

Ken Siong  
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International Ethics Standards Board for Accountants  
529 Fifth Avenue  
New York 10017  
USA

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Dear Ken,

### **Professional Scepticism – Meeting Public Expectations**

The UK Financial Reporting Council (FRC) welcomes the opportunity to respond to IESBA's consultation on Professional Scepticism – Meeting Public Expectations. As the UK's Competent Authority for Audit, our mandate includes: the setting of auditing, assurance and ethical standards; inspection of public interest entity audits and enforcement action against auditors. We also oversee the accountancy profession in regulation of its members and take public interest misconduct cases where conduct falls below expected standards (e.g. where practitioners fail to comply with the fundamental principles and requirements set out in the Code of Ethics). The FRC also is responsible for setting the UK Corporate Governance Code and its associated guidance.

We share IESBA's views regarding the importance of considering further the steps that need to be taken better to embed the application of professional scepticism in the work of professional accountants, and in particular auditors. We also think it is important to consider further how the application of professional scepticism is evidenced in the work of both. In the UK, our recently published reports on audit quality<sup>1</sup> made clear the need for auditors to urgently address a number of factors vital for high quality audit, including the level of challenge (of management) and scepticism. Recently, parliamentary committees have carried out enquiries into some high profile corporate failures in the UK and concluded that auditors have not been sufficiently challenging and sceptical in dealing with management. Audit may not be meeting the needs of users. The enquiries also raised issues about the need for preparers to be subject to similar high expectations in preparing information for users.

Given the importance of professional scepticism, and our view that the term is widely used to portray both thought and action, we strongly advise against focusing IESBA's work on whether or not "professional scepticism" or some alternative term is the right one to use. Whilst we agree that although as a term, professional scepticism may have its limitations, it is a long standing, widely-recognised term, the implications of which are understood not just by those professionals working in accountancy and audit, but also by those who rely on those services (and as acknowledged in the paper clearly articulated in International Standards on Auditing). The issue continues to be how to best apply it, which this consultation does not address.

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<sup>1</sup> <https://www.frc.org.uk/news/june-2018/big-four-audit-quality-review-results-decline>

We would prefer to see IESBA leading a global debate to focus on what actions, key characteristics and behaviours are required on the part of a practitioner to ensure the application of appropriate professional scepticism in a way that will meet the expectations of users of information. In applying those actions, characteristics and behaviours, how should they be clearly and unambiguously evidenced so that regulators, including professional bodies and independent audit regulators like the FRC, can satisfy themselves that ethical and behavioural considerations have been at the forefront of the mind, and have driven the actions and work of those individuals.

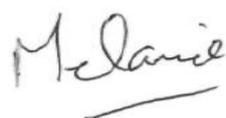
We also have a concern that in seeking to assess whether appropriate professional scepticism has been applied, increasingly, the focus in making that assessment is being distracted by training packages which rely heavily on a quantitative rather than qualitative assessment. We do not endorse or support such an approach and would suggest that IESBA is ideally placed to engage in a debate about the best way in which this assessment can be carried out.

Whilst we agree it may be helpful to continue the debate about the behaviours and actions required of professional accountants and auditors, which were considered by IESBA's Professional Scepticism Working Group, we already do know a lot about what is needed to best meet the expectations of users, namely: high quality, robust and reliable financial information to use for making decisions on capital allocation and investment, and for demonstrating financial stability and regulatory compliance in the public interest. This requires the consistent application of both technical skills and behavioural competencies and given IESBA's limited resources we believe that should be the focus of that. The fundamental principles articulated in the Code offer a sound platform for this assessment, and it may be that this could be better supported by additional application material. However, it would, in our view be unhelpful to invest time and effort in the suggestion that professional accountants do not properly understand or adhere to the Code – failure to do so can be addressed through regulatory enforcement by IFIAR members.

Our responses to the detailed consultation questions are in the Appendix to this letter.

If you wish to discuss this response further, please contact Mark Babington, Deputy Director of Audit Policy on [m.babington@frc.org.uk](mailto:m.babington@frc.org.uk) or on +44-20-7492-2323.

Yours sincerely



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## Appendix

**Question 1:** 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 on for its intended use?

We agree with the basic premise that information prepared by a professional accountant should be something that can be relied upon for its intended use and should have been prepared with due skill and care to meet the needs of those that it has been prepared for. In our work setting technical actuarial standards we set a similar reliability objective.

**Question 2:** 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?

Our experience is that public expectations would also need to include ‘challenging’ information where appropriate, as we believe that there is a strong demand to be able to demonstrate that a professional accountant has undertaken steps to satisfy themselves as to the veracity of the underlying information they are drawing on in preparing material which may be used to support decision making. We also believe that this requires the professional accountant to acquire or develop a sound understanding of the needs of users and the purposes for which the material will be used. In carrying out their role, the practitioner should also be able to demonstrate how the way in which they have delivered work satisfies the Code’s fundamental principles. This should lead a practitioner to a position where they can demonstrate how their work includes sufficient work effort and analysis, that an objective, reasonable and informed third party would share that conclusion

Users want information to be reliable, consistent and comparable – the parallel in terms of mindset and approach for the professional accountant should be that required when giving sworn testimony in a legal case: ‘the truth, the whole truth and nothing but the truth’. Judgment should be exercised in a way that does not allow unnecessary detail to get in the way of making a clear and unambiguous assessment.

**Question 3:** Do you agree that the mindset and behaviour described in paragraph 10 should be expected of all professional accountants?

We agree that the expectation of public stakeholders is likely to be that all professional accountants should adhere to a common and high standard in terms of the mindset and behaviour that they apply in their work. However, we would make two observations in that respect:

- Any assessment by a public stakeholder of matters like mindset, behaviour and judgment will be by reference to the circumstances in which that assessment is made. We can foresee that situations may exist in which the reference point from which the assessment made may not be conducive to the application of a single mindset and behaviour. This re-emphasises the point made in our covering letter – namely that professional scepticism needs to be driven by a series of behavioural competencies, and that its application and evidencing is of fundamental importance; and
- IESBA should explicitly recognise that there are fundamental behavioural differences between preparers of information and auditors of that information. For auditors, the

application of a single mindset and behaviour is unlikely to be sufficiently aspirational to meet the needs of the users of *their* work, and the proposal may just result in a lowest common denominator approach without sufficiently considering users' needs.

**Question 4:** Do you believe that 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 FRC is strongly supportive of a principles-based approach to standard setting, and it would be good to be able to say that the fundamental principles alone are sufficient to drive the behaviours necessary to exercise appropriate professional scepticism. However, we agree with IESBA's assessment and our own investigation and enforcement work shows that this is not consistently the case, and in discussion with stakeholders, one of the greatest challenges is how professional accountants, and in particular auditors consistently evidence how they have demonstrated appropriate professional scepticism.

To address this, we recommend that IESBA:

- Explicitly recognise that although one objective of this project may be to set behaviours required of all professional accountants, the different role that professional accountants undertake mean that in practice different behaviours will be required to meet the objectives of an engagement and the needs of the users of any outputs from that engagement;
- Set out the behavioural characteristics that it considers necessary to demonstrate appropriate professional scepticism and close the expectation gaps that may exist among users of information prepared by professional accountants and also that subject to audit; and
- Set out clearly ways in which professional accountants of all types should seek to evidence how they have applied appropriate professional scepticism in undertaking their work.

**Question 5:** Do you believe that professional scepticism, as defined in the International Standards on Auditing, would be an appropriate term to use?

We believe that the definition as used in the ISAs is a good starting place, as it is a commonly used and well understood term, both among professional accountants and wider stakeholders. However, IESBA could usefully expand and strengthen the definition to make more explicit the user expectation that there has been a robust challenge of management/ the provider of information that the professional accountant has to work with (and in so doing how they have met the requirements set by the fundamental principles for any engagement). Increasingly, our experience is that users also need to have an understanding and appreciation of the parameters that a professional accountant may have applied in exercising professional scepticism, as these parameters are important factors in maintaining user confidence in the work of the professional accountant.

In view of the proposal, it would be helpful if IESBA would set out how, in taking this work forward, it will co-ordinate with the IAASB. It is not helpful to have the same term used in different ways in different standards, and also not helpful for work to address this to not be aligned. We would welcome a clear, well-co-ordinated and well aligned proposal to overcome this. If IESBA reaches a position where the mind-sets and behaviours it is seeking to focus on and address are, in fact, broader, than would generally be understood by the term 'professional

scepticism', then it could consider whether better clarity could be achieved by the use of other terms in place of, or as well as, professional scepticism.

**Question 6:** (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.

We support retaining the term “professional scepticism” for mind-sets and (in particular) behaviours that can be agreed as within its scope, as a well understood term with wide awareness. We have set out in our covering letter our concern that focusing on the definition at this stage is a distraction from addressing the real need here – namely a better articulation of the behaviours/ competencies necessary to consistently apply robust professional scepticism, and also to ensure that professional accountants are able to evidence that in a consistent way that underpins user confidence among those who rely on the information that is produced. Our response to question 5, sets out how this could be done in conjunction with the IAASB.

**Question 7:** (a) Would you support an alternative term to “professional scepticism”, such as “critical thinking”, “critical analysis” or “diligent mindset”?

We have addressed this in our covering letter and in our response to questions 5 and 6. For emphasis, the important issue from our perspective is to develop material that will assist in the consistent application of a high level of robust professional scepticism, by identifying those behaviours and mindset which will allow a professional accountant to demonstrate it, rather than focusing on a definition at this stage. For the record, we believe the terms proposed in the consultation paper are all too passive and do not focus on the actions required of practitioners.

We think that it would be helpful to bear in mind that in an audit context, the ISAs reinforce the fact that audit should be informed by a user perspective, and in the same way the necessary behaviours and mindset for a professional accountant should be informed by the user perspective for the engagement being undertaken.

**Question 8:** 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 describe the type of application material that would be most meaningful to enhance the understanding of those behavioural characteristics and professional skills?

We are supportive of IESBA’s proposal to develop application material and think that this will be helpful in supporting the application of the fundamental principles and appropriate professional scepticism. This could usefully include three elements:

- As IESBA proposes, a non-exhaustive list of behaviours and examples including those set out in paragraph 21 of the consultation paper, written in a way that encourages the professional accountant to be aspirational in the way in which those behaviours are applied, rather than just seeking to comply with a requirement;
- Setting out a process to assess professional scepticism in the context of an engagement, which includes considering whether an objective, reasonable and informed third party would be able to conclude that appropriate professional

scepticism has been applied in carrying out an engagement. If the conclusion would be that appropriate professional scepticism had not been applied, then the proposed approach developed by the professional accountant would need to be revised; and

- Setting out how best to evidence that appropriate professional scepticism has been applied in the context of an engagement.

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

The options in paragraphs 18-21 only demonstrate the importance on any work on professional scepticism being properly aligned and co-ordinated between IESBA and the IAASB. Given that the IAASB's strategy survey makes clear that the Board does not have the capacity or resources to undertake additional projects until 2020, it may well be unhelpful for IESBA to proceed with work in this space unless effective co-ordination arrangements have been put in place.

The Monitoring Group's consultation on standard setting reform has emphasised the importance of better co-ordination in standard setting, and many of the respondents to that consultation agreed strongly with that. We believe that it is very important that IESBA reflects this in any project that is taken forward, and the recommendations we have raised in our response about what we consider to be the priorities for any project on professional scepticism would in part mitigate this by reducing the risk of a further misalignment between the Code and the ISAs.

**Question 10:** 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 most meaningful to help professional accountants understand how bias, pressure and other impediments might influence their work?

We are supportive of IESBA's proposal and feel that this could best be addressed by the professional accountant considering professional scepticism from an objective, reasonable and informed third party perspective as we have set out in our response to question 8.