

Meeting: IESBA CAG

Meeting Location: Madrid, Spain

Meeting Date: September 12-13, 2017

Agenda Item

B

Professional Skepticism and Professional Judgment

Objectives of Agenda Item

1. To note the report-back on the March 2017 CAG discussion.
2. To discuss respondents' feedback on the IESBA's May 2017 Exposure Draft (ED), [*Proposed Application Material Relating to Professional Skepticism and Professional Judgment*](#) and to obtain Representatives' views on the related Task Force response.

Project Status and Timeline

3. Appendix 1 to this paper provides a project history, including links to the relevant CAG documentation. A report back on the last substantive CAG discussion, which occurred in March 2017, is provided in paragraph 12 of this paper.

Background

4. The tripartite Professional Skepticism (PS) Working Group, comprising representatives of the IESBA, the International Auditing and Assurance Standards Board (IAASB) and the International Accounting Education Standards Board (IAESB), was formed in June 2015 to consider how to improve the application of PS by auditors from the perspective of each standard-setting Board's (SSB's) perspective. The IESBA does not have a specific commitment in its Strategy and Work Plan 2014-2018 to undertake a project on PS. However, since June 2015, the IESBA has been actively contributing to the activities of the PSWG, with a view to determining whether there are areas within the IESBA Code where there would be benefit in elaborating on, emphasizing or clarifying ethical considerations relating to PS in ways that would support and complement the discussion of PS in the International Standards on Auditing (ISAs) and the International Education Standards (IESs).
5. In this regard, the IESBA has gained insights from IAASB-led initiatives aimed at enhancing PS in the context of audit engagements, including the June 2015 IAASB [panel discussion](#)¹ aimed at further

¹ During its June 2015 meeting, the IAASB hosted a panel discussion on the topic of PS. IAASB member Prof. Annette Köhler, who chairs the PSWG, introduced the topic. The panel was comprised of: Jeremy Justin, Canadian Public Accountability Board's Representative on the International Forum of Independent Audit Regulators' Standards Coordination Working Group; Helen Munter, Division of Registration and Inspections, US Public Company Accounting Oversight Board; Doug Prawitt, Glen Ardis Professor of Accountancy, Brigham Young University; and Cindy Fornelli, Executive Director, Center for Audit Quality. The purpose of the panel discussion was to:

- Provide IAASB members with a further understanding of the issues related to auditors' application of PS in the context of a financial statement audit and raise questions with experts in this area; and
- Consider how best to address concerns that have been raised about auditors' application of PS in audits of financial statements and planned next steps.

understanding the perspectives of certain stakeholders (in particular regulators); the December 2016 IAASB-commissioned summary of [academic research](#); and the December 2015 Invitation to Comment (ITC), [Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits](#). Based on its work, the PSWG concluded that there is an important link between the application of professional skepticism and compliance with the fundamental principles and recommended that a description of that linkage be developed in the Code.

IESBA Activities since March 2017 CAG Meeting

6. In response to the PSWG recommendation, in March 2017, the IESBA approved a project to develop application material to explain how compliance with the fundamental principles in the Code supports the application of PS as defined in the standards of the IAASB. During the meeting, the IESBA also considered the proposed application material and broadly supported it, subject to some refinements. In addition, the IESBA considered proposed new application material to emphasize the importance of professional accountants (PAs) obtaining an understanding of the facts and circumstances known to them when exercising professional judgment, in the context of applying the conceptual framework.
7. The IESBA also supported this proposal, subject to some refinements. The IESBA approved the two sets of proposed application material in April 2017 and issued an Exposure Draft, [Proposed Application Material Relating to Professional Skepticism and Professional Judgment](#) in May 2017 (the IESBA ED). The proposed application material in the IESBA ED are proposed additions to Section 120² of the restructured Code, the text of which was [agreed in principle](#) by IESBA in December 2016 as part of Phase 1 of its Safeguards and Structure of the Code (Structure) projects. The proposed new application material:
 - (a) Describes how compliance with the FPs in the Code supports the exercise of PS in the context of audit and other assurance engagements (see paragraph 120.13 A1).
 - (b) Emphasizes the importance of PAs obtaining a sufficient understanding of the facts and circumstances known to them when exercising professional judgment in applying the conceptual framework (see paragraph 120.5 A1).
8. The deadline for comments on the IESBA ED was July 25, 2017.
9. At its [June 2017 meeting](#), the IESBA considered Task Force proposals for progressing a longer term initiative on professional skepticism (see Agenda Item 6 of that meeting). Among other matters, the IESBA considered a Task Force analysis to identify the concerns that have led to stakeholder calls for greater exercise of professional skepticism, and possible ways in which concerns regarding professional skepticism might be addressed and be responsive to root cause issues and public expectations.

PSWG Publication

10. On August 14, 2017, the PSWG issued a joint publication, [Toward Enhanced Professional Skepticism](#) (PSWG publication) which outlines observations about the current environment and actions the SSBs will take, as well as the role that other stakeholders can play, in enhancing professional skepticism.

An audio of the panel discussion is available at the [IAASB's website](#).

² Proposed restructured Code, Part 1, Complying with the Code, Fundamental Principles and Conceptual Framework, Section 120, *The Conceptual Framework*

September 2017 IESBA Meeting

11. At its September 2017 meeting, the IESBA will be asked to consider the significant issues raised by respondents to the IESBA ED and related Task Force responses.

Report Back on March 2017 CAG Discussion

12. Below are extracts from the draft minutes of the March 2017 CAG meeting³ and an indication of how the Task Force/IESBA has responded to CAG Representatives' comments.

Matters Raised	Task Force /IESBA Response
LINKAGE BETWEEN FPS AND PS	
<ul style="list-style-type: none">Messrs. Baumann, Fortin, Sobel, Thompson, van der Ende, Yurdakul and Ms. McGeachy-Colby expressed support. Ms. Lang also expressed support, but noted that in her view there is a need for actions beyond standards to make a difference in the application of PS among auditors.	<p>Support noted.</p> <p>One of the key observations of the PSWG in their PSWG publication is that standard setting alone will not be enough and others have a role to play to help cultivate a skeptical mindset (see pages 5 and 10 of the PSWG publication).</p>
<ul style="list-style-type: none">Referring to the continuing PCAOB and International Forum of Independent Audit Regulators (IFIAR) inspection findings regarding a lack of PS by auditors, Mr. Baumann felt that there are a number of efforts that can be taken to enhance auditors' application of PS. He highlighted, for example, strengthening the tone at the top, drilling PS throughout the firm through quality control, revising ISA 540⁴ in relation to management estimates, etc.	<p>Point noted.</p> <p>During the meeting Mr. Fleck noted that words alone will not solve all the issues. However, the significance of the proposed additions to the Code is that they help avoid the situation where firms argue that there is nothing in the Code that directs them to take, or precludes them from taking, certain actions. This comment has been referred to the IAASB.</p>
<ul style="list-style-type: none">Mr. Sobel questioned whether the use of the words "questioning mindset" might create confusion for readers.	<p>Points accepted.</p> <p>Mr. Fleck explained that the Task Force had used the words "questioning mindset" to make the link to the concept of PS as defined in IAASB standards.</p>

³ The March 2017 CAG minutes will be approved during the September 2017 IESBA CAG meeting.

⁴ International Standard on Auditing (ISA) 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

Matters Raised	Task Force /IESBA Response
<ul style="list-style-type: none"> Mr. Thompson asked for clarification about the proposed linkage between confidentiality and PS. Mr. Fortin wondered whether users might be confused with having a description of independence in the Code that refers to only two of the FPs (integrity and objectivity) alongside the proposed application material explaining the linkage between all the FPs and PS, given that PS is also a component of the description of independence. Mr. Yurdakul felt that PS is more closely related to professional competence and due care. Mr. Koktevdgaard also wondered whether the reference to “discrediting the profession” in the proposed application material was overly centered on the profession and whether the focus should instead not be on the broader public interest. 	<p>Points accepted.</p> <p>During the meeting, Mr. Fleck responded that if an auditor is considered trustworthy with confidential information, this would more likely be conducive to the client providing information which would support the application of PS.</p> <p>The examples in the IESBA ED were revised from the draft which was presented to the CAG in March 2017. The IESBA ED included examples relating to the FPs of integrity, objectivity and professional competence and due care only.</p>
<ul style="list-style-type: none"> Mr. Koktevdgaard asked about the link between IESBA Code and IAASB’s standards, and wondered whether the standards of IAASB, IESBA and the International Accounting Education Standards Board (IAESB) should be standalone or inter-dependent. 	<p>Point noted.</p> <p>Mr. Fleck responded that the Code must have general application regardless of the auditing standards used.</p>
<ul style="list-style-type: none"> Ms. McGeachy-Colby supported the WG’s decision to withdraw its December 2016 version of the proposal, which included a requirement for all PAs to apply a “critical mindset.” Although she supported the WG’s current proposal, she was concerned about the proposed timeline and wondered whether it was overly aggressive. In this regard, she noted that there are already three IESBA Exposure Drafts open for comment. 	<p>Point noted.</p> <p>Mr. Fleck acknowledged the concerns but noted the limited nature of the issues and of the text involved.</p>
EXERCISE OF PROFESSIONAL JUDGMENT	
<ul style="list-style-type: none"> Mr. Dalkin noted that given the need to exercise professional judgment, different 	<p>Point noted.</p>

Matters Raised	Task Force /IESBA Response
<p>PAs might form different conclusions about the same set of facts and circumstances. He wondered whether the conceptual framework included a consideration of the concept of the reasonable and informed third party (RITP) test in that context.</p>	<p>Mr. Fleck responded in the affirmative. He explained that the RITP test is required when applying the conceptual framework, in particular when considering significant judgments made and overall conclusions reached as part of addressing threats.</p>
<ul style="list-style-type: none"> Referring to the bullet point that reads “The accountant’s own preconception or bias might be affecting the accountant’s judgment,” Ms. Elliott asked whether bias in that context relates only to the PA’s own bias or whether it also relates to bias in the information provided. 	<p>Point noted.</p> <p>Mr. Fleck explained that the WG intended to refer to the PA’s own “preconceptions or bias” and that this is a response to concerns that PAs may have a general tendency to accept the information from clients at face value without carefully thinking about it.</p>
<ul style="list-style-type: none"> Mr. Fortin drew attention to the phrase “known to the accountant” used in the requirement and suggested that it also be used in the application material. 	<p>Point accepted.</p> <p>During the meeting, Mr. Fleck noted that the WG would further consider this comment.</p> <p>At its March 2017 meeting, the IESBA determined that the proposed requirement was not necessary.</p>
<p>MATTERS RELATING TO A LONGER TERM PS PROJECT</p>	
<ul style="list-style-type: none"> Ms. Petterssen noted that the PIOB does not believe that it is in the public interest to narrow the application of PS to auditors and assurance practitioners only. The PIOB is of the view that the concept of PS is relevant to all PAs, and that PAs who prepare financial and other information also have a responsibility to apply PS in their work. She added that the PIOB appreciates the challenges in coordinating the work of the PSWG, but that it is in the public interest for guidance on PS to be made available to all PAs. In response to a request for clarification from Mr. Koktevdgaard, Ms. Petterssen explained that PIOB members had discussed the topic of PS among themselves and are of the view that there is opportunity to address PS in a broader way sooner than later. Ms. Molyneux thanked Ms. Petterssen for clarifying the 	<p>Points noted.</p> <p>A consideration of whether aspects of the concepts underlying professional skepticism might also have relevance to professional accountants more broadly remains a matter to be explored by the three standard setting Boards (see page 3 and the Standard Setters Actions section of the PSWG publication).</p> <p>As noted above, at its June 2017 meeting, the IESBA considered Task Force proposals for progressing a longer term initiative on professional skepticism (see Agenda Item 6 of that meeting). Among other matters, the IESBA considered a Task Force analysis to identify the concerns that have led to stakeholder calls for greater exercise of professional skepticism, and possible ways in which concerns regarding professional skepticism might be addressed and be responsive to root cause issues and public expectations.</p>

Matters Raised	Task Force /IESBA Response
<p>PIOB's position and indicated that she believed the public interest is about the broader profession as opposed to just auditors.</p> <ul style="list-style-type: none"> Mr. van der Ende also agreed with Ms. Petterssen but believed that the level of PS should be higher for auditors. He suggested a "building blocks" approach whereby all PAs would be required to exercise PS but at varied levels depending on the type of professional activity performed. Mr. Yurdakul was of the view that PS should apply to all PAs but the level should be higher for auditors. He noted that the concept of PS is abstract and therefore not easy to observe. He suggested that the IESBA should focus on how to make PS observable. He also suggested the need to undertake further steps to reinforce the implementation of PS requirements. Mr. Baumann noted that academic research well recognizes that management is inherently biased in its role preparing the financial statements. He added that auditors have a fundamental role to play in addressing this bias and, therefore, the concept of PS is uniquely suited to auditors. Mr. Dalkin indicated the need for caution in considering whether to broaden the applicability of PS to all PAs. He noted that PS is a "term of art" that has a specific meaning in the audit and assurance context. He supported the WG's approach as proposed and expressed support for the use of a different term to convey the expectations of PAs who are not auditors or assurance practitioners. 	<p>The IESBA supported development of a consultation paper that will seek stakeholder input on the relevant issues in 2018.</p>
<ul style="list-style-type: none"> Mr. James asked whether the WG had considered the issue from a different perspective, i.e., taking the concept of "critical mindset" holistically, not only from 	<p>Point noted.</p> <p>Mr. Fleck responded that in light of discussions with IAASB representatives on the PSWG, the WG had</p>

Matters Raised	Task Force /IESBA Response
<p>auditors' perspective but also from the perspective of other PAs. He wondered whether there are aspects of PS that apply more broadly and believed that this is more a challenge for IESBA to address. He illustrated his point by attempting to parse the IAASB's definition of PS into key elements such as "an attitude," "being alert to conditions which might indicate something," etc., which he felt were not necessarily reflected in the FPs. He therefore wondered whether some of those elements might be "add-ons" to the FPs.</p>	<p>consciously avoided doing anything that would detract from the IAASB definition of PS.</p>
<ul style="list-style-type: none"> • Ms. Lang felt that a longer-term initiative to consider PS as a wider concept would be a challenging journey for the standard-setting boards (SSBs). She inquired about the IESBA's plan for progressing such an initiative, including coordination with the PSWG and the other SSBs. She also wondered: <ul style="list-style-type: none"> ○ Whether the short term proposals might muddy the waters vis-à-vis the longer term initiative; and ○ Whether there might be an opportunity to involve others outside of the SSBs. 	<p>Points noted.</p> <p>Mr. Fleck acknowledged Ms. Lang's comments. He summarized some of the concerns raised by some IAASB members about the possibility of extending the applicability of PS beyond auditors, noting that these concerns present challenges for the PSWG and the SSBs in agreeing to an objective, scope and timeline for a longer-term PS project. He also noted that similar to the IESBA, the IAASB had prioritized certain actions in the short term aimed at enhancing PS in the audit and assurance context only. He noted that the WG's short-term proposals are necessary to supplement the very limited material in the extant Code. With respect to the suggestion to involve others beyond the SSBs, he observed that it is already challenging to achieve a coordinated approach among the SSBs. Nevertheless, the consultation and outreach process will ensure that the views of stakeholders are taken into account. Regarding the comment that there is a need for actions as opposed to words, he noted that there has to be a starting point, and that others have to take responsibility for their own actions or inaction.</p> <p>Mr. Siong noted that in his view there is not necessarily a conflict between the public interest imperative of enhancing auditors' application of PS and the public interest imperative of emphasizing the responsibilities of other PAs in applying a degree of</p>

Matters Raised	Task Force /IESBA Response
	professional skepticism in executing their professional duties.
<ul style="list-style-type: none"> Mr. Koktevdgaard asked about the PSWG's timeline for the LT project. 	<p>Point noted.</p> <p>Mr. Fleck responded that there was none yet as there is work to be done in terms of how the IAASB would see the way forward.</p>

Matters for CAG Consideration

13. The CAG is asked to note the report back and consider the matters for CAG consideration in **Agenda Item B-1**.

Material Presented

Agenda Item B-1 Professional Skepticism and Professional Judgment— Summary of Significant Comments, Issues and Task Force Proposals

Agenda Item B-2 Professional Skepticism and Professional Judgment —Proposed Texts (Mark-up from ED)

Material Presented – FOR IESBA CAGs REFERENCE PURPOSES ONLY

[link only] IESBA Exposure Draft, [Proposed Application Material Relating to Professional Skepticism and Professional Judgment](#)

[link only] PSWG Publication, [Toward Enhanced Professional Skepticism](#)

[link only] IESBA June 2017 Agenda Item 6-B, Professional Skepticism – [Consideration of Longer Term Issues](#)

Appendix 1

Project History

Project: Professional Skepticism and Professional Judgment

Summary

	CAG Meeting	IESBA Meeting
Project commencement		September 2016
Development of proposed international pronouncement (up to exposure)	September 2016 December 2016 (teleconference) March 2017	September 2016 December 2016 March 2017 April 2017
Exposure Draft	May 2017 – July 2017	
Consideration of significant comments on Exposure Draft (up to agreement in principle)	September 2017	September 2017

CAG Discussions: Detailed References

Project Commencement	<u>September 2016</u> See Joint IAASB and IESBA CAG meeting material here (see Agenda Items J3, J3-A, J3-B, J3-C, J3-D, J3-E) and Joint IAASB and IESBA CAG meeting minutes (see section J3).
Development of proposed international pronouncement (up to exposure)	<u>December 2016</u> See IESBA CAG meeting material here (see Agenda Items A, A-1 and A-2) and CAG teleconference meeting minutes. <u>March 2017</u> See IESBA CAG meeting material here (see Agenda Items B, B-1, B-2 and B-3) and CAG meeting minutes at Agenda Item A (see section B).