

**Meeting:** IAASB/IESBA CAGs

**Meeting Location:** Madrid, Spain

**Meeting Date:** September 12, 2017

## Agenda Item J1

### Professional Skepticism

#### Objectives of Agenda Item

1. The objectives of this agenda item are to:
  - (a) Note the report-back on the September 2016 joint IAASB/ IESBA Consultative Advisory Group (CAG) discussion; and
  - (b) Receive an update on the activities of the Professional Skepticism Working Group (PSWG) and each of the Standard Setting Boards, including an overview of the recently released PSWG publication, **Agenda Item J1.1**.

#### Status of the Initiative

2. The tripartite PSWG, comprising representatives of the IESBA, IAASB and the International Accounting Education Standards Board (IAESB), was formed in June 2015 to consider how to improve the application of professional skepticism by auditors from the perspective of each standard-setting Board (SSB).
3. The PSWG's work has been informed by IAASB-led initiatives aimed at enhancing professional skepticism in the context of audit engagements, including the June 2015 IAASB [panel discussion](#)<sup>1</sup> aimed at further 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](#)

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<sup>1</sup> 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.

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

[Skepticism, Quality Control and Group Audits](#).<sup>2</sup>

4. 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.
5. 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. As a result, the IESBA issued the Exposure Draft, [Proposed Application Material Relating to Professional Skepticism and Professional Judgment](#) (IESBA ED) in May 2017. At its September 2017 meeting, the IESBA will consider the significant issues raised by respondents on the ED and the Task Force's related responses. A separate IESBA CAG session is planned to discuss those issues.

### Report Back on September 2016 Joint CAG Discussion

6. Extracts from the approved minutes of the joint September 2016 CAG session,<sup>3</sup> and an indication of how the PSWG/SSB has considered/is considering the CAG Representatives' comments are included in the table below.

Matters Raised	PSWG/SSB Response
SPECIFIC MATTERS THAT COULD BE ADDRESSED BY THE IAASB	
Mr. van der Ende supported the work of the PSWG, as did Mr. Yoshii, and in particular the separation between the PSWG's work in the short term versus the longer term. In the short term, especially as it relates to the ISA 315 (Revised) and ISA 540 projects, it will be important for the public (including regulators) to see how the concept of professional skepticism is being enhanced within the auditing standards. He also questioned whether these enhancements could be considered "innovative" if they are based on the extant concept of professional skepticism and suggested that a longer-term focus as to whether a fundamental shift to the definition of professional skepticism may be needed.	Support noted. Professional skepticism is featured in both of the IAASB's ISA 315 (Revised) and the ISA 540 projects. The professional skepticism IAASB Subgroup is currently considering three themes which resulted from responses to the ITC related to a potential shift in the extant definition of professional skepticism within the ISAs. <a href="#">Agenda Item 9-A</a> from the June 2017 IAASB meeting sets out the Subgroup's views on an analysis of one of the proposed themes, whether "levels" of professional skepticism is appropriate.
Ms. Elliott agreed with Mr. van der Ende's comments, but expressed concerns on the timing of the proposed new project related to audit evidence and documentation given the other	Point being considered. During the CAG meeting, Ms. Healy explained that feedback to the ITC had indicated that exploring issues related to audit evidence and documentation

<sup>2</sup> The IESBA was provided a summary and a full compilation of the PS-related responses to the ITC during its September 2016 meeting. This material is available at the IESBA's [September 2016 meeting webpage](#).

<sup>3</sup> The September 2016 Joint CAG minutes were approved in March 2017.

Matters Raised	PSWG/SSB Response
<p>priorities of the IAASB. Mr. Hansen agreed. Ms. Elliott explained that, because professional skepticism is so broadly spread across the ISAs, by only modifying ISA 500 it may give the wrong impression that the Board has not considered taking a holistic view. She was of the view that it might make more sense to take more of a holistic view and potentially consider the definition in ISA 200 first, before undertaking a project to revise ISA 500.</p>	<p>would be more helpful to enhance the application of professional skepticism than changing the definition alone. She also noted that commencing work on ISA 500 would also be very relevant to the IAASB's efforts on the topic of data analytics.</p> <p>Prof. Köhler also noted that efforts on ISA 500 and ISA 230 could lead to consequential amendments to other standards.</p> <p>As is acknowledged in the PSWG publication, <b>Agenda Item J1.1</b>, each SSB is committed to taking immediate and longer term actions towards enhancing professional skepticism.</p>
<p>Mr. linuma supported the proposed new project on audit evidence and documentation, as did Mr. S. Bradbury. Mr. Fortin also suggested that the IAASB consider looking at ISA 200 in conjunction with ISA 500 and ISA 230, to provide more guidance to support the requirement for the auditor to apply professional skepticism and explain how professional skepticism relates to independence. Prof Köhler responded that any work on ISA 200, including any changes deemed necessary to the definition of professional skepticism, would be part of the longer term work of the PSWG. Additionally, Mr. linuma referred to IOSCO's comment letter response to the ITC, noting that they also recommended revising ISA 240 and ISA 620 to enhance the concept of professional skepticism. He also suggested that the IAASB encourage firms to strengthen the apprenticeship model within the firm so as to enable less seasoned auditors to learn their skill by observing more experienced auditors.</p>	<p>Points noted.</p> <p>Prof Köhler responded that any work on ISA 200, including any changes deemed necessary to the definition of professional skepticism, would be part of the longer term work of the PSWG.</p> <p>Additional proposed projects arising from the ITC, or other avenues, will be considered in conjunction with the IAASB strategy and work plan.</p>
<p>Mr. Dalkin cautioned against overuse of the term "professional skepticism" and focus on how the standards can influence performance and behaviors.</p>	<p>Point being considered.</p> <p>For example, see page 6 of the PSWG publication, <b>Agenda Item J1.1</b>.</p>
<p>Ms. Ceynowa explained how the PCAOB Staff is considering addressing some performance issues related to the exercise of professional skepticism. She noted that, in an effort to shift towards a more challenging mindset by the auditor, the PCAOB</p>	<p>Point noted.</p> <p>These items will be addressed by each of the IAASB's task forces and working groups as they progress. For example, see paragraph 34 of the</p>

Matters Raised	PSWG/SSB Response
<p>Staff is proposing using words within the standards such as “corroborate” rather than “compare.” Additionally, the PCAOB is supportive of including clear performance requirements that encourage auditors to apply professional skepticism (including reminders of some requirements), acknowledging that the increased potential for management bias should drive professional skepticism, and during engagement team fraud discussions specifically identifying those areas that may be sensitive to bias.</p>	<p><a href="#">December 2016</a> IAASB (Agenda Item 2A) related to ISA 540.</p>
<p>Mr. Hansen added that the IAASB should also consider what may be missing from the definition and from the standards that make reference to professional skepticism, for example the concept of impaired professional skepticism, especially on a long-term basis and how education may play a role in enhancing auditor behavior.</p>	<p>Point noted.</p> <p>Through the PSWG, the IAASB has been able to benefit from the IAESB representatives’ input on certain matters relating to professional skepticism that link directly to education and skills.</p> <p>In addition, the PS IAASB Subgroup intends to further consider how the definition of professional skepticism might be enhanced through its analysis of themes from the ITC responses. See paragraph 4 of <a href="#">June 2017 meeting Agenda Item 9A</a> related to Professional Skepticism.</p>
<p>Mr. linuma suggested that incremental application guidance could be added to ISQC 1 (e.g., in the context of paragraph A24 of ISQC 1, that focuses on the estimation of personnel needs) to acknowledge that the application or effectiveness of professional skepticism, objectivity, and due care could potentially decrease as the staff workload increases beyond a reasonable level.</p>	<p>Point noted.</p> <p>This comment has been referred to the Quality Control Task Force (responsible for revisions to ISQC 1) for consideration.</p>
<p>Mr. Yoshii also noted that auditor skill sets were particularly important to be able to apply professional skepticism, and noted that he believes auditors need to have skills akin to those of analysts.</p>	<p>Point noted.</p> <p>Several of the key observations of the PSWG relate to education and skills, see pages 4 and 5 of the PSWG publication, <b>Agenda Item J1.1</b>.</p>
<p><b>SPECIFIC MATTERS THAT COULD BE ADDRESSED BY THE IESBA</b></p>	
<p>Mr. Nicolson complimented the PSWG and the SSBs on this very important initiative. He added that there was much to commend to the Strawman. While acknowledging the potential for unintended</p>	<p>Support and points taken into account.</p> <p>A consideration of whether aspects of the concepts underlying professional skepticism might also have</p>

Matters Raised	PSWG/SSB Response
<p>consequences, he believed that professional skepticism is a mindset that applies to all PAs. He added that it is the application of professional skepticism that is key.</p>	<p>relevance to professional accountants more broadly remains a matter to be explored by the SSBs (see page 3 and the Standard Setters Actions section of the PSWG publication, <b>Agenda Item J1.1</b>).</p>
<p>Mr. Koktvedgaard shared his experience of being involved in a number of Danish tribunal cases involving accounting for value-added tax, which raised questions about whether fraud was involved or whether it was just poor audit quality. In his view, the requirements in the IESBA Code and the standards exist, but are not being adhered to because the PA did not exercise appropriate professional judgment to determine the appropriate questions to ask, or the right actions that should be taken.</p>	<p>The short-term proposals in the May 2017 <a href="#">IESBA ED</a> were intended to be a timely response to fill a gap in the Code in the meantime. They are responsive to the PSWG's September 2016 recommendation that the Code should provide more guidance to professional accountants undertaking audit, review and other assurance engagements on how compliance with the FPs supports the exercise of professional skepticism in the context of such engagements.</p> <p>The IESBA ED includes proposals to add new application material to the Code to also:</p>
<p>Mr. Dalkin observed that the concept of professional skepticism is specific to and, in his view, has an established and well understood meaning in the context of audit and assurance engagements. While he believed that it is important for all PAs to be skeptical in fulfilling their responsibilities, he was of the view that this expectation is different from what is expected of PAs in an audit and assurance environment. He suggested that it might be more appropriate to use a different word to describe the skeptical mindset that is expected of PAs who do not perform audits and assurance engagements. In addition, he cautioned against extending the concept of professional skepticism in the ISAs to all PAs because doing so might either weaken it or create confusion. He suggested a need to step back to carefully consider the potential for unintended consequences. He also pointed out that there are some services that PAs perform that require less skepticism and that, in some cases, PAs serve as advocates for their clients (e.g., in litigation support work).</p>	<ul style="list-style-type: none"> <li>• Illustrate this linkage in the context of an audit of financial statements (see paragraph 120.13 A1).</li> <li>• Emphasize the importance of professional accountants 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).</li> </ul> <p>At its <a href="#">June 2017 meeting</a>, 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> <p>The IESBA supported development of a consultation paper that will seek stakeholder input on the relevant issues in 2018.</p>
<p>Mr. Hansen concurred with Mr. Dalkin's caution regarding the potential for unintended consequences. However, Mr. Hansen posited that</p>	

Matters Raised	PSWG/SSB Response
<p>professional skepticism should apply not only to PAs, but also to all other professions. He felt that the Strawman should be seriously considered, and encouraged the IESBA to consider what steps might be taken in the short-term to emphasize the concept of professional skepticism in the restructured IESBA Code.</p>	
<p>Ms. Molyneux was of the view that the Strawman well outlined the issues. She agreed with Mr. Hansen in that she cannot view herself as being a PA without being professionally skeptical. She encouraged IESBA consideration of a short-term response but also a longer-term analysis of the expectations of all PAs. She acknowledged the potential for unintended consequences and the importance of not diminishing the meaning of professional skepticism at it applies to auditors. She added that in her view the concept of professional skepticism should apply not only to all PAs but also to those with responsibilities for overseeing their work, specifically those charged with governance (TCWG). Mr. Dalkin cautioned that he would not necessarily label the objectivity of TCWG as professional skepticism. He wondered whether a different term could be used.</p>	
<p>Mr. Iinuma supported the Strawman, in particular the paragraph that describes the relationship between professional skepticism and the fundamental principles. He reiterated the views expressed by IOSCO in its comment letter responding to the ITC regarding the need for any output from this joint professional skepticism initiative to focus on bringing about a change in auditor behavior. Accordingly, he hoped that the IESBA would endeavor to focus on the need for that change in auditor behavior.</p>	
<p>Ms. Lopez noted that in her view the attitude of professional skepticism is very relevant to PAs in business (PAIBs), not only to PAs performing audits and assurance engagements. As illustration, she highlighted the need for professional</p>	

Matters Raised	PSWG/SSB Response
<p>skepticism in PAIBs' judgments about accounting estimates and accounting policies. She encouraged the PSWG to explore how this broader application of professional skepticism might be reflected in the standards, regardless of whether this would be by way of a short-term or longer-term initiative.</p>	
<p>Ms. McGeachy echoed Mr. Dalkin's concerns about the potential for unintended consequences. While she could envision extending the concept of professional skepticism to PAs performing compilation engagements, she felt it would be more difficult to do so with respect to PAs who provide tax preparation services as these are premised on good faith reliance on information provided by the clients. She questioned the need for the last paragraph of the Strawman that addresses documentation and wondered how a short-term response in the restructured IESBA Code would dovetail with a longer-term project.</p>	<p>Points taken into account.</p> <p>During the meeting, in relation to Ms. McGeachy's comment regarding documentation, Mr. Fleck noted that the paragraph was intended to be a response to regulatory concerns and assist PAs to defend themselves against claims that they did not apply appropriate professional skepticism in their engagements. He added, however, that inclusion of the material on documentation in the restructured IESBA Code would be subject to IESBA deliberation as part of its consideration of the longer term issues and not a foregone conclusion.</p> <p>With respect to the concerns about the potential for unintended consequences, Mr. Fleck responded that the IESBA representatives on the PSWG are alert to such concerns, especially with respect to the suggestion of a short-term response.</p> <p><i>The response to the comments in the row above are also responsive to Ms. McGeachy's comment.</i></p>
<p>Mr. Stewart noted that the discussion about a broader application of professional skepticism raises questions about what role professional skepticism should play with respect to the preparation of financial statements; and what articulation of professional skepticism the IASB might wish to include in its <i>Conceptual Framework for Financial Reporting</i> (the IFRS Framework). He explained that although the IASB and its Staff have not yet formed a formal view about this latter question, based on his read of the IFRS Framework, in particular, how it describes "faithful representation,"<sup>4</sup> it appears that a preparer of</p>	<p>Point taken into account.</p> <p>During the meeting, Mr. Fleck welcomed Mr. Stewart's remarks, especially in view of the fact that compliance with the fundamental principle of integrity requires that PAs not knowingly be associated with misleading information. He noted that one of the ways in which PAs can comply with this fundamental principle is to apply professional skepticism.</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 SSBs (see</p>

<sup>4</sup> The IFRS Framework describes the basic concepts that underlie the preparation and presentation of financial statements for external users. The IFRS Framework notes that "to be useful, financial information must not only be relevant, it must also

Matters Raised	PSWG/SSB Response
financial statements would need to apply professional skepticism in order for the financial statements to meet the objective of faithful representation – i.e., meet the underlying characteristics of completeness, neutrality and freedom from error. Mr. Stewart pointed out that the IFRS Framework currently does not explicitly address professional skepticism. However, he would solicit views from his colleagues about what role, if any, professional skepticism should play in the application of the IFRS Framework in advance of the next CAG meeting.	page 3 and the Standard Setters Actions section of the PSWG publication, <b>Agenda Item J1.1</b> ).
Mr. Fortin wondered whether the question was whether professional skepticism should apply to all PAs.	Point taken into account. During the meeting, Mr. Fleck responded that the IESBA has not yet developed a proposal and that the joint CAGs' input would help determine what steps the IESBA might take in the short term and in the longer term. In this regard, Mr. Fleck added that there are a number of issues for the IESBA to deliberate. <i>The response to the comments in the row above are also responsive to Mr. Fortin's comment.</i>
THE DEFINITION OF PROFESSIONAL SKEPTICISM, INCLUDING CONSIDERATION OF THE POTENTIAL NEED FOR FUNDAMENTAL CHANGES TO THE CONCEPT	
<i>General</i>	
Mr. Koktvedgaard, referring to paragraph 40 of the agenda item, cautioned against the creation of too many requirements such that it becomes a “checklist” for auditors. He stressed that professional skepticism serves as a stand-back and by creating too many requirements, it may diminish what auditors are expected to do.	Point noted. This comment has been referred to the Data Analytics Working Group.
Mr. S. Bradbury added that he believes any enhancements to the definition of professional skepticism should focus on the mindset of the auditor and shift to a more challenging or doubtful attitude, rather than the “critical assessment of audit	Point taken into account. A consideration of whether aspects of the concepts underlying professional skepticism might also have relevance to professional accountants more broadly

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represent faithfully the phenomena it purports to represent. This fundamental characteristic seeks to maximize the underlying characteristics of completeness, neutrality and freedom from error. Information must be both relevant and faithfully represented if it is to be useful.”

Matters Raised	PSWG/SSB Response
evidence” as this is more procedural than behavioral.	remains a matter to be explored by the SSBs (see page 3 and the Standard Setters Actions section of the PSWG publication, <b>Agenda Item J1.1</b> )
Ms. Borgerth commented that the SSBs’ standards should be careful not to move towards an attitude of presumptive doubt because the auditor may not know when they have obtained sufficient appropriate evidence; the end goal should be to ensure the reliability of the information prepared by management.	
<i>Levels of Professional Skepticism</i>	
Mr. Dalkin noted that the suggestion by respondents to the ITC that the auditor should apply a professional skepticism continuum that links higher levels of risk of material misstatement to a more skeptical mindset and skeptical actions by the auditor could be confusing. Mr. Thompson agreed and commented that perhaps this suggestion from respondents is actually linked to the auditor’s risk assessment and obtaining contradictory evidence. Mr. Nicholson also agreed with Mr. Dalkin, pointing out that it comes down to whether the auditor has obtained sufficient appropriate evidence to address the identified risk of material misstatement and satisfy the auditor’s professional skepticism.	Point accepted.  At its June 2017 meeting, the IAASB discussed the concept of “levels” of professional skepticism and supported the recommendations of its Professional Skepticism IAASB Subgroup not to introduce the concept into the ISAs. See June 2017 IAASB agenda papers (Agenda Item 9A).  In addition, the PS IAASB Subgroup will be undertaking an analysis of a potential fundamental shift in the concept of professional skepticism that includes a potential requirement to seek out contradictory or inconsistent evidence.
Mr. Fortin agreed that there are certain instances where the auditor should exercise different degrees of skepticism and highlighted the importance of demonstrating that contradictory evidence has been considered.	
Mr. Koktvedgaard noted that ISA 240 already includes a separate level of professional skepticism when the existence of fraud is identified, and therefore he was of the view that the ISAs already make reference to different levels of professional skepticism.	Point noted.  See paragraph 15 of the June 2017 IAASB meeting <a href="#">Agenda Item 9-A</a> .

Matters Raised	PSWG/SSB Response
CONSIDERATION OF A COMMON DESCRIPTION OF PROFESSIONAL SKEPTICISM BY THE SSBs AND THE POSSIBILITY OF EXTENDING THE CONCEPT BEYOND AUDIT AND ASSURANCE ENGAGEMENTS	
<p>Mr. Hines addressed Ms. Molyneux's and others' comments about the wider application of the concept of professional skepticism noting that, when accountants are providing professional advice, they must take into account the capacity in which they are providing such advice and the service they have been contracted to provide. He therefore was of the view that the importance of professional skepticism may vary depending on whether an individual is providing an audit opinion or participating in a committee.</p>	<p>Point being considered.</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 SSBs (see page 3 and the Standard Setters Actions section of the PSWG publication, <b>Agenda Item J1.1</b>).</p>
<p>Mr. van Hulle emphasized that the concept of professional skepticism is fundamental to what is expected of auditors in terms of being professionals who have a critical attitude / state of mind and are independent and objective. In his view, the concept of professional skepticism should be viewed using a holistic approach (rather than being addressed "piece meal" in only some standards). Mr. van Hulle also noted the auditor must first comply with the fundamental principles within the IESBA Code and be independent to be in a position to apply professional skepticism. He suggested that the terminology used to enhance this concept should be strengthened to convey that "you cannot consider yourself an auditor unless you do X."</p>	

**Matters for IAASB/IESBA CAG Consideration**

7. The CAGs are asked to note the report back and the SSBs' update and share any reactions.

**Material Presented – IAASB/IESBA CAG Papers**

**Agenda Item J1.1** PSWG Publication, [Toward Enhanced Professional Skepticism](#)

**Material Presented – FOR IAASB and IESBA CAGs REFERENCE PURPOSES ONLY**

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