

## Professional Skepticism and Professional Judgment—Summary of Significant Comments, Issues and Task Force Proposals

### How the Project Serves the Public Interest

The project establishes new application material relating to professional skepticism and professional judgment which clarifies what is already implicit in the provisions of the *IESBA Code for Professional Accountants* (Code). The proposed application material relating to:

- Professional skepticism (PS) will heighten auditors' focus on how compliance with the fundamental principles (FPs) supports the exercise of PS by illustrating this linkage in the context of an audit of financial statements.
- Professional judgment (PJ) emphasizes the importance of professional accountants (PAs) obtaining a sufficient understanding of the facts and circumstances known to them when exercising PJ in applying the conceptual framework to comply with the FPs.

Together, the proposed texts will better support PAs (auditors in the case of the proposal relating to PS) in fulfilling their responsibility to act in the public interest and with respect to audits of financial statements, contribute to supporting audit quality.

### Introduction

1. This paper summarizes the significant issues raised by respondents to the May 2017 Exposure Draft, [Proposed Application Material Relating to Professional Skepticism and Professional Judgment](#) (ED) and is organized as follows:
  - A. Background
  - B. Overview of Responses
  - C. Issues and Task Force proposals
    - (i) PS
    - (ii) PJ
  - D. Matters relating longer term PS initiative

### A. Background

2. The two sets of application material were approved for exposure in April 2017 and represent proposed additions to Section 120<sup>1</sup> of the restructured Code, the text of which was [agreed in principle](#) by IESBA in December 2016 as part of Phase 1 of its Safeguards and Structure of the Code (Structure) projects.
3. The ED includes proposed new application material to:
  - Describe how compliance with the FPs in the Code supports the exercise of PS in the context

<sup>1</sup> Proposed restructured Code, Part 1, Complying with the Code, Fundamental Principles and Conceptual Framework, Section 120, *The Conceptual Framework*

of audit and other assurance engagements (see paragraph 120.13 A1).

- Emphasize the importance of PAs obtaining a sufficient understanding of the facts and circumstances known to them when exercising PJ in applying the conceptual framework (see paragraph 120.5 A1).
4. The deadline for comments on the ED was July 25, 2017.

## B. Overview of Responses

5. Comment letters were received from 42 respondents representing a diverse group of stakeholders from many jurisdictions. They are listed in Appendix 2 to this paper. The respondents to the ED comprise the following:

Category of Respondent	Number of Responses
Regulators and Oversight Authorities (Regulators)	2
National Standard Setters (NSS)	2
Firms	9
Public Sector Organizations (Public Sector)	1
IFAC Member Bodies <sup>2</sup> (MBs)	22
Other Professional Organizations (OPs)	6
<b>Total</b>	<b>42</b>

6. Some respondents indicated in their letters that their response either: represent a view of various organizations; or incorporate input from various stakeholders within their respective jurisdictions based on targeted outreach.

## C. Issues and Task Force Proposals

### Professional Skepticism

#### *Feedback from Respondents*

7. The majority of respondents to the ED expressed support for the proposed PS application material.<sup>3</sup> However, a few respondents were not supportive<sup>4</sup> and believed that:
- The IESBA should focus instead on a longer term PS project.<sup>5</sup> Some of those respondents expressed concern that the ED did not deal with the two-way relationship between the exercise

<sup>2</sup> Certain IFAC Member Bodies (e.g., AICPA, JICPA, HKICPA, and WPK), also hold the dual role of ethics standard setter in their respective jurisdictions.

<sup>3</sup> **Regulators:** IRBA, UKFRC; **NSS:** APESB, NZAuASB; **Firms:** BDO, CHI, EYG, GTI, KPMG, PWC, RSM; **Public Sector:** GAO; **MBs:** ACCA/CAANZ, FACPCE, HKCPA, ICAI, ICPA, ICAS, ICAZ, IDW, JICPA, KICPA, MICPA, NYSSCPA, SAICA, WPK; **OPs:** ATT, ACAN, AIC/IAA, PAIB, PKF, SMPC

<sup>4</sup> **Firms:** DTT; **MBs:** AE, FSR, CPAA, CPAC, ICAEW

<sup>5</sup> **Firms:** DTT; **MBs:** CPAA, CPAC, ICAEW

of PS and compliance with the FPs.

- The proposed PS application material is not necessary because it merely states in an explicit manner what is already required in the Code.<sup>6</sup> One of these respondents, AE, questioned whether the PS material would be better suited for a staff publication rather than being positioned in the Code.
  - The proposed application material in 120.13 A1 is inconsistent with the approach taken in the Structure of the Code (Structure) project.<sup>7</sup>
8. Some respondents provided comments and drafting suggestions to improve the proposed PS application material. For example, it was suggested that:
- The lead-in to the list of examples in paragraph 120.13 A1 should be clarified<sup>8</sup> and should for example, explain the link between PS and PJ;<sup>9</sup> and explain how PS supports compliance with the FPs.<sup>10</sup>
  - The examples illustrating how integrity, objectivity and professional competence and due care support PS should be further clarified and streamlined.<sup>11</sup>
  - An additional example should be provided to explain how professional behavior supports the application of PS.<sup>12</sup>
9. Also, a few respondents questioned the appropriateness of having the proposed PS application material positioned in Part 1, Section 120 of the Code which applies to all PAs.<sup>13</sup> A respondent<sup>14</sup> suggested that the proposed PS application material should be positioned in Section 110<sup>15</sup> of the Code.

#### *Task Force Proposals*

10. The Task Force considered all the respondents' comments and drafting suggestions in developing its proposed revisions to paragraph 120.13 A1 of **Agenda Item B-2**.
11. As part of its deliberations, the Task Force affirmed that the first sentence in paragraph 120.13 A1 is intended to provide useful context and remind readers of the Code that the exercise of PS is required under audits, reviews and other assurance standards. The Task Force has made some drafting refinements to the second sentence to clarify that examples that follow explain the linkage for three

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<sup>6</sup> **MBs:** AE, FSR

<sup>7</sup> **Firms:** DTT

<sup>8</sup> **NSS:** APESB; MBs, ACCA/ CANZ, IDW, WPK

<sup>9</sup> **NSS:** APESB

<sup>10</sup> **NSS:** NZAuASB

<sup>11</sup> **MBs:** IDW, JICPA, WPK; OPs, AIC/ IAA,

<sup>12</sup> **Firms:** GTI

<sup>13</sup> **Public Sector:** GAO; **MB:** CPAC

<sup>14</sup> **Public Sector:** GAO

<sup>15</sup> Part 1, Section 110, *The Fundamental Principles*

of the FPs to PS in the context of an audit of financial statements only.

12. The Task Force agrees with respondents who suggest that the examples in paragraph 120.13 A1 should be clearer. The following approach was used to revise the examples in a consistent manner to achieve this objective. In each example:
  - First, a general statement is made about the specific FP using language that aligns closely to the material in Section 110 of the Code.
  - Second, an explanation is provided about how the PA complies with the specific FPs.
  - Third, a statement that starts with the words “In doing so,…” explains how the actions taken by the PA to comply with the specific FP supports the exercise of PS.
13. The Task Force acknowledges that the above approach involves repetition in some cases, but believes that this repetition is necessary for emphasis and helps make the proposed PS application material clearer.
14. The Task Force also agreed to some editorial refinements and structural changes to more closely align the proposed PS text to the formatting and drafting conventions established by Phase 1 of the Structure project.
15. The Task Force reflected on respondents’<sup>16</sup> comments relating to the placement of the PS application material positioned in Part 1 of the Code, and also considered whether it would be better positioned in Part 3<sup>17</sup> and/or Part 4A<sup>18</sup> of the Code.
16. The Task Force believes having the proposed PS application material in the conceptual framework (i.e., Section 120) under the subheading titled, Considerations for Audits, Reviews and Other Assurance Engagements makes it appropriately prominent. As a practical matter, the Task Force also believes that any elaboration of PS in the Code should be made in close proximity to the first mention of PS, which is in paragraph 120.12 A1.
17. The Task Force notes that the International Auditing and Assurance Standards Board’s (IAASB’s) Staff Questions and Answers: [\*Professional Skepticism in An Audit of Financial Statements\*](#) acknowledges that PS, PJ, the FPs and auditor independence are all related concepts (see Q1 and Q2). Therefore, in response to respondents’<sup>19</sup> requests the Task Force considered including the following text as a first sentence to paragraph 120.13 A1:

“Professional skepticism, professional judgment and the fundamental principles are inter-related concepts.”
18. The Task Force ultimately determined that inclusion of the above sentence, which was not in the ED, might have the unintended consequence of being seen to encroach on the scope of the longer term PS initiative.

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<sup>16</sup> **Public Sector:** GAO; **MB:** CPAC

<sup>17</sup> Proposed restructured Code, Part 3 – Professional Accountants in Public Practice

<sup>18</sup> Proposed restructured Code, Part 4B – Independence for Audits and Reviews

<sup>19</sup> **NSS:** APESB, NZAuASB

19. Also, in response to respondents' requests, the Task Force explored a number of options to clarify each of the examples in paragraph 120.13 A1 of the ED. Alternatives to the last sentence to the revised examples in 120.13 A1 of **Agenda Item B-2**, that were explored by the Task Force are set out in Appendix 1 to this paper.

#### **Matters for IESBA CAG Consideration**

1. Representatives are asked for views about the Task Force's revised proposals relating to PS.

### **Professional Judgment**

#### *Feedback from Respondents*

20. Generally, respondents were supportive of the proposed PJ application material in paragraph 120.5 A1 of the ED<sup>20</sup> and provided comments and drafting suggestions to improve it. For example, it was suggested that:
- The first sentence in the ED about PJ should be aligned even more closely to the material that is in the description of PJ in the IAASB's standards (i.e., ISA 200<sup>21</sup>).<sup>22</sup> A respondent<sup>23</sup> suggested that the sentence should read "Professional judgment involves the application of professional knowledge, skill and experience..."
  - The IESBA should incorporate into the Code the material in paragraph 14 of the Explanatory Memorandum to the ED which states that "...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."<sup>24</sup>
  - The word "sufficient" used in the second sentence of paragraph 120.5 A1 of the ED should be avoided.<sup>25</sup>
  - The proposed PJ application material should be drafted in a manner that more closely aligns to the new format and drafting conventions for the Code.<sup>26</sup>

<sup>20</sup> **Regulators:** UKFRC; **NSS:** APESB, NZAuASB; **Firms:** BDO, CHI, EYG, GTI, PWC; **MBs:** ACCA/CANZ, ICAS, IDW, SAICA, WPK; **OPs:** ATT, AIC/IAA, PAIB, PKF, SMPC

<sup>21</sup> The IAASB's standards, International Standard on Auditing (ISA) 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph 13(k) define professional judgment as "the application of relevant training, knowledge and experience, within the context provided by auditing, accounting, and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit engagement."

<sup>22</sup> **Regulators:** UKFRC; **Firms:** PWC; **MB:** IDW

<sup>23</sup> **Firms:** EYG

<sup>24</sup> **NSS:** NZAuASB

<sup>25</sup> **MBs:** ACCA/ CANZ

<sup>26</sup> **Firms:** DTT

21. A few respondents suggested that the proposed PJ application material should be elevated to a requirement.<sup>27</sup>
22. Some respondents<sup>28</sup> were not supportive of the proposed PJ application material, noting that it was either unhelpful; or unnecessary.

#### *Task Force Proposals*

23. Having given due consideration to the various comments and drafting suggestions, the Task Force's proposed the following revisions:
  - Reiterate that applying the conceptual framework to comply with the FPs involves the exercise of PJ (i.e., a reminder of the requirement in R120.5).
  - Avoid the use of the word "sufficient" but clarify in a new paragraph 120.5 A2, that "an understanding of known facts and circumstances is a prerequisite to the proper application of the conceptual framework; and that determining the actions necessary to gain this understanding and coming to a conclusion about whether the FPs have been complied with requires the exercise of PJ.
24. The Task Force agreed to the following enhancements to the bulleted list of examples of matters to be considered by a PA in obtaining an understanding.
  - A new matter is added in response to a suggestion from APESB, which reads "there is reason to be concerned that potential relevant information might be missing from the facts and circumstances known to the accountant".
  - The third bullet in paragraph 120.5 A1 of ED has been revised in response to comments from CPAC and PAIB to now read, "Other reasonable conclusions could be drawn from the information."

#### **Matters for IESBA CAG Consideration**

2. Representatives are asked for views about the Task Force's revised proposals relating to PJ.

### **D. Matters Relating to the Longer Term PS Initiative**

25. Certain respondents, including some of those who did not support the proposals relating to PS in the ED took the opportunity to provide input on the longer term initiative. Some respondents suggested that PS should apply to all PAs<sup>29</sup> and expressed a view that:
  - PS is an "enabler of compliance with the FPs."<sup>30</sup>
  - The approach taken by the International Accounting Education Standards Board (IAESB) is an

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<sup>27</sup> **MBs:** SAICA; **OPs:** ATT

<sup>28</sup> **Firms:** DTT; **MBs:** AE, CPAC, FSR, ICAEW

<sup>29</sup> **NSS:** APESB; **Firms:** BDO; **MBs:** CAPC, FACPCE, ICAEW, ICAS; **OPs:** PAIB, PKF

<sup>30</sup> **MBs:** ICAEW

appropriate basis for extending PS as a requirement for all PAs in the Code.<sup>31</sup>

- The exercise of PS is important for tax and consulting engagements and that the Code should explain the role of PS in performing those non-assurance services.<sup>32</sup>
26. Of those who expressed support for extending the concept of PS to all PAs, a few respondents<sup>33</sup> suggested that different terms should be used to distinguish the skeptical behavior that is expected of auditors and assurance practitioners from that which is expected of all PAs more broadly.
27. There were a few respondents<sup>34</sup> who expressed a contrary view and believed that PS should only apply when PAs perform audit and assurance engagements.
28. A few respondents emphasized the need for continued IESBA-IAASB-IAESB coordination.<sup>35</sup> A few respondents cautioned against changes to the definition of PS, noting the potential risks of confusion for PAs and unintended consequences.<sup>36</sup>
29. The Task Force will consider the comments relating to the longer term PS initiative in developing the draft PS Consultation Paper to be presented at the March 2018 IESBA meeting.

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<sup>31</sup> **Firms:** GTI

<sup>32</sup> **MBs:** NYSSCPA

<sup>33</sup> **Firms:** EYG; **MBs:** IDW,

<sup>34</sup> **Firms:** DTT; **MBs:** IDW; **OPs:** SMPC

<sup>35</sup> **Regulators:** IRBA, UKFRC; **Firms:** BDO, CHI, EYG, PWC; **MB:** AE, **OPs:** PKF, SMPC

<sup>36</sup> **MB:** ACCA, AE, ICAEW; **OPs:** SMPC

**Alternative Wording Considered By the Task Force for PS**  
**[Mark-up From Proposals in Agenda Item B-2]**

**PART 1 – COMPLYING WITH THE CODE, FUNDAMENTAL PRINCIPLES AND  
CONCEPTUAL FRAMEWORK**

**Section 120**

**The Conceptual Framework**

...

**Considerations for Audits, Reviews and Other Assurance Engagements**

120.12 A1 Professional accountants in public practice a...

120.12 A2 Parts 4A and 4B of the Code comprise ...

*Professional Skepticism*

120.13 A1 Under auditing, review and other assurance standards, including those issued by the International Auditing and Assurance Standards Board (IAASB), professional accountants in public practice are required to exercise professional skepticism when planning and performing audits, reviews and other assurance engagements. Complying with the fundamental principles supports the exercise of such professional skepticism in an audit of financial statements as is explained in the following examples:

- Integrity requires the professional accountant to be straightforward and honest. The accountant complies with the principle of integrity by:
  - (a) Adopting a straightforward and honest approach when raising concerns about a position advanced by a client; and
  - (b) Pursuing inquiries about a matter of concern and seeking further evidence in order to reach a conclusion about it.

In this way, integrity supports the exercise of professional skepticism when, for example, the accountant suspects that a position advanced by a client could result in financial statements [and/or other information that] that might include financial information that is materially false or misleading. In doing so, the accountant complies with the principle of integrity and demonstrates a questioning mind and undertakes the critical assessment of audit evidence that is required when exercising professional skepticism.

- Objectivity requires the professional accountant not to compromise professional or business judgment because of bias, conflict of interest or the undue influence of others. The accountant complies with the principle of objectivity by:
  - (a) Recognizing circumstances where bias might arise ~~from, among other circumstances, the accountant's familiarity with the client;~~ and



- (b) Considering the impact of such bias when evaluating the sufficiency and appropriateness of audit evidence related to a material matter in the client's financial statements.

In this way compliance with the principle of objectivity supports the exercise of professional skepticism when, for example, bias arises from the accountant's familiarity with the client. In doing so, the accountant complies with the principle of objectivity, and demonstrates behavior that is consistent with exercising professional skepticism.

- Professional competence and due care requires the professional accountant to have professional knowledge and skill at the level required to ensure competent professional service, and to act diligently in accordance with applicable standards, laws and regulations. The accountant complies with the principle of professional competence and due care by:
  - (a) Having and applying knowledge that is relevant to a particular client's industry and business activities in order to properly identify risks of misstatement.
  - (b) Developing and performing appropriate audit procedures; and
  - (c) Applying such relevant knowledge in critically assessing whether audit evidence is sufficient and appropriate in the circumstances.

In this way, professional competence and due care support the exercise of professional skepticism when, for example, the client is engaged in a [specialized/highly] regulated business activity. In doing so, the accountant complies with the principle of professional competence and due care and demonstrates behavior consistent with the exercise of professional skepticism.

## **List of Respondents to the ED**

**Note:** Members of the Monitoring Group are shown in bold below.

<b>#</b>	<b>Abbrev.</b>	<b>Respondents (42)<sup>6</sup></b>	<b>Region</b>
<b>Regulators and Oversight Authorities (2)</b>			
1.	IRBA	Independent Regulatory Board for Auditors (South Africa)	MEA
2.	UKFRC	United Kingdom Financial Reporting Council	EU
<b>National Standard Setters (2)</b>			
3.	APESB	Accounting Professional & Ethical Standards Board Limited-Australia	AP
4.	NZAuASB	New Zealand Auditing and Assurance Standards Board (External Reporting Board)	AP
<b>Firms (9)<sup>37</sup></b>			
5.	BDO*	BDO International Limited	GLOBAL
6.	CHI	Crowe Horwath International	GLOBAL
7.	DTT*	Deloitte Touche Tohmatsu Limited	GLOBAL
8.	EYG*	Ernst & Young Global	GLOBAL
9.	GTI*	Grant Thornton International Ltd	GLOBAL
10.	KPMG*	KMPG International	GLOBAL
11.	PWC*	PricewaterhouseCoopers International Limited	GLOBAL
12.	RSM*	RSM International	GLOBAL
13.	SRA	Samenwerkende Accountantskantoren	EU
<b>Public Sector Organizations (1)</b>			
14.	GAO	United States Government Accountability Office	NA

<sup>6</sup> ACCA and CAANZ submitted a joint comment letter.

<sup>37</sup> Forum of Firms members are indicated with a \*. The Forum of Firms is an association of international networks of accounting firms that perform [transnational audits](#). Members of the Forum have committed to adhere to and promote the consistent application of high-quality audit practices worldwide, and use the ISAs as the basis for their audit methodologies.

#	Abbrev.	Respondents (42) <sup>6</sup>	Region
<b>IFAC Member Bodies (22)<sup>38</sup></b>			
15.	ACCA and CAANZ	Joint letter from Chartered Accountants Australia and New Zealand Association of Chartered Certified Accountants	GLOBAL
16.	AE	Accountancy Europe	EU
17.	CAI	Chartered Accountants Ireland	EU
18.	CPAA	CPA Australia	AP
19.	CPAC	Chartered Professional Accountants of Canada (CPA Canada) Public Trust Committee	AP
20.	FACPCE	Federación Argentina de Consejos Profesionales de Ciencias Económicas	NA
21.	FSR	Foreningen af Statsautoriserede Revisorer (Danish Institute of Accountants)	EU
22.	HICPA	Hong Kong Institute of Certified Public Accountants	AP
23.	IBRACON	Instituto dos Auditores Independentes do Brasil (Institute of Independent Auditors of Brazil)	SA
24.	ICAEW	Institute of Chartered Accountants in England and Wales	EU
25.	ICAI	Institute of Chartered Accountants of India	AP
26.	ICAP	Institute of Certified Public Accountants of Pakistan	AP
27.	ICAS	Institute of Chartered Accountants of Scotland	EU
28.	ICAZ	Institute of Chartered Accountants of Zimbabwe	AP
29.	IDW	Institut der Wirtschaftsprüfer	EU
30.	JICPA	Japan Institute of Certified Public Accountants	AP
31.	KICPA	Korean Institute of Certified Public Accountants	AP
32.	MICPA	Malaysian Institute of Certified Public Accountants	AP
33.	NYSSCPA	New York State Society of Certified Public Accountants	NA

<sup>38</sup> Certain IFAC Member Bodies hold the dual role of ethics standard setter in their jurisdictions.

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#	Abbrev.	Respondents (42) <sup>6</sup>	Region
34.	SAICA	South African Institute of Chartered Accountants	MEA
35.	WPK	Wirtschaftsprüferkammer (German Public Accountants MB)	EU
<b>Individuals and Other Professional Organizations Including SMPC<sup>39</sup> (6)</b>			
36.	ATT	Association of Accounting Technicians	EU
37.	ACAN	Association of National Accountants of Nigeria	AP
38.	AIC/ IAA	Asociacion Interamericana de Contabilidad (Inter-American Accounting Association)	NA
39.	PAIB	IFAC Professional Accountants in Business Committee	GLOBAL
40.	PKF	PKF International Limited	GLOBAL
41.	SMPC	IFAC Small and Medium Practices Committee	GLOBAL

<sup>39</sup> Constituents of the SMPC are SMPs who provide accounting, tax, assurance and business advisory services principally, but not exclusively to clients who are small and medium-sized entities (SMEs). Members of the SMPC are drawn from IFAC member bodies representing the following 22 countries: Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong, India, Italy, Kenya, Malawi, Malta, Nigeria, South Africa, Spain, Sweden, Turkey, Tunisia, Uganda, United Kingdom, and United States.