

23 August 2018

Mr. Ken Siong,
Senior Technical Director
International Ethics Standards Board for Accountants (IESBA)
International Federation of Accountants (IFAC)
529 Fifth Avenue, 6th Floor
New York, New York 10017 USA
By email: kensiong@ethicsboard.org

Dear Mr. Siong,

RE: Consultation paper *Professional Scepticism – Meeting Public Expectations*

Accounting Professional & Ethical Standards Board Limited (APESB) welcomes the opportunity to make a submission on the International Ethics Standards Board for Accountants' (IESBA) consultation paper on *Professional Scepticism – Meeting Public Expectations*.

APESB is governed by an independent board of directors whose primary objective is to develop and issue, in the public interest, high-quality professional and ethical pronouncements. These pronouncements apply to the members of the three major Australian professional accounting bodies (Chartered Accountants Australia and New Zealand, CPA Australia, and the Institute of Public Accountants).

In Australia, APESB issues APES 110 *Code of Ethics for Professional Accountants* (APES 110) which is based on the IESBA *Code of Ethics* and specifies the fundamental principles of ethical behaviour for professional accountants, as well as a range of professional and ethical standards that deal with various professional services.

Introductory comments

APESB is supportive of the IESBA's project to clarify professional scepticism and its applicability to all professional accountants.

The concept of professional scepticism is an important element in guiding the professional and ethical behaviour of all professional accountants. APESB supports the adoption of a new definition of professional scepticism as articulated in the consultation paper and the development of new application material within the Code.

APESB is of the view that all professional accountants apply varying degrees of professional scepticism which is dependent on the professional activities they perform. Within the accounting profession, a high degree of professional scepticism will be applied by assurance practitioners, forensic accountants, independent experts and insolvency practitioners.

We also do not believe that the term professional scepticism is limited to the accounting profession as most other professions will also apply varying degrees of professional scepticism when exercising professional judgement to arrive at a conclusion or forming opinions in their professional work whether they are medical professionals, lawyers or engineers.

In these circumstances, we do not believe that it is appropriate for a segment of the accounting profession, i.e. auditors, to claim that it only applies in the assurance context due to the existence of a definition within the auditing literature which is clearly audit centric.

Recommendations

APESB recommends that:

- the term 'professional scepticism' be defined in a similar manner as articulated by IESBA in the Code as a concept applicable to all professional accountants;
- additional guidance material be included in the Code to clarify the use of professional scepticism (refer to Appendix B for suggested amendments to Section 120 of the Code that could facilitate this change); and
- IESBA to influence IAASB to rename the existing definition in the auditing standards as "audit scepticism," "assurance scepticism" or a similar term.

Details of our recommendations and the responses to specific questions outlined in your consultation paper are included in Appendix A for your consideration.

Concluding comments

We trust that you will find these comments useful in your final deliberations. Should you require any additional information, please contact APESB's Chief Executive Officer, Channa Wijesinghe at channa.wijesinghe@apesb.org.au.

Yours sincerely,



The Hon. Nicola Roxon

Chairman

Appendix A

APESB's Comments

APESB's responses to the specific questions raised by the IESBA in the Consultation Paper are as follows.

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?

APESB agrees that the public, employers, and clients expect information which a professional accountant is associated with to be able to be relied upon for its intended use.

The media scrutiny of corporate collapses has raised questions of audit quality, the value of an audit opinion and the role of professional accountants¹. It has emphasised the expectation gap in respect of public expectations of the performance of auditors and the service that is being delivered by the external audit process.

It also illustrates that there is lesser recognition by the media and the public of the vital role that professional accountants in business play in preparing reliable financial and non-financial information to be reviewed by auditors. The focus of the media when an entity collapses has been on audit practitioners, and not necessarily the role played in its demise by the Board, management, professional accountants in business or other external factors that may have contributed to the entity's demise.

This position may change if regulators increase their enforcement actions against Boards, management and professional accountants in business. For example, recently the UK Financial Reporting Council imposed sanctions against three professional accountants in business who worked for AssetCo PLC² in a range of senior executive positions and were found to have committed misconduct in relation to the preparation of financial statements. The accountants were each banned for being a member of the accounting profession for periods ranging from 10 - 16 years and were also individually fined amounts ranging from GBP 100,000 – 250,000.

2. Paragraph 10 - Do you agree with the behaviour associated with public expectations of professional accountants? Are there aspects that should be included or excluded from the summary?

APESB agrees that the public, clients, and employers expect professional accountants to act with an impartial and diligent mindset, and to apply that mindset to the work they undertake.

¹ <https://www.bbc.com/news/business-44201251>

² <https://www.frc.org.uk/news/august-2018/three-former-members-of-assetco-management-exclude>

These users of professional services provided by accountants also expect the professional accountant to apply their knowledge and expertise. This behavioural aspect is already clearly required in the Code under the fundamental principle of Professional Competence and Due Care.

We believe the public do expect that accountants will act with a certain degree of professional scepticism when undertaking their professional work and that it varies based on the work performed. We are of the view that there is a continuum of professional scepticism that ranges from a low level to a higher level.

In circumstances where a professional needs to exercise professional judgement in order to arrive at a conclusion or provide an opinion, they will exercise a certain degree of professional scepticism. This is not limited to the accounting (or audit) profession and will be applicable to most other professions.

However, we believe that further analysis is required on how the application of professional scepticism affects the work performed, and whether this is an important aspect of meeting expectations of the public, employers, and clients. We note that some researchers³ have questioned the application of professional scepticism by assurance practitioners and how it impacts the work performed, for example, impact on materiality levels. APESB believes this premise should also be considered by the IESBA to help inform this project on professional scepticism.

Based on the analysis of the impact of professional scepticism, the IESBA should develop guidance that will assist professional accountants to apply professional scepticism in respect of various professional activities they perform for clients and employers. The guidance could also consider obstacles to applying professional scepticism such as groupthink.

3. Paragraphs 13 and 14 - Do you agree that the mindset and behaviour described in paragraph 10 should be expected of all professional accountants? If not, why not?

APESB agrees that the mindset and behaviour described in paragraph 10 should be expected of all professional accountants.

Professional accountants in public practice apply professional scepticism when performing services such as forensic, insolvency, and valuation services engagements. These engagements require an accountant to act as an expert and/or provide an expert report which requires the application of professional scepticism to the information provided by the client or the relevant entity, and they cannot simply accept data or information provided to them. They must interrogate the data or information provided to them to ensure that the final work product withstands scrutiny.

³ Foundation for Auditing research (<http://archieff.mab-online.nl/downloaden/11893/FAR-Research-Project-Professional-skepticism-a-trending-concept-in-need-of-understanding>)

Whenever the fundamental principles of integrity and objectivity (including Independence) are a key requirement of the engagement, a professional accountant must, to varying degrees, display a degree of professional scepticism when undertaking their work.

This point has been considered in a preeminent resource on forensic accounting services which concludes that ‘...forensic accountants and fraud examiners generally maintain a high degree of professional scepticism – a level that probably exceeds that of the traditional auditor – because the nature of their work is different.’⁴

We agree with this statement in respect of forensic accountants as when performing certain professional activities materiality would not be a consideration.

Professional scepticism is also important in the insolvency context to analyse and investigate data⁵ and as noted by a legal practitioner:

“The personal traits associated with healthy levels of professional scepticism include self-confidence, intellectual curiosity, clear communication skills, a strong moral compass, and the ability to suspend judgement until all appropriate evidence has been collated,”

We also note that the International Accounting Education Standards Board (IAESB) include professional scepticism within their standards as an important aspect of professional skills and professional values, ethics, and attitudes that need to be included in the professional education programmes for professional accountants. The concept is applied broadly and is not restricted with respect to the type of activities undertaken by the professional accountant.

4. Paragraph 16 - Do you believe the fundamental principles in the Code and related application material are sufficient to support the behaviours associated with the exercise of appropriate “professional scepticism?”

The set of fundamental principles in the Code establish a robust framework for professional accountants. APESB does not believe substantive changes to the current fundamental principles are necessary.

As noted in our response to Question 2 above, we believe the two key elements of professional scepticism are already contained in the fundamental principles.

We are of the view that an additional definition of professional scepticism and application material is required to incorporate professional scepticism into the Code for all professional accountants. The material should link to the relevant fundamental principles and clarify that the concept is applicable to all professional accountants, not just applied by professional accountants in an assurance context.

⁴ Kranacher, Riley & Wells, *Forensic Accounting and Fraud Examination* (2011) John Wiley & sons, p454.

⁵ <https://www.lawyersweekly.com.au/biglaw/21303-insolvency-expert-urges-professional-scepticism-towards-data-mining>

5. Paragraph 18 - Do you believe professional scepticism, as defined in International Standards on Auditing, would be the appropriate term to use?

APESB recognises that the historical use of the term Professional Scepticism in the accounting profession is in an assurance context. However, as noted above, the use of the term is not exclusive to the assurance services even within the accounting profession, nor is it a term that can exclusively be claimed by the accounting profession to the exclusion of all other professions.

The current definition of professional scepticism in Auditing Standards is:

Professional scepticism means an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatements due to error or fraud and a critical assessment of audit evidence.

The current definition used in the International Standards on Auditing is clearly audit centric and is not appropriate to use as a definition applicable to all professional accountants.

APESB agrees that the disadvantages outlined in paragraph 18 of the Consultation Paper make it evident that this definition should not be used more broadly.

APESB is concerned about how the restriction of the use of the term professional scepticism could be interpreted by the wider accounting profession, general public, clients, and employers. If the term is to be restricted to just assurance practitioners, what message are we sending, if we state that it is only appropriate for auditors to undertake services with an open mindset and the use of their knowledge and experience? Surely the public, clients, and employers would expect that of any professional accountant who performs professional work for them.

Therefore, APESB is of the view that the concept of professional scepticism should be applied by all professional accountants to varying degrees based on the work they perform. We believe the Code can be enhanced by including relevant content in respect of professional scepticism.

APESB is of the view that the International Auditing and Assurance Standards Board (IAASB) should consider renaming professional scepticism in the International Auditing Standards to "Audit Scepticism," "Assurance Scepticism" or a term with similar phrasing. This will create differentiation from the definition of professional scepticism developed by the IESBA.

This approach could then be applied consistently to consider other levels or forms of professional scepticism. For example, within the literature on forensic accounting services, APESB has noted the use of the term 'forensic scepticism' to articulate the approach a

professional accountant should use in performing forensic accounting services such as in a lost profits determination⁶.

APESB acknowledges that the decision to rename professional scepticism in the International Standards on Auditing to another term is a matter for the IAASB to determine.

6. Paragraph 19 -

- (a) Do you believe that the Code should retain/use the term “professional scepticism” 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 new definition along the lines described, could you please provide an alternative definition.**

APESB is of the view that the Code should continue to use the term professional scepticism and develop a new definition along the lines proposed in paragraph 19 of the consultation paper subject to the following editorials:

“Approaching professional activities with an impartial and diligent mindset and applying this mindset and relevant professional expertise to the evaluation of information ~~with which they are associated.~~”

In APESB’s suite of Professional Standards, which apply to a range of non-assurance services, the term professional scepticism is included in the definition of Independence. The definition of Independence in these standards has been modified to reflect the parties involved in the providing the relevant professional activities, for example, the Engagement Team.

This modified definition of Independence has been used in APESB’s standards on quality control for firms as well as non-assurance standards on Forensic Accounting, Taxation, Valuation, Compilation and Due Diligence Committees. During the last decade, stakeholders have not raised with APESB any issues in relation to the use of the term professional scepticism within non-assurance services that require independence.

Accordingly, based on APESB’s experience noted above, we support the development of a new definition of professional scepticism to be used in the Code and subject to our editorial comments, we are supportive of the proposed definition included in paragraph 19.

7. Paragraph 20 -

- (a) would you support an alternative term to ‘professional scepticism’, 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 behaviours to be exercised by all professional accountants?**

⁶ Journal of Accountancy, April 2010, Applying Forensic Skepticism to Lost Profits Valuations, James A.DiGabriele, CPA/ABV/CFF,Ph.D., pages 32-37

APESB is of the view that the term Professional Scepticism should be applied to the proposed definition. We are of the view that this term is generally understood by professionals and will instill the required behaviours in the accounting profession.

APESB has considered whether the three alternate terms suggested in the consultation paper could be used as an alternative to professional scepticism. We do not support the use of the terms 'diligent mindset' or 'critical analysis.'

APESB does not believe the term 'diligent mindset' captures the need to apply knowledge and experience to the activity being performed. We are also concerned about the use of the term 'critical analysis.' The word 'analysis' implies a detailed examination of the information, which is not necessarily what the application of professional scepticism requires.

APESB does acknowledge that the use of the term 'critical thinking' could be an alternative to professional scepticism. It captures the need to consider or think objectively and would be enhanced by the use of professional knowledge and experience. The shortcoming with this term is there is no reference to questioning the information you have received or undertaking other activities to develop some confidence in the information. APESB is not convinced that this term conveys the appropriate attitude required by the professional accountant.

Therefore, APESB's preference would be for the term professional scepticism to be used in the Code rather than any of the proposed alternatives. We also do not believe that professional scepticism is limited to the accounting profession. We believe that other professions also apply professional scepticism when exercising professional judgements or forming opinions in their respective professions whether they are medical professionals, lawyers or engineers. In these circumstances, we do not believe that it is appropriate for the auditors within the accounting profession to claim that it only applies in the audit context.

8. Paragraph 21 - Should the IESBA develop additional material, whether in the Code or otherwise, to highlight the importance of exercising the behaviour 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 behavioural characteristics and professional skills.

APESB supports the addition of a new definition of professional scepticism, and accompanying application and requirements material, in the Code. APESB has considered what those changes could be and are of the view that wholesale changes to the Code are unwarranted. It would be sufficient to develop a definition for professional scepticism, rename the existing definition in International Auditing Standards as Auditor scepticism and make editorial changes to the Conceptual Framework in Section 120 of the Code. APESB have considered the potential changes and have provided suggested mark-ups in Appendix B of this submission.

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

APESB acknowledges the IAASB's concerns surrounding the use of the term professional scepticism. However, we note that our primary goal when developing professional and ethical standards is the betterment of the profession as a whole. Therefore, we are of the belief that IAASB's concerns should not inhibit the development of a requirement within the Code to formalise the concept of Professional Scepticism as applicable to all professional accountants.

As noted in our response to question 5 above, the IAASB may wish to consider adopting a more audit-specific term for the current, audit-centric definition of professional scepticism, such as "audit scepticism" or "assurance scepticism."

The profession should also use this change as an opportunity to educate the public, employers, and clients about the financial reporting supply chain and the importance of all accounting professionals using professional scepticism in the production or review of information that can be relied upon.

10. Paragraph 22 - Should the Code include application or other material to increase the awareness of biases, pressure and other impediments to approaching professional activities with an impartial and diligent mindset and exercising appropriate professional scepticism 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.

As noted in question 2 above, APESB is supportive of additional guidance on professional scepticism, especially where it highlights existing requirements in guidance in the Code.

In relation to the specific inclusion of content on bias, pressure and other impediments, APESB notes that the IESBA has included a section in the restructured Code on the pressure to breach the fundamental principles. We are of the view this is a positive step in assisting accountants to recognise and address situations where the pressure is involved.

APESB believes that unconscious bias is a potentially under-recognised threat to the fundamental principle of Objectivity, and we, therefore, support the inclusion of specific application material addressing this threat.

In addition, APESB believes that there is a need to educate professional accountants about these issues. The application of these concepts will not be effectively addressed by only including guidance in the Code. Education is key for the effective implementation of these proposed changes. APESB encourages the IESBA to support IFAC member bodies in the education of professional accountants on the impact of unconscious bias, but also on the importance of the application of professional scepticism to their work.

Appendix B

Extract from the International Code of Ethics for Professional Accountants (including International Independence Standards) – marked up

SECTION 120

THE CONCEPTUAL FRAMEWORK

Paragraphs 120.1 to R 120.4 remains unchanged.

R120.5 When applying the conceptual framework, the professional accountant shall:

- (a)** Exercise professional judgment;
- (b)** apply an appropriate degree of professional scepticism based on the professional activity;
- (c)** Remain alert for new information and to changes in facts and circumstances; and
- (d)** Use the reasonable and informed third party test described in paragraph 120.5 A4.

Exercise of Professional Judgment

120.5 A1 Professional judgment involves the application of relevant training, professional knowledge, skill and experience commensurate with the facts and circumstances, including the nature and scope of the particular professional activities, and the interests and relationships involved. In relation to undertaking professional activities, the exercise of professional judgment is required when the professional accountant applies the conceptual framework in order to make informed decisions about the courses of actions available, and to determine whether such decisions are appropriate in the circumstances.

120.5 A2 An understanding of known facts and circumstances is a prerequisite to the proper application of the conceptual framework. Determining the actions necessary to obtain this understanding and coming to a conclusion about whether the fundamental principles have been complied with also require the exercise of professional judgment with the application of an appropriate degree of professional scepticism depending on the nature of professional activities undertaken.

120.5 A3 In exercising professional judgment to obtain this understanding, the professional accountant might consider, among other matters, whether:

- There is reason to be concerned that potentially relevant information might be missing from the facts and circumstances known to the accountant.
- There is an inconsistency between the known facts and circumstances and the accountant's expectations.
- The accountant's expertise and experience are sufficient to reach a conclusion.
- There is a need to consult with others with relevant expertise or experience.
- The information provides a reasonable basis on which to reach a conclusion.

- The accountant's own preconception or bias might be affecting the accountant's exercise of professional judgment.
- There might be other reasonable conclusions that could be reached from the available information.

Applying Professional Scepticism

120.5 A4 Professional scepticism is approaching professional activities with an impartial and diligent mindset and applying this mindset and relevant professional expertise to the evaluation of information. A professional accountant will apply different levels of professional scepticism depending on the professional activity to be performed. While some professional activities will require a limited degree of professional scepticism, professional activities that require independence such as Assurance Engagements, independent valuation services, insolvency services and certain forensic accounting services will require the application of a higher degree of professional scepticism.

120.5 A4 renumbered to 120.5 A5 and R120.6 to R120.11 remain unchanged.

Considerations for Audits, Reviews, and Other Assurance Engagements

Independence

120.12 A1 Professional accountants in public practice are required by *International Independence Standards* to be independent when performing audits, reviews, or other assurance engagements. Independence is linked to the fundamental principles of objectivity and integrity. It comprises:

- (a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, and exercise objectivity and professional scepticism.
- (b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm's or an audit or assurance team member's integrity, objectivity or professional scepticism has been compromised.

120.12 A2 *International Independence Standards* set out requirements and application material on how to apply the conceptual framework to maintain independence when performing audits, reviews or other assurance engagements. Professional accountants and firms are required to comply with these standards in order to be independent when conducting such engagements. The conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles applies in the same way to compliance with independence requirements. The categories of threats to compliance with the fundamental principles described in paragraph 120.6 A3 are also the categories of threats to compliance with independence requirements.

Professional Audit Scepticism

120.13 A1 Under auditing, review and other assurance standards, including those issued by the IAASB, professional accountants in public practice are required to exercise ~~professional~~ scepticism when planning and performing audits, reviews and other assurance engagements. ~~Professional~~ Scepticism and the fundamental principles that are described in Section 110 are inter-related concepts. In an assurance context, scepticism which is

used by assurance practitioners to identify material misstatements will be referred to as “audit scepticism”

120.13 A2 In an audit of financial statements, compliance with the fundamental principles, individually and collectively, supports the exercise of ~~professional~~ audit scepticism, as shown in the following examples:

- Integrity requires the professional accountant to be straightforward and honest. For example, the accountant complies with the principle of integrity by:
 - (a) Being straightforward and honest when raising concerns about a position taken by a client; and
 - (b) Pursuing inquiries about inconsistent information and seeking further audit evidence to address concerns about statements that might be materially false or misleading in order to make informed decisions about the appropriate course of action in the circumstances.

In doing so, the accountant demonstrates the critical assessment of audit evidence that contributes to the exercise of ~~professional~~ audit scepticism.

- Objectivity requires the professional accountant not to compromise professional or business judgment because of bias, conflict of interest or the undue influence of others. For example, the accountant complies with the principle of objectivity by:
 - (a) Recognizing circumstances or relationships such as familiarity with the client, that might compromise the accountant’s professional or business judgment; and
 - (b) Considering the impact of such circumstances and relationships on the accountant’s judgment when evaluating the sufficiency and appropriateness of audit evidence related to a matter material to the client’s financial statements.

In doing so, the accountant behaves in a manner that contributes to the exercise of ~~professional~~ audit scepticism.

- Professional competence and due care requires the professional accountant to have professional knowledge and skill at the level required to ensure the provision of competent professional service, and to act diligently in accordance with applicable standards, laws and regulations. For example, the accountant complies with the principle of professional competence and due care by:
 - (a) Applying knowledge that is relevant to a particular client’s industry and business activities in order to properly identify risks of material misstatement;
 - (b) Designing and performing appropriate audit procedures; and
 - (c) Applying relevant knowledge when critically assessing whether audit evidence is sufficient and appropriate in the circumstances.

In doing so, the accountant behaves in a manner that contributes to the exercise of ~~professional~~ audit scepticism.