

**August 15, 2018**

## **IFAC Small and Medium Practices (SMP) Committee response to the International Ethics Standards Board for Accountants (IESBA) Consultation Paper: Professional Skepticism – Meeting Public Expectations**

### **INTRODUCTION**

The SMP Committee (SMPC) is pleased to be given the opportunity to respond to the IESBA (the Board) on this Consultation Paper (CP). The SMPC is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small-and medium-sized entities (SMEs), who contribute significantly to every countries' economy. Members of the SMP Committee have substantial experience within the accounting profession, and include small-and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Individuals are drawn from IFAC member bodies representing 22 countries from all regions of the world.

### **GENERAL COMMENTS**

SMPs provide a diverse range of services from accounting, audit and tax, to business advisory and consulting, which include (but are not limited to) corporate advisory, management accounting, business development, human resources and restructuring/ insolvency.

We believe that it is imperative for the public to be able to have an appropriate level of trust in the information provided by a Professional Accountant (PA) as being of a standard where they can have confidence it has been prepared with the necessary integrity and due care to enable quality and reliable reports to be produced.

The term Professional Skepticism (PS) is long established in the auditing environment and is considered a core part of an auditors activities, together with the exercise of professional judgement. Nevertheless, we acknowledge that PS and the associated behavioral characteristics, may mean something different to different people, especially in relation to how the concepts are applied by PAs who practice in different areas of the profession and who may not formally recognize these as PS as defined in the ISAs. We therefore support the IESBA's CP to explore this topic further.

As recognized in the CP, the IAASB does not require the exercise of PS as defined in its audit and assurance standards for non-assurance services (e.g., compilation and agreed-upon procedures engagements), instead highlighting the fundamental principles of the IESBA Code and requirements as expected of practitioners. There are concerns that adding a requirement "on top" for all professional accountants in public practice (PAPPs) to exercise PS may exacerbate existing confusion about the difference in professional services as well as result in an increase of the work effort in non-assurance activities. This could also end up undermining the public's perception of value of audit and assurance services as well as the current IAASB standards and dilute, or otherwise adversely affect, the understanding



and application of PS in the context of audit and other assurance engagements. It is therefore essential for the IESBA to continue to liaise closely with the IAASB in progressing further work in this area.

We agree that beyond the audit and assurance environment, PS seems to have become a “catch all” term that is used inconsistently to capture the behaviors and actions that the public expects professional accountants to demonstrate when performing professional activities. There is a risk that extending the term PS to all PAs, irrespective of their roles, would serve to increase the so-called expectations gap, especially that part of the gap that is based on unreasonable expectations due to the lack of understanding of the different roles and scope of various types of services performed by a PA.

We are also significantly concerned about the potential unintended consequences, including an expectation from regulators for PAs to document how they have exercised these behaviors everyday on every task performed. We are concerned if this was to occur, it may not lead to an improvement of quality output, but could result in increased costs for no benefit.

The SMPC believes that the fundamental principles already in the Code (especially integrity, objectivity and professional competence and due care) should be sufficient to meet the standard of behaviors described in Paragraph 10 providing PA's have these principles at the front of their mind when considering how they approach their duties. In our view, the IESBA should develop additional guidance materials on the application of these fundamental principles, in order to make it clear to all PA's of the standards expected of them as a PA. We consider for reasons set out in this letter that having two different definitions for PS adopted by the Standard Setting Boards would be unhelpful and therefore, IESBA should consider approaching this project by highlighting through guidance materials the characteristics which should be expected of PAs that captures the essence of a “diligent mindset” or “critical thinking”.

## **SPECIFIC COMMENTS**

The followings are the SMPC's specific responses to the questions in the CP.

### **Question 1**

*Paragraph 5 – Do you agree with the premise that a key factor affecting public trust in the profession is whether information with which a professional accountant is associated can be relied upon for its intended use?*

We believe that it is imperative for the public to be able to have an appropriate level of trust in the information provided by a Professional Accountant (PA) as being of a standard where they can have confidence it has been prepared with the necessary integrity and due care to enable quality and reliable reports to be produced.

We believe where the problem can arise is that the public may not understand the different types of reports and roles of the PA and therefore does not understand the depth of work performed and that the individual degree of reliance on information provided by the client differs significantly depending on the type of the role or engagement. Therefore the issue of addressing public trust in the profession is also one of educating the users of information prepared by PAs of these differences and at the same time acknowledging there



is an underlying requirement that certain standards must be adopted by a PA in order to prepare quality output.

The SMPC believes that the fundamental principles already in the Code (especially integrity, objectivity and professional competence and due care) are sufficient to meet this standard providing PA's have these principles at the forefront of how they approach their duties. In our opinion, the IESBA may wish to develop additional guidance on the application of these fundamental principles in order to make it clear to all PA's of the standards expected from them as a PA.

In addition, to address the expectations gap, further resources should be developed by the Standard Setting Boards and employed by the profession in educating the public and other users of financial statements on the different types of engagements. It needs to be clear that the degree of reliance arising from the association of an auditor who has performed an audit engagement where they have obtained a reasonable assurance over the work performed is very different to the degree of reliance where a PAPP has completed a non-assurance service such as a compilation engagement.

In our view, the relationship between a PA's association with information and the notion of "relied upon for its intended use" needs further consideration, as it would be unreasonable to expect all forms of association to involve testing the veracity of information. Indeed, given the different types of circumstances where association might be a factor, it is not a question of whether the information can be relied upon for its intended use, but whether the information can be used as intended (and relied upon to the extent appropriate in the specific circumstances), by the intended users.

Such guidance will also foster public appreciation of what acting with integrity ought to mean; so whilst an auditor can be expected to exercise a relatively high degree of professional skepticism in obtaining audit evidence, a PA performing non-assurance work such as compilation would act with integrity in a different way. For example, in some circumstances this may mean a PA can be expected not to turn a blind eye when information supplied by a client appears to be misleading or otherwise incorrect.

### **Question 2**

*Paragraph 10 – Do you agree with the behavior associated with public expectations of professional accountants? Are there aspects that should be included or excluded from the summary?*

The SMPC agrees in principle with the behaviors expected of PA's as set out in paragraph 10. We believe that the fundamental principles in the Code supports and requires PA to adopt many of these behaviors.

### **Question 3**

*Paragraphs 13 and 14 – Do you agree that the mindset and behavior described in paragraph 10 should be expected of all professional accountants? If not, why not?*

We refer to our comments above in response to Q2. We believe the Code already requires this mindset and behavior for all PAs. Specifically, section 111 of the Code adequately reflects the mindset and behavior expected of all PAs when it comes to being associated with information as part of the fundamental principle



of integrity and specifically, under section 220 – with regards to preparation and presentation of information – where it clarifies the relation of a PA to information the PA knows or has reason to believe is misleading.

Paragraph 13 identifies the issue that public perception does not take into consideration the different roles undertaken by the PA. The points raised in Paragraph 14 are key issues worthy of consideration as the ability of a PA to apply the behaviors described in Paragraph 10 will depend on the PA's experience and therefore scalability needs to apply. Further the PA (commensurate with their level of seniority) should be empowered to exercise professional judgement in deciding the level of evaluation they should conduct based upon materiality and impact on end users.

#### **Question 4**

*Paragraph 16 – Do you believe the fundamental principles and related application material are sufficient to support the behaviors associated with the exercise of appropriate “professional skepticism?”*

We believe that the fundamental principles in the Code already require the behaviors associated with the exercise of PS to be embraced by all PA's. We acknowledge the concerns raised in the CP in relation to public trust and believe additional guidance could be provided to PA's demonstrating how by following the fundamental principles they need to embrace the behaviors associated with PS as described in Paragraph 10. We believe that all PAs need to be aware of the standards of behavior expected in the Code in order to avoid information that they use or are associated with being misleading or incomplete and to ensure their work is of a quality that can be relied upon for its intended use.

It is also our view that it is not appropriate to presume the lack of public trust in the profession lies solely with the Code and/ or the behavior of PA's. We believe some of this perception is due to a lack of understanding by the public and resources need to be developed by the profession to help the public understand the diverse range of reports and the differing role of PAs in the preparation of those reports.

#### **Question 5**

*Paragraph 18 – Do you believe professional skepticism, as defined in International Standards on Auditing, would be the appropriate term to use?*

No. The term PS adopted by the IAASB is understood by the PA's particularly those who practice in the area of audit. This definition however does not embrace the needs identified in the IESBA CP. For example, the PS adopted by the IAASB deals with attitudes and mindsets, whereas IESBA has focused on behaviors. Furthermore, the IAASB definition is focused on identifying misstatement due to error and fraud, whereas IESBA focuses on behaviors that should result in maximizing the quality and reliability of output.

#### **Question 6**

*Paragraph 19 –*

- (a) Do you believe that the Code should retain/use the term “professional skepticism” but develop a new definition?*
- (b) If so, do you support a new definition along the lines set out in paragraph 19?*



*(c) If you do not support a definition along the lines described, could you please provide an alternative definition.*

As indicated in Question 5, we do not believe that the definition of PS used by IAASB will meet the aims of IESBA. Therefore its adoption is not supported.

We are further concerned that using the term PS with a different definition in the Code, compared to the ISAs would create confusion, possibly leading to an increase in the expectations gap and potentially reducing the robustness of the IAASB's current definition. It would also be challenging for PAs required to adhere to the ISAs on the one hand and to the Code on the other hand.

The focus should be on developing guidance material which highlights the PS concept within the current Code that is driven by the compliance of the fundamental principles. This includes the characteristics expected of a PA, such as the willingness to ask the right questions when the PA believes client information may be misleading or otherwise incorrect and taking any appropriate follow through action when warranted.

We believe that when developing any related application material IESBA will need to address the different expectations on PAs depending upon their roles, level of experience and reflect the concept of "scalability". The Code would need to state that PAs should continue to exercise professional judgement in determining the nature and extent of actions to be taken in the circumstances. The scalability would be in the determination of appropriate actions, rather than in the degree of PS applied.

#### **Question 7**

*Paragraph 20 –*

- (a) Would you support an alternative term to 'professional skepticism', such as 'critical thinking', 'critical analysis' or 'diligent mindset'?*
- (b) If not, what other term(s), if any, would you suggest which focusses on the mindset and behaviors to be exercised by all professional accountants?*

We are concerned that developing an alternative term may cause unnecessary confusion, especially when being translated. For example, the phrase "critical analysis" may give rise to unintended expectations regarding the additional work effort (i.e., analysis) required in non-assurance activities. The concept of "diligent mindset" is already covered by the fundamental principle of professional competence and due care.

#### **Question 8**

*Paragraph 21 – Should the IESBA develop additional material, whether in the Code or otherwise, to highlight the importance of exercising the behavior and relevant professional skills as described? If yes, please suggest the type of application material that in your view would be the most meaningful to enhance the understanding of these behavioral characteristics and professional skills.*

Since we believe that the fundamental principles within the Code are sufficiently robust, strengthening the guidance in relation to the existing fundamental principles of the Code is worth exploring both within and outside of the Code (e.g. staff publications, case studies) to bring to the fore the concept of PS for all



accountants. However, IESBA will need to be careful in its use of words to not inadvertently increase work effort requirements in an inappropriate way for the nature of the activities covered. Short, succinct materials will be most useful for education and training purposes.

**Question 9**

*What implications do you see on IAASB's International Standards as a result of the options in paragraphs 18 to 21?*

As already highlighted, the SMPC firmly believes that coordination with the IAASB is essential, and any changes to the Code should not undermine the IAASB's standards relating to non-assurance engagements. Out of the four options as outlined in the CP, the development of additional application materials to expand upon the concepts underlying the existing fundamental principles in the Code carries less risk of creating confusion in the marketplace and coupled with the possible danger of "watering down" of the IAASB standards covering the audit and assurance engagements may therefore be a more appropriate way to further project the robustness of the restructured Code – to the PAs and the public at large.

**Question 10**

*Paragraph 22 – Should the Code include application or other material to increase awareness of biases, pressure and other impediments to approaching professional activities with an impartial and diligent mindset and exercising appropriate professional skepticism in the circumstances? If yes, please suggest the type of materials that in your view would be the most meaningful to help professional accountants understand how bias, pressure and other impediments might influence their work.*

We would encourage the IESBA to explore whether additional guidance and practical examples might be a way to address the issue of impediments PAs may encounter when applying the fundamental principles. We continue to believe that the fundamental principles and related requirements of the restructured Code remain sound and fit for purpose.

**CONCLUSION**

As rightly pointed out by IESBA in the first sentence of paragraph 10 in the CP, the nature and context of the work being undertaken as well as the particular role or position of the PA will determine whether PAs should apply any of the characteristics and actions identified in paragraph 7.

In our view, paragraph 7 – which lists commentators' beliefs as to the behaviours associated with the public expectations of PAs generally – illustrates well the existence of an expectations gap, specifically:

- In the first bullet point, there will need to be a clear distinction between understanding information needed to make sound judgments based on facts and circumstances known (i.e., information already known), and the need to obtain additional information (which is in the first part of the first bullet point). For non-assurance engagements, the need to obtain additional information should be limited to situations in which the PA becomes aware that the facts and circumstances known are incomplete, or



that it becomes apparent that a sound judgment cannot be made based upon the facts and circumstances known.

- The second bullet point: while we support the view the PA should “make informed challenges of views developed by others” there should be some context around this statement. For example in an assurance engagement, a PAPP should rightly be expected to have a questioning mind in considering views expressed by others (i.e., where these are audit/assurance evidence), including obtaining further evidence when necessary. However, they would not question views if these are sufficiently supported by evidence or otherwise appear reasonable. Where PAs undertake other work, including non-assurance services, they should only be expected to question views they believe to be unreasonable or contradictory to information already known to them or ought to be known to them.
- The fourth bullet point should be amended to “ensure thoughtful consideration of all known and relevant available information is given before providing judgement”. This would avoid the need for a PA to obtain *all* relevant information that is available, which exceeds the requirements placed on auditors of financial statements (auditors are required to obtain information constituting *sufficient appropriate audit evidence* – not all relevant information that would be available).

We would like to thank IESBA for this opportunity to provide our feedback into this important and timely topic. Please contact us if the Board needs further clarification from the SMPC.

Sincerely,

A handwritten signature in blue ink that reads 'Monica Foerster'. The signature is written in a cursive, flowing style.

Monica Foerster  
Chair, SMP Committee