

## Professional judgment in the IESBA Code of Ethics

Professor Sir Andrew Likierman, London Business School

### *Inquiring Mind*

#### **5. Do you agree with the concept of an inquiring mind as set out in the proposals in Section 120?**

The Board has been admirably transparent in the way it has sought to widen the concept of professional skepticism through one of an “inquiring mind”. However:

- The concept is so general that it is unclear why it should apply only to accountants, or indeed only to professionals. An inquiring mind is desirable for virtually any skilled occupation. It is very low bar for professional accountants, and not one that will convince even the milder critics of the profession.
- The characteristics of an inquiring mind are subject to a wide range of interpretations. The only way to make it meaningful and workable in the context of accountancy is to make clear what constitutes an inquiring mind, and that there are criteria that can be taught, measured and monitored. For an inquiring mind it is unlikely that such tests can be found. Without a definition and tests for the criteria, the concept is destined to be confusing for those in the profession and meaningless for those outside it.

The underlying issue is that the Board has been asked to solve an insoluble problem – to turn the concept of professional skepticism based on the application of rules and requirements to one with a general application that is context-specific. The problem can be addressed through using a concept that already forms part of the professional and ethical framework – that of professional judgment.

#### The case for using “professional judgment”

Professional judgment is defined in 120. 5.A1 as “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". The importance of professional judgment is illustrated by 48 references to it in the Ethics Code, with another 6 to "business or professional judgment" and more to judgment alone.

The above definition does not currently include any of the personal qualities that are central to the Board's focus in this consultation on the importance of behavioural aspects through applying Psychology and Behavioural Economics. Considering the central role of professional judgment, not only in ethics, but in every aspect of accountancy, this omission is surprising. So too is the absence of a framework which would enable the profession to train, measure and monitor professional judgment, putting it where it belongs - at the heart of professional practice.

A framework based on the wider application of judgment, to encompass the concept of an inquiring mind, is set out below. It has been devised following discussions with a range of people in all walks of life and in different countries. The application to professional judgment has followed discussions not only in accountancy, but with those in other professions. It is intended to provide a practical basis for firms to measure and monitor professional judgment, and where necessary demonstrate to others than they have done so.

The framework is only an outline. Recognising the practical difficulties of revising the existing definition of professional judgment, this could be considered as the basis for application guidance within the Code itself, or as implementation guidance outside the Code. I would be happy to support the Board on how the framework would work in practice and a more detailed exposition for judgment more generally will appear in the Harvard Business Review in January.

### A proposed framework

I would suggest that professional judgment is "The combination of personal qualities, relevant knowledge and experience with professional standards to form opinions and make decisions". Recognising the sensitivity of departing from the existing definition, the words "personal qualities" could be added to it. This would be compatible with the variations of the definition which already exist, such as those in the context of ISAE 3000 and CSRE 2000. Whatever the definition, judgment needs to incorporate 6 elements:

(i). What I take in

Professionals spend a great deal of time absorbing information through answers to questions, in and discussion and from written material. The quality of understanding is an important first step to form a professional judgment, including being aware of personal filters. Understanding does not necessarily improve with seniority and knowledge. Impatience, overconfidence or increasing rigidity of approach may reduce the quality of what is taken in.

(ii). Who and what I trust

This is essential to the quality of professional judgment, the more so as the use of the internet, including social media, has become pervasive. Problems often start with misplaced trust in people or data. Examples of the importance of trust are in judging the quality of data submitted for a financial plan or the professional competence of a member of the team.

(iii). What I know about this

Rich professional experience is a great source of value to professional firms and a source of pride to seasoned professionals. But even combined with knowledge, it is not enough. Professional judgment is about putting both in the context of taking a view or making a decision. The quality of this judgment will be the way in which relevant experience and knowledge can be brought to bear in a given situation, such as a cash management problem or the interpretation of variances from budget. It also means knowing one's limitations and seeking advice where necessary.

(iv). How I feel about this

Good professional judgment implies that the professional will be able to be dispassionate. But work in Psychology and Behavioural Economics has demonstrated that this cannot be taken for granted. The professional will need to be aware of, and address, his or her own biases, not least the balance between personal risk aversion and commercial uncertainty.

(v). How I choose

The combination of experience, knowledge and personal qualities comes together to formulate choices as much in day-by-day financial management as such contentious areas

as the treatment of goodwill or the choice of transfer prices. Professional judgment will be demonstrated in many ways, such as applying decision analysis techniques while recognising common biases. It means ensuring that choices, including timing and incorporating risk, have been appropriately framed, and differentiate between judgments that do not involve estimation uncertainty and those that do.

(vi). How I carry it out

The professional providing an opinion or carrying through a recommendation to a decision will need to demonstrate professional judgment on turning plans into reality, as well as being able to assess those making a recommendation on implementation. An example would be an assessment of risks in the trade-off between speed and cost in the probability of an IT project being completed on time.

An inquiring mind is required throughout this framework, but especially in (i), (ii), (iv) and (v).

With clarity on professional judgment, the need for a distinction with inquiring mind in 120.5 is unnecessary. This approach also accords with the proposed revision to IES 4, which states in paragraph 9: "IFAC member bodies shall provide, through professional accounting education programmes, a framework of professional values, ethics and attitudes for aspiring professional accountants to (a) exercise professional judgment...."

## ***Bias***

6. Do you support the approach to addressing bias? If so, do you agree with the list of examples of bias set out in paragraph 120.12 A2? Should any examples be omitted or new ones added?

The increased emphasis on identifying and countering bias is welcome. It would be better, nonetheless, to reconsider para 120.12.A2. Anchoring, availability, confirmation and representation biases, as well as Groupthink and overconfidence are well established in the Psychology literature. Automation and selective perception appear to stretch the category. A definition of a bias would be welcome to help readers unfamiliar with the literature to understand and mark the boundary of what constitutes a bias.

In terms of what is included in the text, rather than include what is inevitably partial and potentially contentious list of biases, it would be better to cut the paragraph to mention two or three and refer readers to the considerable literature for more information.

Whatever else is changed, 120.12.A3 needs to include the importance of self-awareness, since paragraph 120.12.A1 refers only to the need to be aware in general terms of the risk of biases, not that the individual should be aware that he or she is prone to them. And in 120.5.A4, the list of circumstances requiring further investigation is preceded by the words "might consider, among other matters". Such a relaxed approach is hardly appropriate to what is supposedly a cornerstone of professional practice and merits more robust endorsement.

### ***Summary of recommendations***

- Give professional judgment a clearer role as the basis of professional practice (to include an agreed definition) incorporating personal qualities and a framework for training, measurement and monitoring
- Provide greater clarity on what biases are, the need to be aware of them and guidance about them, rather than an inevitably incomplete list.

*October 2019*