis of the implications for non-assurance engagements, and further discussion among the three SSBs and their respective CAGs needed
- The three SSBs do not have enough information to make an informed decision about these matters

# Matters for IAASB Consideration

## 2. IAASB members are asked:

- Whether you support the preliminary recommendation for the IESBA to discuss the relationship between the fundamental principles in the IESBA Code (as well as independence) and professional skepticism and consider how this relationship should be addressed within the IESBA Code; or
- Do you believe that further analysis and dialogue is needed to be able to reach an informed decision?
- What other activities do you believe are necessary by the IESBA in response to the feedback received to date?

## CAG Feedback

- General support for seeking to describe the linkage between PS and the fundamental principles and independence
- Mixed views as to whether “PS” should apply to all PAs; need to consider the consequences of doing and not dilute what it means for audits and assurance
- Agreement that further dialogue, especially with PAIBs, should be sought on the topic

## Matters for IAASB Consideration (cont.)

3. IAASB members are asked to share their views on the preliminary wording included in **Agenda Item 8-C**, in particular:
  - Whether the draft appropriately describes the linkage between the concept of professional skepticism and the fundamental principles of ethics set out in the IESBA Code;
  - Whether the draft captures all of the components of professional skepticism and, if it does not, what should be excluded or included; and
  - Whether there are any potential implications of wording of this nature on the IAASB's standards.

### CAG Feedback

- Comments focused on higher-level feedback on the concept behind the Strawman, as opposed to more specific feedback on the preliminary wording

# Definition of PS, Including Considering the Need for a Fundamental Change

- There may be a need to more fundamentally revisit the concept of professional skepticism—and what is expected of auditors
  - What can be done through current IAASB standard-setting activities?
  - What are the key considerations relating to audit evidence that need to be explored (e.g., the possibility of auditors actively seeking contradictory evidence)?
  - Should the concept of PS move towards a more doubting attitude?
  - Is there a need for auditors to apply “levels” of professional skepticism?
- Q4: The IAASB is asked for their views on the matters set out in Section F of Agenda Item 8-A to inform the PSWG’s further consideration of these matters.

## CAG Feedback

- Concept of levels of professional skepticism resonates to a degree (in part due to approach in ISA 240), but focus should be on risk assessment and obtaining evidence
- Mixed views about moving towards an attitude of presumptive doubt due to concerns over the need to guide auditors about when enough evidence has been obtained

# Consideration of a Common Description of Professional Skepticism by the SSBs and Extending the Concept beyond Audits

- PS defined in ISA 200 in the context of key assurance concepts of misstatements and evidence, not explicitly addressed in the IAASB's non-assurance standards
  - But IESs expect all professional accountants to develop competence in PS
- ITC noted the need to further explore whether the concept of PS is consistently described across the ISAs, IES, and IESBA Code
  - Are the links between the term PS and other concepts (such as professional judgment, integrity, independence of mind, objectivity, and sufficient appropriate audit evidence) clear and well-understood?

# Consideration of a Common Description of Professional Skepticism by the SSBs and Extending the Concept beyond Audits (cont.)

- Need to further consider the implications of a common description and the possibility of extending the concept beyond audits, in particular:
  - Whether doing so has the unintended consequence of extending assurance-type work effort and related documentation requirements to other activities of professional accountants
  - How would a common description relate to the definition in ISA 200?
- Q5: The IAASB is asked for their views on the matters set out in Section G of Agenda Item 8-A to inform the PSWG's further consideration of these matters.

## CAG Feedback

- Mixed views on whether the concept of PS should apply to all PA
- Support for a holistic approach to revising the ISAs to include the concept of PS and strengthen auditor compliance with fundamental principles of IESBA Code (consider starting with the definition of PS in ISA 200), caution against making piecemeal changes

# Actions by Others to Enhance the Application of PS

- Respondents to the ITC highlighted that others have a role to play, including
  - Regulators and audit oversight authorities
  - Audit committees
  - Companies, including internal audit functions
  - Accounting firms
  - Member bodies and other professional organizations
- Q6: IAASB members are asked whether there are other parties in the financial reporting supply chain who have a role to play in enhancing the application of professional skepticism and, if so, what such parties would be expected to do.

## CAG Feedback

- General acknowledgment of the role for others
- Specific mention of how education may play a role in enhancing auditor behavior

# Way Forward

- The PSWG will continue to engage as a central point for discussion of common issues as and when needed in relation to matters that require coordination, and will consider the feedback from the respective Board and CAG meetings at its October 2016 physical meeting
- The outcome of the PSWG's deliberations will be discussed at the IAESB meeting in November and the IAASB and IESBA meetings in December, with updates to their respective CAGs as necessary
- PSWG will be responsible for considering whether a thought piece, feedback statement or other brief publication would be useful in the near term to give prominence to the work that the SSBs will be undertaking, individually and in coordination, and to also highlight the role of others
- View of the Chair of the PSWG: In line with stakeholder responses to the ITC, the three SSBs should coordinate their approaches to fundamental issues relating to professional skepticism, rather than having any one SSB commence unilateral projects

The logo consists of the letters 'IAASB' in a white, serif, all-caps font, centered within a solid blue rectangular background.

IAASB

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