

15 August 2018

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Submission via [www.ifac.org](http://www.ifac.org)

Dear Ken

## Submission on Consultation Paper: Professional Scepticism – Meeting Public Expectations

We welcome the opportunity to provide feedback on the Consultation Paper (“the CP”). We support a holistic approach to this important topic, therefore we commend the three boards (IESBA, IAASB and IAESB) for their commitment to working collaboratively on this project.

We are grateful to the IESBA for holding a roundtable event in Melbourne Australia and for the invitation to attend. The discussion around professional scepticism was very productive. There was a general consensus between stakeholders at that event that, whatever the outcome, the *International Code of Ethics for Professional Accountants (including International Independence Standards)* (“the Code”) should remain principles-based.

Another pertinent point arising from the roundtable is that it is unclear from the CP what the perceived problem is that the IESBA is attempting to address; shortcomings in the Code itself, deficiencies in the application of the Code, the expectation gap or some combination of these.

In our view it is important that the IESBA adopts an evidence-based approach to determine the extent of which the perceived problems can be attributed to specific shortcomings of the Code. Therefore we question what research has been done in this area. We caution that making changes to the Code alone will not address problems associated with unrealistic and impractical public expectations.

The expectations of the public exist without necessarily understanding the role of a professional accountant. Therefore we feel that the management of public expectations needs to be an integral part of this project. To retain trust in the profession and serve the public interest, we consider that more could be done through public education to close the expectation gap.

Professional scepticism is developed through learning and experience. Therefore changes to the Code alone are unlikely to achieve the desired outcomes. Stakeholders such as universities and firms must all perform a role in providing education and training for professional accountants.

Appendix A provides our responses to the specific questions raised in the CP. Appendix B provides information about Chartered Accountants Australia and New Zealand. If you have any questions about our submission, please contact Ceri-Ann Ross, Reporting and Assurance Leader, at Ceri-Ann.Ross@charteredaccountantsanz.com.

Yours sincerely



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## Appendix A: Responses to specific questions

### 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 do not agree with this premise because the fundamental principle of integrity in the Code requires the following:

*“A professional accountant shall not be knowingly be associated with reports, returns, communications or other information where the accountant believes that the information:*

- a) Contains a materially false or misleading statement;*
- b) Contains statements or information provided recklessly; or*
- c) Omits or obscures required information where such omission or obscurity would be misleading”* (paragraph R111.2).

On this basis involvement of a professional accountant should engender trust and bring credibility to the information with which they are associated. But the extent to which the public may ‘rely’ on it depends on the nature of the work the professional accountant has been engaged to do. The public often does not have regard to the inherent limitations of the engagement undertaken and hence their expectations around reliance are unreasonable.

Regardless of the involvement of a professional accountant, those charged with governance of an entity are still responsible for such information and must be held accountable. In our view the key factor affecting public trust in the profession is due to this expectation gap.

Another contributing factor adversely affecting public trust in the profession may be that the term ‘accountant’ has no legal definition in many countries – anyone can hold themselves out to be an accountant. Those who are not professional accountants are not subject to the Code or any technical and professional standards in the conduct of their work. This important distinction is often overlooked or not understood.

### Question 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?

Paragraph 7 appears to better capture ‘behaviours’ that could be expected of a professional accountant. This is then condensed down to paragraph 10 which focuses on what could be expected in terms of the mindset of a professional accountant.

### Question 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?

We support the statement in paragraph 10 that *“whether it is appropriate to expect all professional accountants to apply all or any of the characteristics and actions identified in paragraph 7 depends upon the nature and context of the work being undertaken and the particular role or position of the professional accountant”*. This sentiment should be extended to the mindset described in paragraph 10.

All stakeholders in the financial reporting supply chain should be held to the same account. By way of example; financial statement auditors should not be judged against more stringent requirements than financial statement preparers. But although the underlying concept is the same, certain characteristics and actions may manifest in different ways depending on the factors in paragraph 14. These factors clearly demonstrate the need for scalability with this concept.

**Question 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?”**

We believe the behaviours in paragraph 7 and mindset in paragraph 10 are already implicit in the Code. Application of the fundamental principles of objectivity and professional competence and due care should reasonably be expected to result in a demonstration of the described characteristics and actions. This is consistent with the IESBA's recognition in paragraph 16 that *“the expected behaviour of all professional accountants may correlate to or be components of one or more of the Code's existing fundamental principles.”*

In relation to assurance engagements, there is already additional application material to support the behaviours associated with the exercise of appropriate professional scepticism. Paragraph 120.13 A1 of the Code notes that professional scepticism and the fundamental principles are inter-related concepts. Furthermore, paragraph 120.13 A2 of the Code highlights the fundamental principles that contribute most to professional scepticism; integrity, objectivity and professional competence and due care, and how it can be demonstrated. Of particular relevance is:

*“Integrity – pursuing enquiries 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.”*

However, there is no application guidance for non-assurance engagements on how professional accountants would demonstrate the same underlying concept, or how it links to the fundamental principles. This is an area we recommend application material be developed.

In addition we wish to comment on the proposition in paragraph 16(b) that *“the existence of these expectation gaps suggests that ... professional accountants do not properly understand or adhere to the Code”*. This is unfounded and illogical. What it does indicate is that the public does not understand the Code, but that is not unreasonable given it is not produced for the public to use directly. The Code is for professional accountants to enable them to act in the public interest.

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

We do not support the extension of the term ‘professional scepticism’ to non-assurance engagements. In July 2017, we issued a joint response with the ACCA to the IESBA exposure draft on the proposed application material relating to professional scepticism and professional judgement. We reiterate our comments that simply extending the concept of professional scepticism as applied in assurance engagements to all areas of a professional accountant’s work would, at best, threaten clarity of the Code. We also believe that it would undermine the value of the concept for assurance practitioners.

There is no doubt that professional scepticism is also important for certain non-assurance engagements. However, the term has different meanings in different contexts and the extent of challenge varies depending on the nature of the engagement. In the context of an assurance engagement, professional scepticism requires active challenge (“a critical assessment”). However, for some other engagements, a professional accountant is only required to challenge information provided by a client or employer when they have cause to doubt the integrity of that information.

**Question 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 definition along the lines described, could you please provide an alternative definition?

The Code should retain the term ‘professional scepticism’, as currently defined in the International Standards on Auditing (ISAs), but only in the context of assurance engagements. As mentioned above in our response to question 5, we do not support the use of the term ‘professional scepticism’ for non-assurance engagements. That includes both the extension of the current definition to non-assurance engagements, and the development of a new definition so that it applies to all professional accountants. This would dilute the meaning of the term for assurance engagements, and it is unclear how a single definition could be scalable to all types of professional activity.

**Question 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 behaviors to be exercised by all professional accountants?

We are not convinced that there is a need for a ‘new’ defined term for the mindset and behaviours to be exercised by all professional accountants in this regard. The behaviours in paragraph 7 appear to focus on how to apply professional judgement. We question whether the term and definition is already encapsulated by ‘professional judgement’ in paragraphs 120.5 A1-A3 of the Code. In particular:

*“In exercising professional judgement to obtain this understanding, the professional accountant might consider, among other matter, whether:*

- *There is a 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 expectation”* (paragraph 120.5 A3).

The mindset in paragraph 10, if made a requirement of the Code, would be challenging to enforce as it may or may not result in observable behaviours. Drafting must have regard to enforceability of the Code.

**Question 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 skills as described? If yes, please suggest the type of application material that in your view would be most meaningful to enhance the understanding of these behavioural characteristics and professional skills.**

We do not believe that any new requirements or concepts are necessary in the Code. Therefore, of all the four options, this is the option we support the most. As mentioned in our response to question 4, we believe the behaviours in paragraph 7 and mindset in paragraph 10 are already implicit in the Code. However, there may be benefit in making these explicit by way of application material.

The fundamental principle of professional competence and due care requires an accountant to: “*act diligently in accordance with applicable technical and professional standards*” (paragraph R113.1(b)). Assurance practitioners are required to comply with the applicable assurance standards which ensure a consistent approach to such work. However, for some other professional activities there are no such technical and professional standards to describe the work effort that is expected of a professional accountant, for example professional accountants in business, and for tax and business advisory engagements.

This also ties into our response to question 4, that application material on how the behaviours in paragraph 7 and mindset in paragraph 10 link to the fundamental principles for non-assurance engagements and how they can be demonstrated (ie the work effort expected) would be useful and well received.

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

*Option 1 – require all professional accountants to exercise professional scepticism as defined in the ISAs.* We reiterate our response to question 5; we do not support the extension of the term ‘professional scepticism’ to non-assurance engagements. Professional scepticism is defined in the ISAs as “*an attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence*”. The definition is audit-specific and sets out an expected level of work effort, therefore this option is not viable. Whilst unlikely to impact on the ISAs, it would impact the conduct of other professional activities. We agree with the disadvantages laid out in the CP, and believe these far outweigh the potential advantage of using a well-established term and definition.

*Option 2 – require all professional accountants to exercise professional scepticism but develop a different definition.*

With reference to our response to question 6 – we do not support redefining the term ‘professional scepticism’ so that it can apply to all professional accountants. In our view this option would have the greatest impact on the ISAs as it would require the definition of ‘professional scepticism’ to be amended. In turn, additional guidance may be required to avoid reducing the robustness of the current definition. Again, we agree with the disadvantages laid out in the CP, and believe these far outweigh the potential advantage of using a well-established term.

*Option 3 – develop a different term and definition of behaviour expected of all professional accountants.*

As per our response to question 7, we do not support the development of a ‘new’ defined term that is applicable to all professional accountants. This option may impact on the ISAs because assurance practitioners would have to exercise appropriate professional scepticism as well as the new concept. Additional guidance may be required to explain how these two concepts are inter-related.

*Option 4 – develop additional application material.*

As mentioned in our response to question 8 – this is the option we support the most. This option is unlikely to impact on the ISAs.

From paragraph 16 the concern still appears to centre on assurance engagements. An area of the audit that requires the exercise of greater professional scepticism relative to other areas is accounting estimates. Therefore we recommend that ISA 540 (Revised) *Auditing Accounting Estimates and Related Disclosures* be implemented first to see if this addresses the concerns expressed about the exercise of professional scepticism in the course of audit engagements.

**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 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 to understand how bias, pressure and other impediments might influence their work.**

As previously mentioned, we support additional application material that links the required characteristics and actions to the fundamental principles for non-assurance engagements so that the expected level of work effort is clear. Such application material should include how bias, pressure and other impediments might inhibit this, using the threats and safeguards approach.

## Appendix B: About Chartered Accountants Australia and New Zealand

Chartered Accountants Australia and New Zealand is a professional body comprised of over 117,000 diverse, talented and financially astute members who utilise their skills every day to make a difference for businesses the world over.

Members are known for their professional integrity, principled judgment, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations.

We focus on the education and lifelong learning of our members, and engage in advocacy and thought leadership in areas of public interest that impact the economy and domestic and international markets.

We are a member of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance and Chartered Accountants Worldwide which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

We also have a strategic alliance with the Association of Chartered Certified Accountants. The alliance represents 788,000 current and next generation accounting professionals across 181 countries and is one of the largest accounting alliances in the world providing the full range of accounting qualifications to students and business.