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August 15, 2018

Mr. Ken Siong
Senior Technical Director
International Ethics Standards Board for Accountants
529 Fifth Avenue
New York, New York 10017

Re: Invitation to Comment, Professional Skepticism - Meeting Public Expectations

Dear Mr. Siong:

The Center for Audit Quality (CAQ)¹ appreciates the opportunity to respond to the International Ethics Standards Board for Accountants (IESBA) *Invitation to Comment, Professional Skepticism - Meeting Public Expectations* (Consultation Paper). The CAQ applauds IESBA's outreach to gather stakeholder input on these important topics and encourages the continued pursuit of developing a holistic, global view of audit quality.

The purpose of the Consultation Paper is to seek input on IESBA's consideration of the longer-term professional skepticism topics. We are encouraged by IESBA's focus on professional skepticism as an essential input to audit quality and commend further exploration of the key sections of the Consultation Paper, including:

- a. The behavioral characteristics in professional skepticism
- b. Whether all professional accountants should apply these behavioral characteristics
- c. Whether the Code of Ethics for Professional Accountants² (the Code) should be further developed, and/or other actions outside of the Code undertaken, to address behaviors associated with the exercise of appropriate professional skepticism

¹ [The Center for Audit Quality \(CAQ\)](http://www.thecaq.org) is an autonomous public policy organization dedicated to enhancing investor confidence and public trust in the global capital markets. The CAQ fosters high quality performance by public company auditors; convenes and collaborates with other stakeholders to advance the discussion of critical issues that require action and intervention; and advocates policies and standards that promote public company auditors' objectivity, effectiveness, and responsiveness to dynamic market conditions. Based in Washington, D.C., the CAQ is affiliated with the American Institute of CPAs.

² [The Code of Ethics for Professional Accountants \(the Code\)](http://www.ifac.org) establishes ethical requirements for professional accountants. A member body of International Federation of Accountants (IFAC) or firm may not apply less stringent standards than those stated in

The public company auditing profession is committed to working with other stakeholders to continually improve audit quality and enhance the confidence investors and others place in the integrity of audited financial statements. The CAQ has collaborated with stakeholders to contribute to the development of market-based tools and resources aimed at reinforcing the need for the exercise of skepticism for all members of the financial reporting supply chain, including through the formation of the Anti-Fraud Collaboration.³ Based on this and other work, we focus our comments specifically on our views related to professional skepticism. This letter represents the observations of the CAQ, but not necessarily the views of any specific firm, individual, or CAQ Governing Board member.

The CAQ offers four high-level recommendations related to professional skepticism:

1. Create a better understanding of behavioral characteristics
2. Seek clarity and address ambiguity
3. Use collaboration to promote action
4. Address the expectation gap

Each of these recommendations is discussed in detail below. It is the CAQ's hope that these recommendations can strengthen public confidence and increase the level of trust in the accounting profession as a whole.

1. Create a better understanding of behavioral characteristics

The importance of professional skepticism cannot be understated, especially in light of complexities such as globalization, emerging technologies, and the nuanced intricacies of business and financial reporting. We view drivers of skepticism as a combination of personality traits, learned skills, and incentives.

While the CAQ views a questioning mindset as a starting point for appropriate application of professional skepticism, auditors must also understand that even the best-managed organizations can be susceptible to misstatement due to error or fraud. The appropriate application of professional skepticism requires the auditor to embrace their role as an evaluator and apply critical reasoning throughout the audit of financial statements; it is embedded in the process of developing a supported conclusion, not a biased justification of management's assertion. An auditor's fortitude to challenge management and gather additional audit evidence, including seeking contradictory evidence as needed based on the auditor's risk assessment is an important part of the auditor's appropriate application of professional skepticism.

In a [2016 comment letter](#) to the International Auditing and Assurance Standards Board (IAASB) on this same topic, the CAQ noted that professional skepticism is defined in international auditing standards. The standard⁴ requires "a questioning mind" and a "critical assessment of audit evidence." In our view, to be operational, concepts such as a questioning mind and critical assessment need to be supplemented with clear direction

this Code. However, if a member body or firm is prohibited from complying with certain parts of this Code by law or regulation, they should comply with all other parts of this Code. Some jurisdictions may have requirements and guidance that differs from this Code. Professional accountants should be aware of those differences and comply with the more stringent requirements and guidance unless prohibited by law or regulation.

³ Formed with our partners from Financial Executives International, the National Association of Corporate Directors, and The Institute of Internal Auditors, [the Anti-Fraud Collaboration](#) promotes the deterrence and detection of financial reporting fraud through the development of thought leadership, awareness programs, educational opportunities, and other related resources specifically targeted to the unique roles and responsibilities of the primary participants in the financial reporting supply chain.

⁴IAASB, *Handbook of International Quality Control, Auditing Review, Other Assurance and Related Services Pronouncements*, Edition Volume I (2013).

and practical application. Examples—including what behaviors, actions, and documentation constitute appropriate professional skepticism in executing an auditor’s responsibility to obtain sufficient appropriate audit evidence across a range of risk scenarios for different assertions and accounts—are essential.

All members of the financial reporting supply chain have an obligation to exercise skepticism, to ask questions, and to not take things at face value. The CAQ recommends that IESBA take a deeper look into the biases that are associated with professional skepticism. Understanding these behavioral characteristics is key to unlocking the traits and characteristics of auditors and other accountants. Biases that should be looked at more thoroughly include (but are not limited to):

- **Confirmation bias:** A bias that suggests we don’t perceive circumstances objectively. We pick out those bits of data that make us feel good because they confirm our prejudices.⁵
- **Anchoring bias:** During normal decision making, individuals anchor, or overly rely on, specific information or a specific value and then adjust to that value to account for other elements of the circumstance. Usually once the anchor is set, there is a bias toward that value.
- **Overconfidence bias:** A bias in which a person’s subjective confidence in his or her judgments is reliably greater than the objective accuracy of those judgments, especially when confidence is relatively high.⁶
- **Groupthink bias:** This bias occurs when a group with a particular agenda makes irrational or problematic decisions because its members value harmony and coherence over accurate analysis and critical evaluation.⁷
- **Availability bias:** The availability bias includes a tendency to consider information that is more readily available from memory that as more likely, relevant, and more important. It limits alternatives for consideration.

Enhancing the understanding of these biases specifically, and characteristics of professional skepticism more broadly, will help not only auditors but also audit committees serve the public interest. Armed with this understanding, audit committees will be well positioned to ask vigorous and probing questions of management and auditors, both to test the integrity of management and to communicate a clear expectation of ethical behavior. Effective audit committees know when to drill down with follow-up questions, are familiar with potential “red flags,” and understand how to identify and assess possible nonverbal cues.

2. Seek clarity and address ambiguity

The Consultation Paper notes that professional skepticism “in many respects, has become a ‘catch all’ term that is used inconsistently...” Both international and domestic auditing standards stress the importance of a critical and questioning mind that can deliver a critical assessment of audit evidence, but the ambiguity and varied interpretation surrounding professional skepticism can cause inconsistency and confusion.⁸

Professional skepticism, by design, is rooted in the fundamental principle of objectivity. Yet some academic observers note that the absence of clear direction and practical application guidance on what behaviors and actions constitute appropriate professional skepticism leads to varied practices by auditors and an

⁵ See [Science Daily](#)- Confirmation and anchoring bias.

⁶ See [Ethics Unwrapped](#)- Overconfidence bias.

⁷ See [Psychology Today](#)- Groupthink bias.

⁸ Steven M. Glover and Douglas F. Prawitt, “[Enhancing Auditor Professional Skepticism](#)” (Nov. 2013), p. 3.

environment in which “reasonable observers, professionals, and regulators might understandably disagree.”⁹ Addressing the ambiguity may provide sufficient information to encourage all professional accountants, as well as other members of the financial reporting supply chain to exercise an appropriate level of skepticism.

According to a 2014 article in [Current Issues in Auditing](#), inspection reports from regulators around the world often express concern with the application of professional skepticism. However, in order to enact measures to improve skepticism, there must be a better understanding of the concepts that underlie it and the factors at different structural levels that influence it. Recommendations that overlook important concepts and influences on professional skepticism may not yield incremental improvement in audit or financial reporting quality.¹⁰

The CAQ believes that, as a first step, IESBA could provide supplemental guidance that would promote greater consistency and more effective application of professional skepticism and would reinforce its importance to audit quality across the audit profession. While it is not our goal to redefine professional skepticism, it would be helpful for IESBA to assess in more detail those impactful words and phrases that can be interpreted differently, such as diligence, due care, skepticism and impartiality in their standards. We also believe that greater clarity would contribute to more consistency in expectations on how far an auditor needs to go in collecting, assessing, and documenting evidence to demonstrate the skeptical mindset and critical challenge of management’s assertions.

3. Collaborate to promote professional skepticism

Given the importance of the appropriate application of professional skepticism and judgment to audit quality, the public company auditing profession has been proactive in identifying potential enhancements to improve audit quality, including the foundational elements of independence, objectivity, and professional skepticism. To support this effort, the CAQ has worked with members of the financial reporting supply chain to develop tools, research, and other materials to support an audit environment that promotes and reinforces skepticism. A description of some of those activities are included in the Appendix. The CAQ recommends that IESBA consider these as references as they determine how best to move forward in enhancing skepticism.

4. Address the expectation gap

Regulators and other stakeholders may have expectations about the level of skepticism auditors should apply in evaluating management assertions that are different from the expectations one might interpret from auditing standards. For example, independent audit regulators identify a number of root causes related to a lack of professional skepticism in their inspection findings, but it is unclear whether the findings can be attributed to deficiencies in connection with professional judgment, action, or documentation.¹¹

The CAQ recommends that IESBA provide application guidance that goes through due process to auditors that includes examples that illustrate their expectations regarding (1) the appropriate application of professional skepticism in assessing audit risks in certain areas and (2) how to reflect that application in documentation.¹²

⁹ Steven M. Glover and Douglas F. Prawitt, “[Enhancing Auditor Professional Skepticism](#) (Nov. 2013), p. 3.

¹⁰ Steven M. Glover and Douglas F. Prawitt, “[Enhancing Auditor Professional Skepticism](#) (Nov. 2013), p. 5, M.W. Nelson, “A model and literature review of professional skepticism in auditing,” *Auditing: A Journal of Practice & Theory* 29 2: 1-34.

¹¹ See IAASB, [Staff Questions and Answers: Professional Skepticism in an Audit of Financial Statements](#) (2012), p. 9, which cites certain paragraphs regarding required procedures addressing the review of biases (par. 32(b)).

¹² See International Forum of Independent Audit Regulators, [Report on 2015 Survey of Inspection Findings](#) (Mar. 2016), p. 23.

The CAQ supports the role IESBA can play in enhancing audit quality and public interest, and commends the IESBA for taking a multi-stakeholder approach to gathering input on professional skepticism. We welcome the opportunity to further discuss this important topic.

Sincerely,

A handwritten signature in black ink, reading "Cynthia M. Fornelli". The signature is fluid and cursive, with the first name "Cynthia" being more prominent than the last name "Fornelli".

Cynthia M. Fornelli
Executive Director
Center for Audit Quality

Appendix: CAQ Collaborative Tools and Research

- [Anti-Fraud Collaboration \(AFC\)](#). Through this collaboration—in which the CAQ participates with Financial Executives International, the National Association of Corporate Directors, and The Institute of Internal Auditors—tools and information are being developed to increase collaboration and communication among members of the “financial reporting supply chain” to help advance efforts to lessen fraud risk.
- [*The Fraud-Resistant Organization: Tools, Traits, and Techniques to Deter and Detect Financial Reporting Fraud*](#). The AFC drew on a wealth of research to provide valuable information about the conditions that might make an organization more susceptible to fraud—and how to mitigate those conditions. The report identifies three central themes that are critical to fraud deterrence and detection—strong tone at the top, skepticism, and robust communications—and explains how financial reporting supply chain participants can incorporate these important traits into their efforts and their organizations.
- [Audit Committee Collaboration \(ACC\)](#). This collaboration is a partnership of leading corporate governance and policy organizations that work together to expand audit committee member access to useful tools and materials with the goal of strengthening audit committee performance and transparency.
- [External Auditor Assessment Tool](#). The ACC designed this tool to assist audit committees, or their counterparts, in evaluating the external auditor to assess the quality of the audit, or select or recommend the retention of the audit firm. It is available in versions for US audit committees and audit committees worldwide.
- [Professional Judgment Resource](#). This resource is designed to provide auditors with an example of a decision-making process to facilitate important auditing and accounting judgments in a professionally skeptical manner. It outlines an example of a decision-making process grounded in essential actions that include identifying and defining the issue, and reviewing and completing the documentation and rationale for the conclusion. The resource also identifies several of the more common judgment tendencies and traps that can potentially lead to bias and weaken professional skepticism, and includes illustrative examples of these tendencies, as well as strategies to avoid them.