

TOWARD ENHANCED PROFESSIONAL SKEPTICISM

AUGUST 2017

OBSERVATIONS OF THE IAASB-IAESB-IESBA PROFESSIONAL SKEPTICISM WORKING GROUP

This publication was prepared by the Professional Skepticism Working Group, which is comprised of representatives from the International Auditing and Assurance Standards Board (IAASB), International Ethics Standards Board for Accountants (IESBA), and the International Accounting Education Standards Board (IAESB).

It does not necessarily reflect the views of the boards, does not constitute an authoritative pronouncement, nor does it amend, extend, or override the IAASB's International Standards,¹ the IESBA's Code of Ethics for Professional Accountants (the Code), or the IAESB's International Education Standards (IES).

¹ The IAASB's International Standards are comprised of the International Standards on Quality Control, the International Standards on Auditing, the International Standards on Review Engagements, International Standards on Assurance Engagements, and the International Standards on Related Services.

Professional skepticism lies at the heart of a quality audit.

In 2015, the International Auditing and Assurance Standards Board (IAASB), International Ethics Standards Board for Accountants (IESBA), and the International Accounting Education Standards Board (IAESB) convened a small, cross-representational working group—the Professional Skepticism Working Group—to formulate views on whether and how each of the three boards’ sets of international standards could further contribute to strengthening the understanding and application of the concept of professional skepticism as it applies to an audit.

Professional skepticism is 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.

**International Standard
on Auditing 200**



Today, the topic of professional skepticism is featured prominently in each of the board’s strategic considerations, and all three boards have important initiatives related to professional skepticism. All three boards see the opportunity for shorter term actions as well as the need for longer term considerations, in consultation with each other.

The importance of professional skepticism to the public interest is underscored by the increasing complexity of business and financial reporting, including greater use of estimates and management judgments, changes in business models brought about by technological developments, and the fundamental reliance the public places on reliable financial reporting.

This publication presents several observations the Working Group believes are central to enhancing the exercise of professional skepticism in an audit. These observations are based on formal and informal feedback received by the boards, input from academic research, and ideas from others offering insights—all aimed at enhancing the exercise of professional skepticism.

This publication also highlights actions of the three boards regarding professional skepticism as it relates to auditors. For other professional accountants, the question has been asked whether aspects of the concepts underlying professional skepticism also have relevance. Initiatives by the relevant boards are therefore also noted.

OUR KEY OBSERVATIONS TO DATE

1. Increased attention to business acumen is central to the exercise of professional skepticism.

In today's complex and rapidly changing business environment, strong business acumen is essential. For example, a sufficient knowledge of the client's business model and strong professional competencies, in addition to a strong understanding of relevant standards, laws, and regulations, enable robust professional skepticism. Education and continuing, effective training remain vital.

2. Environmental factors can influence the ability to exercise professional skepticism.

Professional skepticism can be impeded by factors from tight financial reporting deadlines and resource constraints, to a firm's tone at the top and incentive systems, to local culture and groupthink. Heightening awareness of these and other factors is the first step to mitigate their impact.

3. Awareness of personal traits and biases is essential.

Personal traits play a role in the exercise of professional skepticism. These include, for example, confidence; an inquisitive nature; an individual's response to stress, time pressures, or conflict; knowledge; practical experience; and cultural background. Equally, a range of biases such as anchoring bias, confirmation bias and groupthink can act as impediments to the proper exercise of professional skepticism.

In consideration of these factors, standards might be improved by including more guidance about how an awareness and understanding of personal traits and biases can enhance the exercise of professional skepticism.

4. Building in professional skepticism from the outset is key.

Instilling professional skepticism starts at the beginning of one's career. For auditors, some have said it needs to be "part of their DNA."

Education and training can raise awareness and develop the needed attitude. At both the firm and engagement level, it is critical to reinforce and monitor the application of professional skepticism, including through setting the right tone at the top.

5. There is more that the three standard-setting boards can do, both in the immediate term and the longer term.

The Working Group provided **recommendations** to all three boards outlining actions that they may take individually as well as collectively. These included immediate actions, which are being acted on with priority attention, as well as considerations requiring further study.

A snapshot of the actions of the three standard-setting boards is included in the section “Standard Setters’ Actions.”

6. Beyond audit, aspects of the concepts underlying professional skepticism may be relevant to all professional accountants.

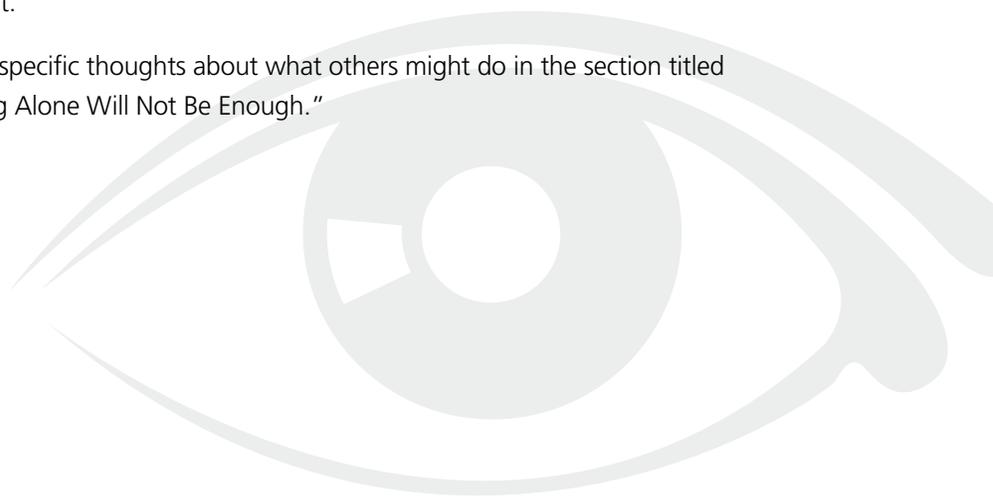
There are questions about whether and how aspects of the concepts underlying professional skepticism should apply more broadly to all professional accountants, and not just auditors. There is a view that an understanding of the concepts underlying professional skepticism can benefit all professional accountants. Also, it is observed that compliance with the fundamental principles in the Code can support the exercise of professional skepticism.

The boards, in particular the IESBA and IAESB, recognize the need for further study about whether and, if so, how aspects of the concepts underlying professional skepticism should be pertinent to all professional accountants.

7. Standard setting alone will not be enough.

All stakeholders with an interest in professional skepticism have a role to play to help cultivate a skeptical mindset.

We provide some specific thoughts about what others might do in the section titled “Standards Setting Alone Will Not Be Enough.”



STANDARD SETTERS' ACTIONS

Each of the three standard-setting boards has acted on the inputs we and others provided regarding where further work or enhancements to the standards may provide benefit. The following is a snapshot of their immediate actions and longer term studies.

IAASB

INTERNATIONAL AUDIT AND ASSURANCE STANDARDS BOARD

The IAASB's International Standards already include many explicit references to professional skepticism. The IAASB's [Professional Skepticism Q&A](#) highlights aspects of the ISAs that are particularly relevant to professional skepticism during an audit of financial statements. It also highlights the role of others in supporting professional skepticism. The IAASB also sought input on how to reinforce the fundamental concept of professional skepticism throughout the audit in its approach to professional skepticism in its 2015 Invitation to Comment, *Enhancing Audit Quality in the Public Interest (summary of stakeholder responses to the Invitation to Comment)*.

The IAASB focuses on professional skepticism in every project. This is more than just referring to the concept—it involves looking for opportunities to embed the expectation of professional skepticism into the design of the requirements, and to challenge whether the standard can do more to promote professional skepticism.

The IAASB is seeking to reinforce professional skepticism through different sections of the ISAs and in different ways. Professional skepticism focus areas in current IAASB projects include:





INTERNATIONAL ETHICS STANDARDS BOARD FOR ACCOUNTANTS

The IESBA is committed to clarifying the behavior that is expected of all professional accountants in the public interest.

With respect to auditors and assurance practitioners, as an initial step, the IESBA's May 2017 Exposure Draft (ED), *Proposed Application Material Related to Professional Skepticism and Professional Judgment*, proposed guidance that clarified how compliance with the fundamental principles embodied in the Code supports the exercise of professional skepticism in the context of audits, reviews, and other assurance engagements.



More broadly, the ED also proposed guidance that emphasizes the importance of professional accountants obtaining a sufficient understanding of the facts and circumstances known to them when exercising professional judgment in the context of complying with the fundamental principles.

While the IESBA's efforts in the short term will be informed by the feedback on the May 2017 ED, the IESBA intends to consider as part of a longer term initiative whether there is a public interest need to develop material to describe the role and expectations of professional accountants. This material might include consideration about how the work of professional accountants contributes to enhancing the integrity and reliability of information with which they are associated.





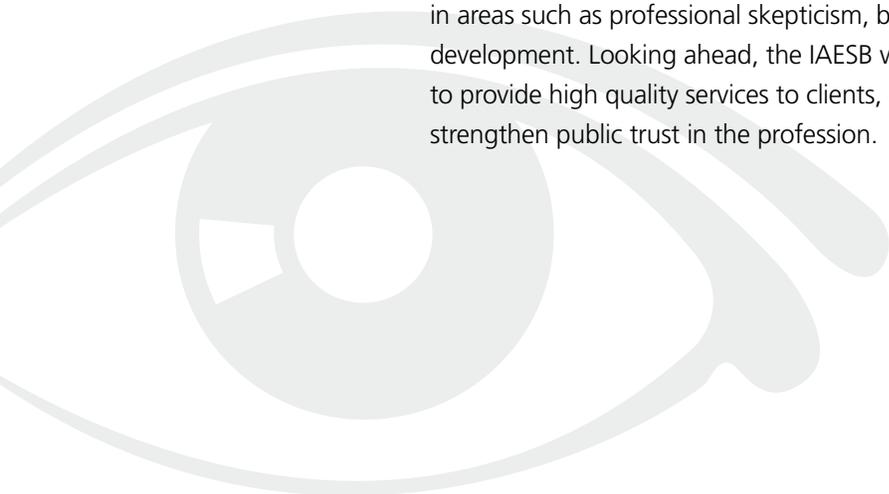
INTERNATIONAL ACCOUNTING EDUCATION STANDARDS BOARD

The IAESB is committed to developing its International Education Standards (IESs) and supporting materials to enhance the skills and competence needed by all professional accountants to apply professional skepticism.

As shown below, the IAESB has and will undertake research and gather examples of best practices. The IAESB will also engage with stakeholders to decide how best to establish and support the education and training needed to improve the application of professional skepticism. This process may result in an overview of research, revisions to the IESs, and development of support materials, thought leadership, and best practice materials.



The above initiatives will help inform the IAESB's development of IESs and guidance materials in areas such as professional skepticism, behavioral competence, and continuing professional development. Looking ahead, the IAESB will consider what is needed to support individuals to provide high quality services to clients, employers, and other stakeholders, and thereby to strengthen public trust in the profession.



THE JOURNEY FORWARD

The work of the boards on professional skepticism has been a journey, and there is still further to travel. The Working Group believes that to serve the public interest and satisfy their mutual obligation to address the issues highlighted in this paper, the boards' efforts should be undertaken in close consultation with each other.

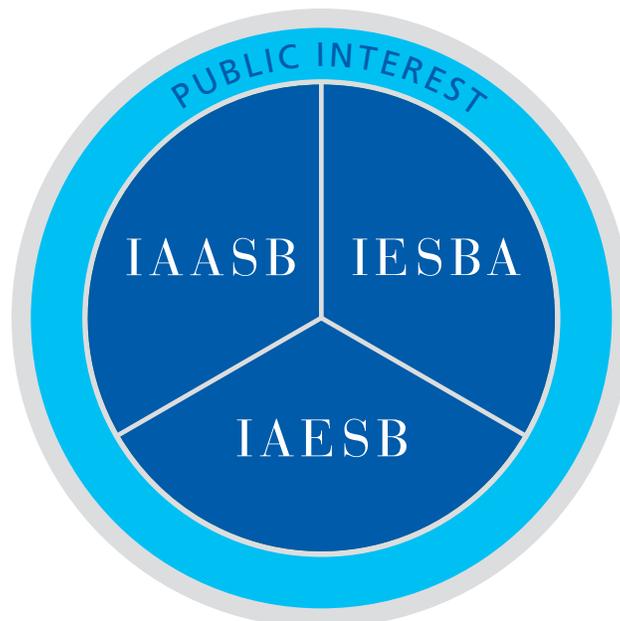
If behavioral change is needed, it is necessary to carefully study how to effect it.



For the IAASB, whose remit includes audit, assurance, and related services, this means considering and analyzing the merits of fundamental changes to the concept and definition of professional skepticism in light of the public's expectations. This is particularly around how the definition relates to the critical assessment of audit evidence, and documentation.

The IESBA and the IAESB remits include all professional accountants, not just auditors. These boards have been challenged as to whether and how the IAASB's concept of professional skepticism, or aspects thereof—such as the

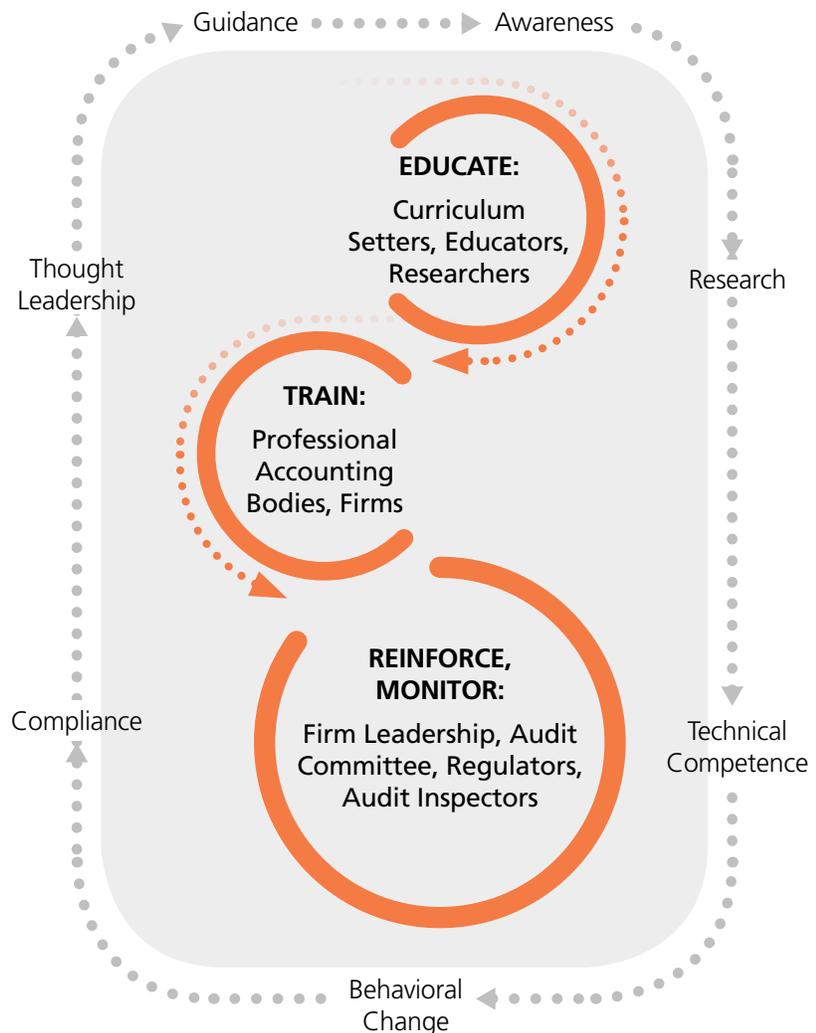
“questioning mindset”—has relevance to professional accountants who do not perform audits or other assurance engagements.



STANDARD SETTING ALONE WILL NOT BE ENOUGH

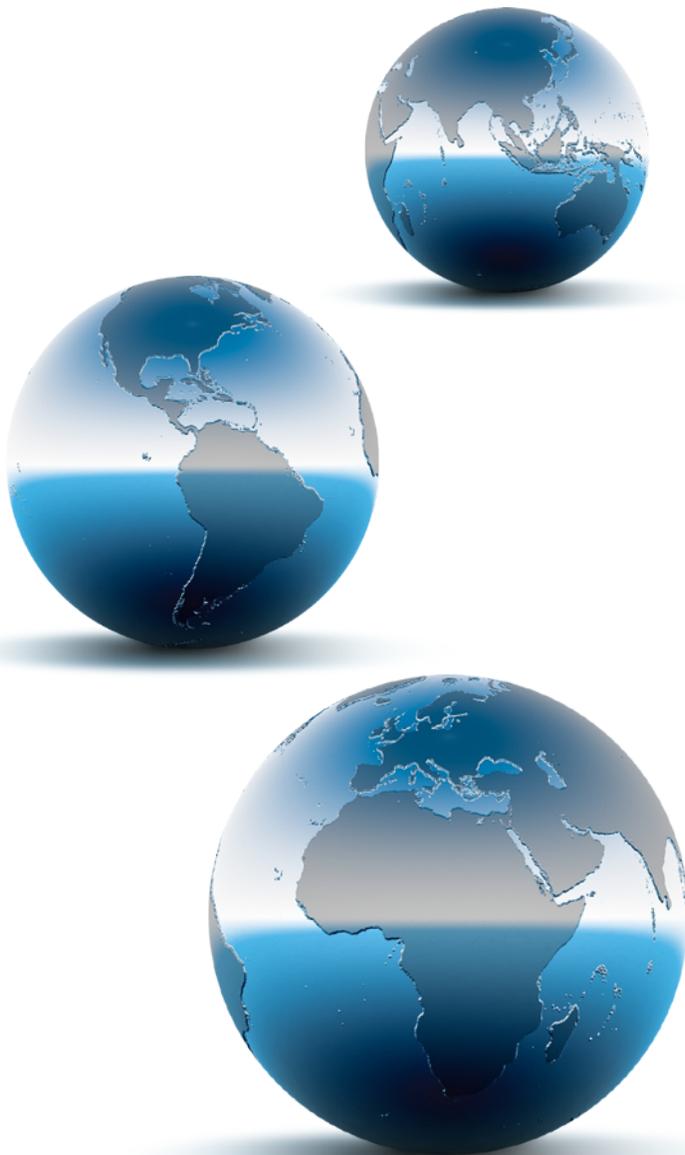
Exercising professional skepticism is primarily an individual responsibility. However, all stakeholders with an interest in high quality financial reporting and auditing, and an interest in professional skepticism, have a role to play to help cultivate a skeptical mindset. For some, including firms, this means educating or training more junior staff on what “good” professional skepticism looks like in practice. For others, such as audit committees, it may mean continuing to challenge auditors to ask tough questions of management.

The three standard-setting boards will continue to liaise with stakeholders to improve their understanding of, and support for, professional skepticism.



The three standard-setting boards will continue to liaise with their stakeholders to better understand how to improve, and encourage support for, the exercise of professional skepticism.

The Working Group is grateful to all those that have engaged with us and the three standard-setting boards to date, including the special guest speakers from academia and audit inspectors that have presented to the three standard-setting boards, all commentators on the discussion papers from the boards, and others that have interacted with the Working Group through the journey. Continued support from all stakeholders will be necessary to advance professional skepticism.



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