

Professional skepticism lies at the *heart* of a quality audit

This communiqué forms part of a series from the International Auditing and Assurance Standards Board (IAASB) Professional Skepticism Working Group, providing updates on the IAASB's efforts to appropriately reflect professional skepticism in its standards, together with other relevant news and information.



Professional Skepticism and Quality Management (QM)

QM Standards Issued for Public Comment

Taking into account responses received to the [Invitation to Comment \(ITC\)](#)¹, in February 2019 the IAASB released a suite of proposed standards relating to QM at the firm and engagement level. One of the most significant public interest issues highlighted in the ITC was fostering an appropriately independent and skeptical mindset of the auditor. The [explanatory memorandums](#) for proposed **ISQM 1**,² proposed **ISQM 2**,³ proposed **ISA 220 (Revised)**⁴ and related overall matters are open for comment until July 1, 2019.

Professional Skepticism at the Firm Level

Proposed **ISQM 1** focuses on the firm's system of quality management, which has a pervasive effect on the exercise of professional skepticism at the engagement level. For example:

- The firm's culture and the tone set by leadership should promote the importance of quality, and the need to exercise professional skepticism when performing audit, review or other assurance engagements.
- Allocating appropriate resources to perform engagements may prevent impediments to professional skepticism, such as limited time, knowledge or experience.

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." Similar definitions apply for review (ISRE) and other assurance (ISAE) standards. The related concept of **professional judgment** applies to all of the IAASB's standards.

Professional Skepticism and Quality Objectives

Proposed **ISQM 1** requires the firm to establish the quality objective that engagement teams "exercise appropriate professional judgment and, when applicable to the type of engagement, professional skepticism, in planning and performing engagements such that conclusions reached are appropriate."

Under proposed ISQM 1, the firm identifies and assesses the quality risk(s) related to the quality objective, and designs and implements response(s), taking into account the nature and circumstances of the firm and its engagements. In relation to the exercise of professional skepticism and professional judgment, the firm's responses include those required by the standard, such as consultation and engagement quality reviews.

¹ *Invitation to Comment: Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits*

² Proposed International Standard on Quality Management 1 (Previously International Standard on Quality Control 1), *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services*

³ Proposed International Standard on Quality Management 2, *Engagement Quality Reviews*

⁴ Proposed International Standard on Auditing 220 (Revised), *Quality Management for an Audit of Financial Statements*

Professional Skepticism and Quality Management (continued)

Engagement Quality Reviews

Engagement quality (EQ) reviews support the exercise of professional skepticism at the engagement level by providing an objective evaluation of engagement teams' significant judgments.

Proposed **ISQM 2** sets out criteria for eligibility of the EQ reviewer. It requires firms to put limitations on the eligibility of an individual to be appointed as EQ reviewer for an engagement on which the individual previously served as engagement partner. These limitations position the EQ reviewer to objectively evaluate and challenge the significant judgments made and the exercise of professional skepticism by the engagement team.

Although the EQ reviewer is not a member of the engagement team, some might argue that, at least indirectly, the EQ reviewer also exercises professional skepticism in reviewing selected engagement documentation supporting significant judgments and the conclusions reached thereon. The IAASB is seeking views on how proposed ISQM 2 addresses professional judgment and professional skepticism by the EQ reviewer.

Professional Skepticism at the Engagement Level

Proposed **ISA 220 (Revised)** was discussed in the last communiqué. To reiterate, it emphasizes that professional skepticism supports the quality of judgments and the overall effectiveness of the audit team in achieving quality at the engagement level. Examples of impediments to professional skepticism listed in proposed ISA 220 (Revised) include resource constraints, such as tight deadlines or budget limitations; lack of cooperation by management; and over-reliance on audit tools and templates.

It is noted that auditor biases also affect professional skepticism: availability bias, confirmation bias, overconfidence bias and anchoring bias—perhaps the most direct linkage so far between the IAASB's standards and concepts from psychology. Possible actions the engagement partner may take to deal with such impediments are described, including explicitly alerting the engagement team to situations when vulnerability to bias may be greater.

Extended External Reporting (EER) Assurance

Applying professional skepticism will be addressed in Phase 2 of the EER Assurance project. The Task Force can be contacted via the [project web page](#) and are keen to learn about aspects of EER assurance engagements that need particular professional skepticism to be applied. The Task Force would welcome any input to their work in this area, including practical examples that will enhance the guidance.

The Path Ahead...

IAASB Proposed Strategy and Work Plan

The IAASB is also seeking comments on its [Proposed Strategy for 2020–2023 and Work Plan for 2020–2021](#). The strategic actions proposed include continuing to focus on professional skepticism in the context of audit evidence and ongoing ISA projects, as well as considering how professional skepticism can be further enhanced within the ISAs.

CROSS-BOARD COMMUNICATION



Ongoing communication between the IAASB, the International Ethics Standards Board for Accountants (IESBA) and the International Accounting Education Standards Board (IAESB) gives an opportunity to coordinate activities and provide input.

In particular, the IAASB's Professional Skepticism Working Group has provided input into the IESBA's project addressing the [role, mindset and behavioral characteristics expected of all professional accountants](#). The Working Group has also stayed in touch with the IAESB on its proposed revisions to the International Education Standards related to [technology and professional skepticism](#).

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