

15 August 2018

Mr Ken Siong  
Technical Director  
International Ethics Standards Board for Accountants  
International Federation of Accountants  
529 Fifth Avenue  
New York, NY 10017  
USA

Dear Ken,

***IESBA Consultation Paper, Professional Scepticism, Meeting Public Expectations***

Thank you for the opportunity to comment on the IESBA consultation paper seeking input on whether and how behavioural characteristics comprised in professional scepticism can be extended to all professional accountants via the IESBA Code of Ethics for Professional Accountants (the Code), to better meet public expectations of the profession. We submit the feedback from the New Zealand Auditing and Assurance Standards Board (NZAuASB) in the attachment.

The External Reporting Board (XRB) is a Crown Entity responsible for developing and issuing accounting and auditing and assurance standards in New Zealand. The XRB's outcome goal is to contribute to the creation of dynamic and trusted markets through the establishment of an accounting and assurance framework that engenders confidence in New Zealand financial reporting, assists entities to compete internationally and enhances entities' accountability to stakeholders. The NZAuASB has been delegated responsibility by the XRB for developing and issuing auditing and assurance standards, including ethical standards for assurance practitioners.

The NZAuASB's mandate is limited to developing and issuing auditing and assurance standards, including ethical standards for assurance practitioners. This applies only to professional accountants in their role as assurance practitioners. However, this submission will also comment on the overall subject matter of the consultation paper to the extent it is relevant to, or impacts on, that mandate.

The NZAuASB supports the IESBA's vision for the Code to enable all professional accountants to act in the public interest by not associating with misleading information. The NZAuASB therefore supports the IESBA's initiative to understand what specific actions can be undertaken to help all professional accountants to understand this expectation, and how to enhance their behaviours and efforts in meeting the expectation.

However, it is not clear to the NZAuASB that the proposals included in the consultation paper on using professional scepticism or a concept with similar connotations are the best way to achieve this. The NZAuASB cautions the IESBA to be clear about what problem it is trying to fix. Is the problem with the Code, the application of the Code, and/or dealing with expectation gaps?

The NZAuASB does not support “professional scepticism” being introduced into the Code as a “catch all” term for all professional accountants. Adopting this approach might dilute or otherwise adversely affect the understanding and application of professional scepticism in the context of audit and other assurance engagements, and therefore be detrimental to the public interest.

The NZAuASB believes that the Code’s existing fundamental principles provide an appropriate foundation for the expected professional behaviour of all professional accountants. However, if the issue is with the application or understanding of the Code by professional accountants other than auditors, there may be a need to better emphasise the expected professional behaviour of those professional accountants in the Code, and to develop additional guidance material on how to apply the fundamental principles when performing various professional engagements. Guidance about threats (including biases, pressures and other impediments) is particularly important. Focusing on threats and how these threats should be considered from a public interest perspective is likely to be beneficial for all professional accountants.

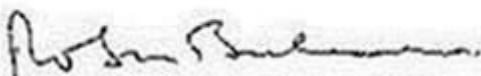
The NZAuASB further strongly supports the option discussed at the recent roundtable in Melbourne of having an overarching statement of purpose for all professional accountants in the Code, for example, to emphasise professionalism, by acting in the public interest and complying with the fundamental principles. The NZAuASB acknowledges that it is difficult to define public interest, and there may be a need to provide additional guidance to professional accountants in business on how to balance between obligations to their employers and the need to act in the public interest.

If, despite the above, the IESBA decides to proceed with an approach with similar connotations to professional scepticism (to address the problem as defined), the NZAuASB favours a designation other than “professional scepticism” is used to describe it.

The NZAuASB agrees with the IESBA that the overall solution should also include working with the International Accounting Education Standards Board and professional bodies to provide the necessary education and awareness of the fundamental principles, and the expected behaviour of professional accountants in meeting those fundamental principles.

Should you have any queries concerning our submission please contact either myself at the address details provided below or Sylvia van Dyk ([sylvia.vandyk@xrb.govt.nz](mailto:sylvia.vandyk@xrb.govt.nz)).

Yours sincerely,



**Robert Buchanan**

**Chairman**

Email: [robert@buchananlaw.co.nz](mailto:robert@buchananlaw.co.nz)

## **Submission of the New Zealand Auditing and Assurance Standards Board**

### **IESBA Consultation Paper: *Professional Scepticism, Meeting Public Expectations***

#### **I Schedule of Responses to the IESBA's Specific Questions**

**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 upon for its intended use?

**Response:**

The NZAuASB supports the IESBA's focus on the public trust in the profession and how to enhance that trust. As a principle, all professional accountants must behave in a manner that enhances this trust. Any time a professional accountant fails to uphold this principle in doing their work, the public trust in the profession will suffer. The NZAuASB agrees that there is a perception held by some sections of the public that information with which a professional accountant is associated should be relied upon for its intended use.

However, the NZAuASB cautions that expectations of professional accountants need to be realistic and consistent with what can reasonably be expected from them based on the nature, scope and extent of the work they undertake. The NZAuASB considers another key factor affecting public trust in the profession may be attributed to an expectation gap, that is, the public not understanding the scope of the professional accountant's association with information, depending on the nature of the engagement undertaken. The NZAuASB therefore cautions the IESBA to be clear about what problem it is trying to fix. Is the problem with the Code, the application of the Code and/or an expectation gap?

**Question 2:** Do you agree with the summary of behavioral characteristics associated with public expectations of professional accountants? Are there behavioral characteristics that should be included or excluded from the summary?

**Response:**

The NZAuASB agrees with the summary of behavioural characteristics noted. The NZAuASB notes that any meaningful application of the existing principles of Objectivity, Professional Competency and Due Care by professional accountants should reasonably be expected to result in a demonstration of the described behavioural characteristics. The summary of behavioural characteristics is already embedded in the existing Code. Making this more explicit may help with the application of the Code.

Para 111.2 of the Code already stipulates how professional accountants must behave when being associated with information.

Para 111.2 "A professional accountant should not 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 furnished recklessly; or

- c) Omits or obscures required information where such omission or obscurity would be misleading.”

The Code, however, is silent on how much effort should be exercised by the professional accountant to form this belief. The described behavioural characteristics do not clarify the required level of effort to demonstrate them. Therefore, it is unclear whether including a summary of behavioural characteristics in the Code will improve professional accountants’ adherence to the fundamental principles. However, it may be helpful for the Code to explain that not associating with misleading information involves considering whether the information is balanced, unbiased and fit for purpose.

**Question 3:** Do you agree that the mindset and behavioural characteristics described in paragraph 10 should be expected of all professional accountants? If not, why not?

**Response:**

The NZAuASB agrees with the description in paragraph 10 that all professional accountants should approach professional activities with an impartial and diligent mindset; and apply that mindset together with relevant professional expertise to the evaluation of information with which they are associated.

As stated in the response to question 2, the NZAuASB believes that the proposed mindset and behavioural characteristics described in paragraph 10 are already implied in the Code’s existing fundamental principles. This is consistent with the IESBA’s acknowledgement in paragraph 16 of the consultation paper that the expected behaviour of all accountants may correlate to or be components of one or more of the Code’s existing fundamental behaviours. The IESBA further states such an expectation not currently being met suggests either:

- (a) That the Code is not clear on this matter; or
- (b) That professional accountants do not properly understand the Code in this relation; or
- (c) Some combination of (a) and (b).

In addition to the expectation gap involving the public not understanding the roles and responsibilities of accountants, the NZAuASB believes expectations not being met may be significantly or partially due to factors other than the Code and how it is understood. For example, a professional environment can be plausibly believed to adversely impact on how ethical requirements are implemented where:

- (a) a professional accountant is not held accountable for decisions made; and/or
- (b) there are no or very limited adverse consequences for unethical behaviour in the presence of strong incentives (monetary or otherwise) or pressure to commit such behaviour.

The NZAuASB believes that it is important that the IESBA adopts an evidence-based approach to determine the extent to which the observed issues can be attributed to specific shortcomings of the Code. Otherwise, potential benefits from any form of improvement in the Code may never materialise to the expected extent, in turn fuelling the perception that the Code still requires further improvement.

**Question 4:** Do you believe the fundamental principles included in the existing Code and related application material are sufficient to support the behaviors associated with the application of appropriate professional skepticism?

**Response:**

As noted in responses to questions 2 and 3 above, the Code already contains a clear expectation for professional accountants not to be associated with information they believe to be materially inaccurate or misleading. The NZAuASB recommends that the expectation could be further strengthened by emphasising in the Code the need for the professional accountant to consider whether the information is balanced and unbiased.

The NZAuASB believes that the Code's existing fundamental principles provide an appropriate foundation for the expected professional behaviour of all professional accountants. It is more likely that the issue is with the application or understanding of the Code. There may be a need to better emphasise the expected professional behaviour of professional accountants in the Code, and to develop additional guidance material on how to apply the fundamental principles when performing various types of professional engagements.

The NZAuASB further believes that the work effort required for a professional accountant to be reasonably comfortable that they have met the existing requirement in the Code for avoiding association with misleading information cannot be addressed in the Code for all the different types of engagements. Instead, this should be addressed by professional standards that set out how a particular professional service (or role) is to be conducted to meet the Code's requirements, and through education to enhance professional accountants' compliance with the ethical standards.

The IESBA should also consider the possibility that part of the described expectation gap may be due to inaccurate public understanding of what a professional accountant can be reasonably expected to do, and professional accountants not being sufficiently aware of the requirements in the Code.

Addressing this in the Code alone will not solve problems associated with unrealistic expectations and inadequate understanding of the Code.

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

**Response**

The IAASB defines professional scepticism as "*an<sup>1</sup> 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 the evidence*".

The Oxford Dictionary defines scepticism as "an attitude of being sceptical" and "sceptical" as someone who is "not easily convinced" or "having doubts or reservations". This common definition of the word scepticism seems to overlap significantly with how professional scepticism is defined by the IAASB.

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<sup>1</sup> ISA200, paragraph 13(l) Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing

Professional accountants in public practice undertaking engagements other than audit or other assurance engagements already apply the concept of scepticism in undertaking their engagements. But the NZAuASB does not believe that professional scepticism, as defined in the ISAs, would be the appropriate term to use to apply to all professional accountants. The Code should not use the term professional scepticism unless in relation to audit and other assurance engagements. The issue is how to extend the expectation of “scepticism” from a professional assurance role that primarily exists to bring trust and credibility to information (because the users cannot trust the preparer) to the wide variety of other roles undertaken by professional accountants.

The NZAuASB also considers that professional scepticism as defined by the IAASB (especially the emphasis placed on evidence) for the purpose of audit and other assurance engagements may be impractical to be applied by all professional accountants and for all types of professional engagements and may dilute or otherwise adversely affect the understanding and application of professional scepticism in the context for which it was designed. The NZAuASB further notes that professional scepticism has been, and continues to be, the focus of considerable attention in audit and assurance, where it has been the subject of significant emphasis, application guidance, and training.

**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 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.

**Response:**

If a professional approach with similar connotations to professional scepticism is to be required by the Code, the NZAuASB suggests that a designation other than “professional scepticism” is used to describe it. The NZAuASB does not support using the term professional scepticism where the nature and expected level of work effort cannot reasonably be expected to meet the work effort associated with the application of professional scepticism as required by the ISAs. The NZAuASB further believes providing a second definition of professional scepticism would result in watering down of professional scepticism and undo years of education for auditors.

The NZAuASB does not disagree with the definition along the lines set out in paragraph 19, that is:

*“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”.*

However, the NZAuASB questions the need for a definition along the lines described. As mentioned in the response to question 4, the NZAuASB believes that the Code’s existing fundamental principles provide an appropriate foundation for the expected professional behaviour of all professional accountants. It is more likely that the issue is with the application or understanding of the Code. It would be preferable to better emphasise the expected professional behaviour of professional accountants in the Code, for example the importance of considering

whether the information is balanced and unbiased, and to consider developing additional guidance material on how to apply the fundamental principles when performing various professional engagements.

**Question 7:** Would you support an alternative term to ‘professional skepticism’ - such as ‘critical thinking’ or ‘diligent mindset’? If not, what other term(s), if any, would you suggest which focusses on the mindset to be applied by all Professional Accountants?

Response:

The NZAuASB will support an alternative term to professional scepticism should the IESBA decide to develop a new defined term. Another term to consider may be for professional accountants to have a “cautious approach to professional work”, that is, to be careful to not be associated with misleading information and to consider whether the information is balanced and unbiased.

Caution requires an active state of mind, and an awareness of threats and the need to scan for threats (including the threat of bias in presenting information). This better resonates with the objectives of being careful not to be associated with misleading information and in selecting the best of the options based on available knowledge about the information.

**Question 8:** Should the IESBA develop additional material, whether in 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 behavioral characteristics and professional skills.

Response:

The NZAuASB agrees that guidance is needed to explain how professional accountants can satisfy themselves that they have met the key requirement of avoiding association with misleading information. The NZAuASB believes that educating professional accountants, especially professional accountants in business, plays a crucial role in enhancing how the Code’s existing fundamental principles are implemented.

The NZAuASB supports providing more application guidance on how to apply the fundamental principles, in the public interest, when performing professional services, specifically focussing on guidance for some common roles undertaken by professional accountants in business, and also for consultation and tax engagements. The guidance should address the role of bias, pressure and other impediments applicable to the various roles.

The NZAuASB has also reflected on, and supports the option discussed at the recent roundtable in Melbourne of having an overarching statement of purpose for all professional accountants in the Code, for example, to emphasise professionalism, acting in the public interest and complying with the fundamental principles. However, that approach may also require additional guidance to professional accountants in business on how to balance between obligations to their employers and the need to act in the public interest.

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

**Response:**

The NZAuASB shares the IAASB's concern about the impact of using the existing definition of professional scepticism or an alternative definition called professional scepticism in the Code. As discussed in the preceding comments, the notion of professional scepticism is strongly associated with both the role a professional accountant is expected to play, and the appropriate level of work effort to satisfy expectations. Using the term professional scepticism in circumstances that these characteristics are absent, detracts from the strength of the concept. The NZAuASB therefore recommends avoiding reference to professional scepticism in the Code unless referring to practitioners undertaking audit or other assurance engagements.

**Question 10:** Should the Code include application or other material to increase awareness of biases, preconceptions, pressure and other impediments to the approaching professional activities with an impartial and diligent mindset and applying appropriate professional skepticism 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, preconception, and pressure might influence their work.

**Response:**

The NZAuASB supports guidance material to explain threats that professional accountants may encounter when they are associated with information that is not fit for intended purposes. Guidance about threats (including biases, pressures and other impediments) is particularly important. Focusing on threats and how they should be considered from a public interest perspective is likely to be beneficial for all professional accountants. Also, it could be beneficial to develop specific guidance for professional accountants in business with major responsibilities and bearing on business decisions (e.g. those charged with governance or chief financial officers etc) about their obligation not to be associated with misleading information and to consider whether the information is balanced, unbiased and fit for purpose.