

## Agenda Item J3-B

### **Responses to Invitation to Comment—Excerpt of Impediments to Professional Skepticism and Relationship to Fundamental Principles in IESBA Code of Ethics**

**Objective of this table:** To analyze the responses to the ITC, indicate the links to the fundamental principles and independence in the IESBA Code of Ethics (“the Code”) and provide the respondents’ suggested actions. This table also provides references to the preliminary recommendations of the Professional Skepticism Working Group presented in **Agenda Item J3-A**.

#### **Relevant references to the International Standards:**

##### *IESBA Fundamental Principles*

Integrity - to be straightforward and honest in all professional and business relationships.

Objectivity - to not allow bias, conflict of interest or undue influence of others to override professional or business judgments.

Professional Competence and Due Care - to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards.

Confidentiality - to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the professional accountant or third parties.

Professional Behavior - to comply with relevant laws and regulations and avoid any action that discredits the profession.

IMPEDIMENTS IDENTIFIED BY RESPONDENTS	LINK TO FUNDAMENTAL PRINCIPLE(S) AND INDEPENDENCE <sup>1</sup>	IMPACT LEVEL	SUGGESTED ACTIONS BY RESPONDENTS	REFERENCE TO SUGGESTED ACTIONS BY THE PSWG WITHIN ISSUES PAPER J3-A
<p><b><u>Auditor Bias: Inherent cognitive biases of the auditor<sup>2</sup></u></b></p> <ul style="list-style-type: none"> <li>• Risk of confirmation bias</li> <li>• Risk of availability bias</li> <li>• Risk of anchoring bias</li> <li>• Risk of overconfidence bias</li> </ul>	<p>Objectivity Professional Competence and Due Care Independence of mind</p>	<p>Auditor Level</p>	<p>IAASB – The IAASB could provide more implementation support on the importance of professional skepticism being an attitude and that a key attribute is the ability to determine the level and extent of professional skepticism that has been applied in any given circumstance. Additional guidance could be provided on personality traits that directly impact professional skepticism.<sup>3</sup> Explicitly recognize personal biases in the definition of professional skepticism.<sup>4</sup> Professional judgment frameworks (and guidance included) that make auditors aware of how their own feelings or biases can impact their skeptical judgments.<sup>5</sup></p> <p>Firms – Coaching and mentoring by experienced team members, setting the tone within the team, supported by firms' training – based on a better understanding</p>	<p>27 – 30</p>

<sup>1</sup> Note: This column reflects the views of the PSWG and not that of any particular respondent.

<sup>2</sup> Investors: CFA Institute; Regulators and Audit Oversight Authorities: UKFRC; NSS: AUASB, CAASB, JICPA, NZuASB; Accounting Firms: EYG, GTI, PwC; Member Bodies and Other Professional Organizations: ACCA, AICPA, CAANZ, CAQ, CPAA, ICAP, MAASB, SAICA; Academics: AAA, AH, Glover-Prawitt; Individuals: CBarnard

<sup>3</sup> NSS: CAASB

<sup>4</sup> Accounting Firms: GTI

<sup>5</sup> Academics: AAA, Glover-Prawitt

IMPEDIMENTS IDENTIFIED BY RESPONDENTS	LINK TO FUNDAMENTAL PRINCIPLE(S) AND INDEPENDENCE <sup>1</sup>	IMPACT LEVEL	SUGGESTED ACTIONS BY RESPONDENTS	REFERENCE TO SUGGESTED ACTIONS BY THE PSWG WITHIN ISSUES PAPER J3-A
			<p>of the root causes of poor application of skepticism.<sup>6</sup></p> <p>Regulators – Enhancing professional skepticism cannot only be resolved through more standard-setting or guidance. The relevance of obtaining insight in the “root causes” for inspection and review findings was noted and the analysis of causal factors in this in moving forward with this project.<sup>7</sup></p>	
<p><b><u>Payor Model, Fees from Non-Audit Services and Fee Pressures</u></b></p> <p><u>Payor Model</u> – How auditors are appointed and their remuneration fixed may not appropriately accommodate their independence from those responsible for the financial statements.<sup>8</sup></p> <p><u>Public Sector Specific – Payor Model</u> – A legislative audit office funded by parliamentary</p>	<p>Objectivity Professional Competence and Due Care Professional Behavior Independence of mind</p>	<p>Profession Level Firm Level</p>	<p>IESBA – The drivers of and impediments to the exercise of professional skepticism are enshrined in the Code of Ethics, including integrity, independence and objectivity. Certain threats to independence were also listed as threats to the ability to exercise professional skepticism, including the focus on client retention because of the payor model, the familiarity bias, and excessive fees from non-audit services.</p> <p>Audit Committees – Competent audit committee members who ask appropriate</p>	<p>32 – 34, 36 – 37</p>

<sup>6</sup> Accounting Firms: PwC

<sup>7</sup> NSS: JICPA; Accounting Firms: GTI, PwC; Member Bodies and Other Professional Organizations: AICPA, IBRACON, ICAEW, SMPC; Individuals: JGrant

<sup>8</sup> Investors: CalPERS; Member Bodies and Other Professional Organizations: CAANZ, JICPA, NZAuASB

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<p>appropriations rather than client billings may benefit from increased independence, but will also face short-term pressures to contain audit effort to that originally budgeted in order to complete all statutory and discretionary engagements within available funding limitations.<sup>9</sup></p> <p><u>Fees</u> – Fee Pressures <sup>10</sup> or significant fees from non-audit services<sup>11</sup> 1-assurance practice may be pressured to keep pace with growth in advisory revenues and profits, which may result in audit partners accepting new clients with riskier profiles and/or in industries where the firm has</p>			<p>questions of the management and of the practitioner.<sup>16</sup></p> <p>IESBA Fee WG – IESBA recently established the Fees Working Group (WG). One of the objectives of the WG is to undertake fact finding on fee-related matters to identify whether there are trends or other factors that indicate a relationship between fees and threats to auditor independence and compliance with the fundamental principles such as objectivity and professional competence and due care. Audit fees are usually calculated based on the level of experience of audit team members and time spent. The WG's fact finding results on a relationship between fees and due care could lead to findings on environmental factors that inhibit the auditor's application of professional skepticism. We expect that the finding results will be communicated to various stakeholders through the IAASB's and</p>	

<sup>9</sup> Public Sector: AGC

<sup>10</sup> Monitoring Group: IAIS; Investors: CalPERS; Regulators and Audit Oversight Authorities: H3C; NSS: CAASB, CNCC-CSOEC; Public Sector: AIC, AGSA; Preparers: PAIB; Member Bodies and Other Professional Organizations: CPAA, EFSA, ICAEW, ICAS, SAICA; Individuals: JGrant

<sup>11</sup> Monitoring Group: IAIS; Investors: IA; Academics: TRay

<sup>16</sup> Investors: IA; NSS: CAASB; Member Bodies and Other Professional Organizations: CAQ, SAICA

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<p>little or no experience,<sup>12</sup> 2-audit partners may focus greater attention and more experienced resource to the advisory line of business rather than the assurance practice,<sup>13</sup> 3-Firms may be unable to effectively manage compensation and cultural challenges between the assurance and advisory lines<sup>14</sup>)</p> <p><u>Client Retention</u> – Fear of audit tendering, in particular for large clients that represent significant revenue for the audit firm<sup>15</sup></p>			<p>IESBA's outreach activities, to help improve the audit environment.<sup>17</sup></p> <p>IAASB – Regular communication and brainstorming sessions among the team members on risk assessment and audit related matters.<sup>18</sup> This could be accomplished through additional requirements within the auditing standards.</p>	
<p><b><u>Environmental Factors</u></b></p> <p><u>Groupthink</u> – Individual skepticism may be negatively influenced by the level of</p>	<p>Integrity Objectivity Professional Competence and Due Care</p>	<p>Profession Level/ Firm Level/ Engagement Level</p>	<p>Firms – Diversity of backgrounds of the engagement team members. Individuals from different backgrounds (i.e. chartered accountants, engineers, business experts) inevitably bring a diverse range of skills and</p>	<p>38 – 39</p>

<sup>12</sup> Monitoring Group: IAIS; NSS: CAASB

<sup>13</sup> Monitoring Group: IAIS

<sup>14</sup> Monitoring Group: IAIS

<sup>15</sup> NSS: CAASB; Accounting Firms: GTI; Academics: Tray

<sup>17</sup> NSS: JICPA

<sup>18</sup> Monitoring Group: IAIS; Member Bodies and Other Professional Organizations: IBRACON, ISCA

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<p>skepticism of others on the engagement team<sup>19</sup></p> <p><u>Risk of priming</u> – Whereby environmental cues may influence certain types of behaviour (for example if certain language used in standards “promotes” actions that do not support appropriate scepticism).<sup>20</sup></p> <p><u>Environmental Influences</u> – Environmental and contextual factors including business environment, laws and regulations, local norms/culture</p> <p><u>Resource constraints/High Staff Turnover</u> – Human resource constraints due to turnover and</p>	Professional Behavior		<p>experiences which can add value when exercising professional skepticism.<sup>23</sup></p> <p>IAASB – Consider whether changes to the “Challenging management’s reasoning or sources” rather than “corroborating evidence” that shifts the auditor’s mindset from one of an accepting attitude to one that is more skeptical.<sup>24</sup></p> <p>Firms – Effective resourcing and planning commensurate with the work to be performed, as well as considering appropriate contingency plans for dealing with unexpected developments<sup>25</sup></p> <p>Firms – Firm level audit resource allocations should recognize that some engagements may require more resources than originally planned to address unanticipated issues including those arising</p>	

<sup>19</sup> NSS: CAASB; Accounting Firms: BDO

<sup>20</sup> Accounting Firms: PwC

<sup>23</sup> NSS: CNCC-CSOEC

<sup>24</sup> Monitoring Group: IOSCO

<sup>25</sup> Monitoring Group: IAIS

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<p>staff workloads<sup>21</sup> (some note that the clarified ISAs, for example, not only clarify but also add significant new requirements and add to staff workload)<sup>22</sup></p> <p><u>Tight financial reporting deadline/Time constraints</u> – There may be a limited amount of time in which to complete the audit procedures due to either tight deadlines and/or budgetary constraints.</p>			from the application of professional skepticism. Firms must ensure budgets and related performance measures do not in fact or appearance unduly constrain the application of skepticism. <sup>26</sup>	
<p><b><u>Performance metrics</u></b> Policies and procedures around performance and compensation metrics and incentives for auditors that do not appropriately encourage professional skepticism<sup>27</sup></p>	<p>Objectivity Professional Competence and Due Care Professional Behavior</p>	Firm Level	Firms – Setting performance and compensation metrics that reward auditors for high quality work could help in increasing the application of professional skepticism. <sup>28</sup>	31

<sup>21</sup> Monitoring Group: IAIS; Public Sector: AGSA

<sup>22</sup> NSS: JICPA

<sup>26</sup> Public Sector: AGC

<sup>27</sup> Monitoring Group: IAIS; NSS: IDW; Public Sector: AGSA; Preparers: PAIB

<sup>28</sup> Monitoring Group: IAIS; Investors: IA

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			There was a focus on the firm's responsibility to create a firm culture <sup>29</sup> that encouraged professional skepticism, including appropriate "tone at the top," <sup>30</sup> incentives that are focused on appropriate judgment and audit quality, <sup>31</sup> and promoting the status of the audit within the firm so that it is not seen as a commodity. <sup>32</sup>	
<b><u>Familiarity Threat</u></b> Long-term relationships (familiarity threat) <sup>33</sup>	Objectivity Independence of mind and appearance	Firm Level/ Engagement Level	Firms – Rotation and other strategies to manage familiarity risks should be in place to enable the appropriate application of professional skepticism.	36
<b><u>Unqualified Audit Opinion</u></b> Indirect pressure for providing an unqualified audit opinion, upsetting the client. <sup>34</sup>	Integrity Objectivity Professional Behavior Independence of mind	Engagement Level	No specific suggested actions by respondents.	35
<b><u>Automated Files/Checklists</u></b> Excessive reliance on IT processes, in the context of the automation of audit files (staff	Professional Competence and Due Care Professional Behavior	Firm Level/ Engagement Level	IAASB – Technology can be used as a powerful tool to help the auditor in applying skepticism e.g. by using data analysis to filter exceptional situations that need to be	40

<sup>29</sup> Member Bodies and Other Professional Organizations: CAANZ, CAQ, CIIPA, IBRACON, ICAEW, ICAP, INCPC, SAICA, SMPC; Accounting Firms: EYG, GTI, KPMG

<sup>30</sup> Investors: IA; Accounting Firms: DTT, EYG, PwC; Member Bodies and Other Professional Organizations: AIC, CIIPA, ICAP, ISCA, SMPC; NSS: CAASB, MAASB, NZAuASB

<sup>31</sup> Accounting Firms: KPMG; Member Bodies and Other Professional Organizations: AICPA, CAANZ, CAQ, ICAP, SMPC

<sup>32</sup> Accounting Firms: CHI

<sup>33</sup> Also noted as a Public Sector issue by INTOSAI since the client base remains the same year after year.

<sup>34</sup> Monitoring Group: IAIS; NSS: NZAuASB; Academics: TRay



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focus may be on completion of IT audit steps in a virtual environment instead of learning how to “read people,” think critically, and probe.) <sup>35</sup> Having staff focus primarily on the steps and procedures in the audit, without appropriate time spent teaching the fundamental concepts. <sup>36</sup>			investigated. <sup>37</sup> Through the Data Analytics Working Group the IAASB could consider how the use of technology may drive the application of professional skepticism.	
<b><u>Documentation</u></b> Difficulty of documenting professional skepticism in determining the nature, timing, and procedures of the audit, especially in regard to addressing conflicting evidence. <sup>38</sup>	Integrity Professional Competence and Due Care Professional Behavior	Engagement Level	IAASB – Enhanced documentation <sup>39</sup> requirements would drive professional skepticism. IAASB could by requiring relevant actions and audit documentation (ex. that the auditor needs to document how they have challenged the management on critical matters such as estimates etc.) ensure that the level of transparency would increase. The most important thing is the documentation of the logical application of professional skepticism in the audit file.	51 – 54

<sup>35</sup> Monitoring Group: IAIS; NSS: NZAuASB; Accounting Firms: GTI

<sup>36</sup> NSS: CAASB

<sup>37</sup> NSS: NBA

<sup>38</sup> Public Sector: GAO

<sup>39</sup> Accounting Firms: DTT, GTI, PwC; Member Bodies and Other Professional Organizations: CAANZ, CIIPA, IBRACON, SAICA

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			IAASB could also consider to write requirements which requires a more challenging mindset than how they are written today. Though we recognize that this might cause our audits to be more time consuming. <sup>40</sup>	
<b><u>Personal Traits</u></b> Personal background of the auditor, including their behavioral traits, cultural/ environmental considerations, and competence level (especially for particular industries such as financial services) when undertaking an audit <sup>41</sup> (some believe this is out of the control of standard setters) <sup>42</sup>	Integrity Objectivity Prof Competence and Due Care Professional Behavior	Auditor Level	<p>IAASB – Auditors could be reminded to resist persuasion and to objectively consider issues from different perspectives.<sup>43</sup> This could be accomplished through additional application guidance within the standards.</p> <p>Firms – Incorporating ethics screening in the hiring process may help flag those individuals who may not have a propensity to apply professional skepticism.<sup>44</sup></p> <p>Firms/IAESB – Courage is one of the most important attitude to have or to develop for an appropriate application of professional skepticism. Although it is directly linked with</p>	30

<sup>40</sup> Public Sector: INTOSAI

<sup>41</sup> Monitoring Group: IAIS

<sup>42</sup> NSS: IDW; Accounting Firms: GTI; Public Sector: AGSA; Member Bodies and Other Professional Organizations: ICAP, ICPAK, ISCA, SMPC

<sup>43</sup> Monitoring Group: IOSCO

<sup>44</sup> Monitoring Group: IAIS

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			personal traits, such a driver of skepticism can also be developed through training, education and mentoring. <sup>45</sup>	
<p><b><u>Difficult Client Interactions</u></b></p> <p>Where inexperienced auditors are left to interact with difficult client management (reduced evidence collection as those auditors may in fact attempt to avoid interactions with management)<sup>46</sup>, this includes challenging management<sup>47</sup>. Certain interactions with the client may give the auditor a more accepting mindset, for example, the client's management may put pressure on, or persuade, less experienced auditors to accept</p>	<p>Integrity</p> <p>Objectivity</p> <p>Professional Behavior</p>	Auditor Level	<p>Firms – Effective review and coaching by experienced members [of the engagement team], “Tone at the Top”<sup>49</sup> (including an effective EQC review)<sup>50</sup> Also, regular communication and brainstorming sessions among the team members on risk assessment and audit related matters.<sup>51</sup></p> <p>Firms/IAESB – Training, education and mentoring – Initial but also continuous training are important drivers for the appropriate application of professional skepticism. We consider that what is useful is to have the opportunity to share experiences and encourage more senior members to share their experiences on instances where they have been faced with</p>	30

<sup>45</sup> NSS: CNCC-CSOEC

<sup>46</sup> Monitoring Group: IAIS; Public Sector: INTOSAI

<sup>47</sup> Member Bodies and Other Professional Organizations: ISCA

<sup>49</sup> Monitoring Group: IAIS; NSS: CAASB

<sup>50</sup> NSS: CAASB

<sup>51</sup> Monitoring Group: IAIS; Member Bodies and Other Professional Organizations: IBRACON, ISCA

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its position as the appropriate or only position. <sup>48</sup>			an issue that required their skepticism and or their judgment. <sup>52</sup>	
<b><u>Competence</u></b> Inappropriate or out-of-date technical knowledge <sup>53</sup> (management's information and/or expertise is greatly superior to that of the auditor)	Professional Competence and Due Care Professional Behavior	Firm Level/Auditor Level	IAASB – The standards should stress the importance of considering skills in the recruitment process, and on keeping skills up-to-date through continuing education, or indeed developing new skills in relation to the changing environment (IT, financial information) <sup>54</sup> IAESB – The education board should consider behavioral competence as a separate competence area and should seek to understand behavioral influences over matters such as the appropriate application of professional skepticism and more generally how an individual's professional skills can be developed to better enable them to self-regulate their own behavior and to understand and influence others' behaviors.	

<sup>48</sup> Accounting Firms: GTI

<sup>52</sup> NSS: CNCC-CSOEC

<sup>53</sup> Monitoring Group: IAIS; Accounting Firms: SWA; Preparers: PAIB

<sup>54</sup> Regulators and Audit Oversight Authorities: H3C