

27 July 2017

Ken Siong
Technical Director
International Ethics Standards Board for Accountants
545 Fifth Avenue, 14th Floor
New York, 10017
USA

Dear Ken,

IESBA Exposure Draft – Proposed Application Material Relating to Professional Skepticism and Professional Judgment

Thank you for the opportunity to comment on the IESBA exposure draft *Proposed Application Material Relating to Professional Skepticism and Professional Judgment*. We submit the feedback from the New Zealand Auditing and Assurance Standards Board (NZAuASB).

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.

Overall comment

The NZAuASB notes that the IESBA has further plans to elaborate on the relevance of professional scepticism to compliance with the fundamental principles in longer terms. The NZAuASB agrees with the IESBA that appropriately addressing professional scepticism in the Code involves considerations beyond the limited changes proposed in the ED and looks forward for future communications in relation to those plans.

In relation to the questions requested to be addressed by the ED, the NZAuASB supports the proposed additions to clarify what is already implicit in the Code in relation to the linkage between professional scepticism and the Fundamental Principles as well as the emphasis on understanding facts and circumstances in exercising professional judgement when applying the conceptual framework. We believe these additions will be helpful in applying the conceptual framework in Section 120 of the proposed restructured Code until the IESBA's comprehensive response for addressing professional scepticism in the Code is prepared and implemented.

In formulating this response, the NZAuASB sought input from New Zealand constituents.

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).

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Robert Buchanan', with a long horizontal flourish extending to the right.

Robert Buchanan

Chairman

Email: robert@buchananlaw.co.nz

Submission of the New Zealand Auditing and Assurance Standards Board

IESBA Exposure Draft *Proposed Application Material Relating to:*

- (a) *Professional Skepticism-Linkage with the Fundamental Principles; and*
- (b) *Professional Judgment- Emphasis on Understanding Facts and Circumstances*

Schedule of Responses to the IESBA's Specific Questions

Proposed Application Material Relating to Professional Skepticism (paragraph 120.13 A1)

1. **Do respondents agree that the proposed application material enhances the understandability of the conceptual framework in Section 120 of the proposed restructured Code?**

Response:

The NZAuASB agrees that the proposed application material in para 120.13 A1 relating to professional scepticism clarifies what is already implicit in the conceptual framework. However, the NZAuASB notes that this paragraph states that "... Compliance with the fundamental principles supports the exercise of such professional scepticism. ...". The NZAuASB is of the view that the fundamental principles are part of the essential attributes that underpin professional scepticism. Thus, compliance with the fundamental principles is a prerequisite for appropriate application and demonstration of professional scepticism by professional accountants. The NZAuASB believes that there is a stronger linkage between the fundamental principles and professional scepticism than what is suggested by the proposed para 120.13. Therefore, the NZAuASB recommends replacing the word "support" with "underpin".

2. **Do the examples in the proposed application material clearly describe how compliance with the fundamental principles of integrity, objectivity, and professional competence and due care support the exercise of professional skepticism in the context of an audit of financial statements? If not, why not?**

Response:

The NZAuASB considers the proposed examples need to improve. We believe that recognising the fundamental principles as essential attributes of professional scepticism (as explained under question 1 above) will provide a better flow for the examples in the proposed application material. For instance, professional scepticism involves "being alert to conditions which may indicate possible misstatement due to error or fraud". Recognising such conditions and being alert to their indicators require professional competency and due care. A professional accountant without appropriate level of knowledge and skill for a particular engagement is unlikely to be able to identify all of the relevant indicators for risk of material misstatement that are relevant to a particular client's financial statements. Thus, the fundamental principle of professional competence and due care is a significant facilitator of professional scepticism.

Similarly, maintaining a curious and questioning mind depends on, among other things, the professional accountant's ability to appropriately counter bias, conflict of interest or the undue influence of others. Compliance with the fundamental principle of objectivity enables the professional accountant to be aware of this bias and to address such risks of bias by taking additional steps to critically evaluate relevant evidence.

We also believe guidance which addresses assurance engagements other than audit engagements (e.g. reviews and other assurance engagements) would be more useful. This is because there is already sufficient guidance around the independence risks when performing audits.

Proposed Application Material Relating to Professional Judgment (paragraph 120.5 A1)

3. Do respondents agree that the proposed application material enhances the understandability of the conceptual framework in Section 120 of the proposed restructured Code?

Response:

The NZAuASB agrees that the proposed application material in para 120.5 A1 relating to professional judgement enhances the understandability of the conceptual framework in Section 120 of the proposed restructured Code.

The NZAuASB notes that the proposed application material emphasizes the importance of professional accountants obtaining a sufficient understanding of the facts and circumstances known to them when exercising professional judgement in applying the conceptual framework. However, it neither explains why this is important nor does it provide any examples. The explanatory memorandum provides a very good explanation of why this is important in para 14 of the ED.

“... if a professional accountant were to accept information at “face value” without regard to whether it could lead the professional accountant to become associated with materially false or misleading information, it would constitute non-compliance with the fundamental principles, in particular, integrity and professional competence and due care...”

The NZAuASB suggests adding the above statement to the application material to clarify the reason why obtaining sufficient understanding of the facts and circumstances is important when exercising professional judgement in applying the conceptual framework.

4. Do respondents agree that the proposed application material appropriately emphasizes the importance of professional accountants obtaining a sufficient understanding of the facts and circumstances known to them when exercising professional judgment in applying the conceptual framework? If not, why not?

Response:

We believe that the application material provides relevant guidance about application of professional judgement when obtaining understanding of the facts and circumstances known to the professional account and some examples of the risks involved.