

Supplement to Agenda Item 6A-3

EER Assurance: Destination of material from June 2019 IAASB Issues Paper (Agenda Item 8 of June 2019 meeting) in phase 2 drafting

Chapter 5 / Challenge 8: Professional Judgment and Professional Skepticism

| Sections of June Board Meeting EER Issues Paper | Suggested destination and treatment of June Issues Paper content |
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| <p>Introduction and context</p> <p>120. The Standard requires the practitioner to plan and perform an engagement with professional skepticism, recognizing that circumstances may exist that because the subject matter information to be materiality misstated.¹ The Standard also requires the exercise of professional judgment in planning and performing an assurance engagement, including determining the nature, timing and extent of procedures,² and the application of assurance skills and techniques as part of an iterative, systematic engagement process.³</p> <p>121. The DP summarized the challenges faced by practitioners in exercising professional skepticism and professional judgment in the context of an EER engagement as follows:</p> <p><i>“There may be more areas that require judgment in applying EER frameworks than in applying financial reporting</i></p> | <p>Paragraphs 120 to 124 is largely context, rather than being practical guidance so has not been covered in detail in the draft guidance, but reference to the EER ‘themes’ (to be included in Chapter 1) have been included in the draft guidance for Chapter 5 on PS and PJ.</p> <p>The concepts discussed in these paragraphs have been covered in summarized form, and through the use of the diagram and examples.</p> <p>Paragraphs 125 to 137 are not included in the guidance as they are quite theoretical/conceptual - suggest moving to Supplement, although further consideration to be given to whether the guidance should address independence and ‘stand back’.</p> <p>Diagram has been included in the draft guidance to show behaviours needed and example impediments.</p> |

¹ ISAE 3000 (Revised), paragraph 37

² ISAE 3000 (Revised), paragraph 38

³ ISAE 3000 (Revised), paragraph 39

frameworks, and more areas where the judgments in preparing the subject matter information are susceptible to subjectivity and management bias. There are therefore generally more areas where there is a need to apply professional judgment and professional skepticism in EER assurance engagements. At the same time, given the broader and more diverse subject matters addressed, it may be more challenging for the practitioner to obtain the competence needed to support the application of professional judgment and professional skepticism in relation to such engagements.”

122. The Task Force initially identified the following aspects to be addressed in the guidance during phase 2 of the project, and discussed these with the Board at the March 2019 Board meeting:
- a) How this challenge is closely related to the issue of practitioners obtaining the necessary competence, especially in the case of practitioners without significant assurance experience.
 - b) Not all the experts involved in an EER assurance engagement may be accustomed to applying professional judgment and professional skepticism, as defined in the assurance framework, throughout the engagement.
 - c) How individuals’ skills in exercising professional skepticism can be developed.
 - d) Frameworks and methodologies can help reinforce exercise of good judgment and of professional skepticism.
 - e) A key area often requiring professional skepticism in EER assurance engagements is in relation to an entity’s ‘materiality process’, particularly checking that the criteria are complete.
 - f) Exercising professional judgment and professional skepticism is important in understanding the engagement circumstances, assessing risks (or identifying areas where material misstatement is likely), designing further

procedures and in obtaining and evaluating evidence.

123. In the break-out sessions during the March 2019 Board meeting, Board members suggested that the following additional considerations should be addressed in developing the guidance:

- a) The guidance in relation to this challenge needs to be scalable.
- b) How professional skepticism is related to quality management, including considering the new material in the quality management exposure drafts.
- c) A need to challenge whether more or less exercise of professional judgment and professional skepticism is really required in an EER assurance engagement as compared to an audit, or whether their exercise is simply different because of the need to evaluate the different subject matter and criteria of these types of engagement.
- d) Reporting considerations, including explaining uncertainties, and what might trigger a modified assurance conclusion in relation to narrative or future-oriented information.

124. In addressing these challenges, the Task Force is of the view that it is helpful to consider first:

- a) How the Standard and other standards define professional judgment and professional skepticism, and how the two concepts relate to each other, as this will assist in identifying the skills needed in their exercise; and
- b) The impediments to being able to apply professional skepticism and professional judgment, including how the application of these skills may be different in the context of an EER engagement compared to a financial statement audit engagement.
- c) Skills needed to exercise professional judgment and

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| <p>professional skepticism</p> | <p>125. The exercise of professional judgment is required in applying all of the International Standards issued by the IAASB⁴, including ISAE 3000 (Revised); that is, in complying with their requirements.</p> <p>126. In an assurance engagement, information obtained in complying with the requirements can be considered as evidence as it is used by the practitioner in reaching the practitioner's conclusion.⁵ All <u>decisions</u> to be made in applying the requirements of the standards, for example the decisions around determining, evaluating and assessing information, are "about courses of action that are appropriate in the circumstances of the engagement",⁶ and are informed by the evidence obtained by the practitioner.</p> <p>127. In an assurance engagement, professional judgment applies the relevant training, knowledge and experience, within the context provided by assurance and ethical standards,⁷ in making those informed decisions about the courses of action that are appropriate in the circumstances of the engagement.</p> <p>128. Independence includes a mindset or attitude that avoids influences that might compromise the exercise of professional judgment in forming an assurance conclusion, and that might therefore compromise that conclusion.⁸ It also allows the practitioner to act with integrity and exercise objectivity and professional skepticism effectively in forming an assurance conclusion.⁹</p> |
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⁴ IAASB Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements 2018 Edition Volume 1, Preface paragraph 17

⁵ ISAE 3000 (Revised) paragraph 12(i)

⁶ ISAE 3000 (Revised) paragraph 12(t)

⁷ ISAE 3000 (Revised) paragraph 12(t)

⁸ IAASB Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements 2018 Edition Volume 1 Glossary of Terms *Independence*

⁹ ISAE 3000 (Revised), paragraph A33

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| <p>129. Professional skepticism is applied throughout the engagement; that is, in performing procedures and in making decisions throughout the engagement. It is an attitude (of mind), and the definition in the Standard highlights three aspects of that attitude: a questioning mind, being alert to conditions which may indicate possible misstatement, and a critical evaluation of evidence.¹⁰</p> <p>130. The Task Force discussed that the ability to apply professional skepticism is also supported by the effective exercise of other skills, such as being willing to consider points of view to check their own, acting with the courage to challenge, where necessary, and the ability to suspend drawing conclusions in decision-making and follow through with inquiry and challenge until the practitioner is satisfied that the explanations and other evidence obtained support the decision being made (see diagram below paragraph 135).</p> <p>131. Professional skepticism and professional judgment are closely linked with each other, as well as with the considerations identified in relation to challenge 9: <i>Obtaining the Competence Necessary to Perform the Engagement</i> and the considerations relating to evidence identified in relation to challenge 6: <i>Obtaining Assurance with Respect to Narrative Information</i> and challenge 7: <i>Obtaining Assurance with Respect to Future-Oriented Information</i>. The Task Force therefore proposes to develop the guidance on challenge 8 in close conjunction with the guidance on challenge 9 and the evidence-related guidance on challenges 6 & 7.</p> <p>132. Assurance skills and techniques include the application of professional judgment and professional skepticism. Competence in applying them, as for all assurance skills and techniques, is developed through extensive training and practical application.¹¹</p> | |
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¹⁰ ISAE 3000 (Revised), paragraph 12(u)

¹¹ ISAE 3000 (Revised) paragraph 31b

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| <p>133. The Task Force recognises that practical experience is a particularly important element in acquiring such skills, including through the good example of engagement partners and more experienced engagement team members providing appropriate direction, supervision and review. Those involved in the engagement with responsibility for complying with the requirements of the Standard in planning or performing the engagement need time to develop their competence in exercising professional judgment and professional skepticism and in applying other assurance skills that support their effective application, to a level appropriate to their role in the engagement. The level of competence of those involved in the engagement, who have such responsibility, is likely to vary and they may therefore be subject a varying degree of direction, supervision and review by others with greater competence, which is an important aspect of engagement quality management at the engagement level. This is discussed further in relation to challenge 9: <i>Obtaining the Competence Necessary to Perform the Engagement</i>.</p> <p>134. The Task Force concluded in light of the above that the exercise of professional skepticism importantly involves being able to stand back, suspend decision-making and critically assess the evidence related to the decision being made with professional judgment in complying with the requirements of the Standard. It also concluded that a critical assessment requires an appropriate level of subject matter competence, in the circumstances of the engagement, and involves understanding and addressing the impediments to professional skepticism that may need to be overcome in making that decision.</p> <p>135. The Task Force also noted that whilst the attitude of professional skepticism is a constant, the degree of competence and the actions needed to apply it can vary, both between assurance engagements (considering the circumstances of particular engagements) and within a particular assurance engagement (depending on the nature of the decisions being made).</p> | |
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136. The diagram below illustrates the relationship between the skills and characteristics of attitude needed for the exercise of professional skepticism (a constant), the impediments to the exercise of those skills, and possible actions that may be taken, depending on the identified impediments.



Needs for, and impediments to, the exercise of professional skepticism and professional judgment on an EER engagement

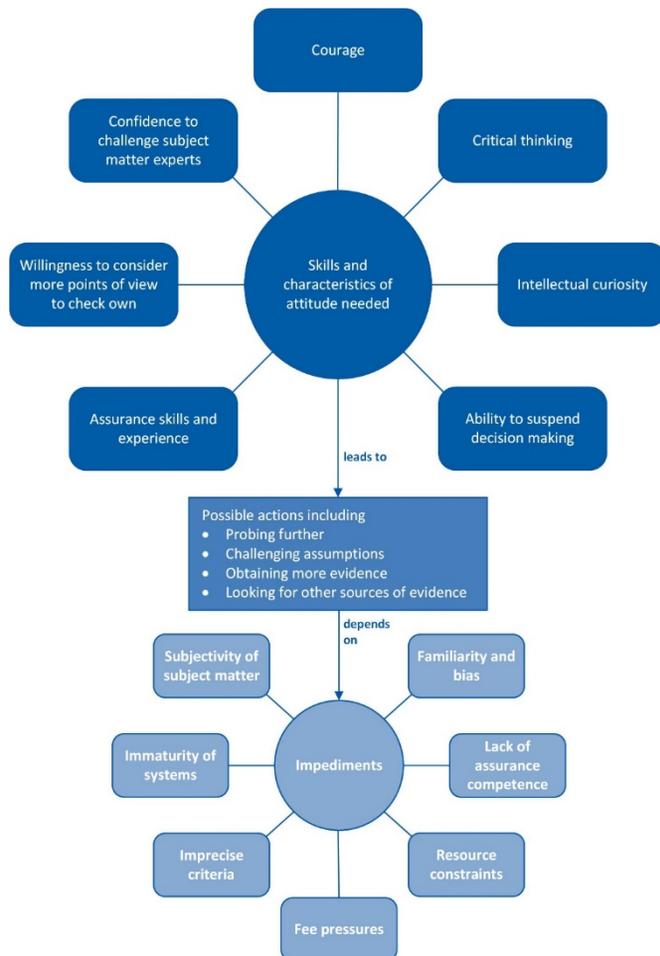


Diagram was considered to be useful, so it has been included in the guidance with a brief paragraph to set context. Some terminology reconsidered and additional boxes added. Terminology considered as follows:

- Use of the word courage has different meanings to different people (from bravery through to challenge);
- ‘Courage of convictions’ may come closer – defined by Collins and Oxford, respectively, as “ confidence to do what you believe is right, even though other people may not agree or approve” and “be brave enough to do what you feel to be right”

There may be impediments other than those illustrated, so additional blank boxes included in the diagram in the phase 2 draft guidance.

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| <p>137. The actions needed in applying professional judgment and professional skepticism on an engagement will vary with the nature and difficulty of the decisions that are required to be made and the difficulty in performing procedures to comply with the requirements of the Standard; the greater the complexity or difficulty, the greater the skills and competence that are likely to be needed to be able to apply professional judgment and professional skepticism and to take actions that are appropriate in the circumstances.</p> <p>138. Understanding the impediments on the engagement in relation to the ability to apply professional judgment and professional skepticism, including how the application of these skills may be different in the context of an EER engagement compared to a financial statement audit engagement, is helpful in understanding the actions that may be needed to overcome those impediments.</p> <p>Subject matter expertise on EER engagements</p> <p>139. An EER engagement may be undertaken in relation to a wide range of underlying subject matters, many of which will require specialized subject matter competence, for example, scientific or engineering skills. As a result, it may be necessary to involve a relatively higher proportion of experts in an EER assurance engagement than in a financial statement audit, where the assurance practitioner is trained in the underlying subject matter competence (financial accounting) relevant to an audit engagement.</p> <p>140. While subject matter experts may well need to apply a questioning mindset, be alert to possible error or bias in their work, and be able to critically assess evidence, the exercise of those skills in their work as an expert may be different from applying those skills in making decisions in applying the requirements of the Standard. Although some subject matter experts involved in an EER assurance engagement may also have experience and some level of competence in applying professional judgment and professional skepticism and other</p> | <p>The material in paragraphs 137 through 148 has not been included within the draft guidance, but the concepts have been/will be illustrated in the examples in the various areas where PJ/PS are needed. Consideration to be given to further/a broader range of examples throughout the guidance.</p> |
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assurance skills, it is not necessary for such an expert to have such experience or competence during the conduct of their work as an expert used by a practitioner in the context of an assurance engagement.

141. However, if such an expert is also responsible for applying a requirement(s) in the Standard, they will require some level of competence in assurance skills (including professional judgment and professional skepticism) and will, in that respect be a member of the engagement team, whose work is subject to direction, supervision and review under the oversight of the engagement partner. This is discussed further in relation to challenge 9: *Obtaining the Competence Necessary to Perform the Engagement*.

Using the work of management's expert

142. In the context of an EER engagement, management may employ their own subject matter expert/s to assist in the preparation of the subject matter information, giving rise to a number of risks, including that their work may reflect management bias.
143. If information to be used as evidence has been prepared using the work of a responsible party's or preparer's expert, the practitioner is required to evaluate the competence, capabilities and objectivity of that expert, obtain an understanding of the work of that expert and evaluate the appropriateness of that expert's work as evidence.
144. The skills and competence needed in applying professional judgment and professional skepticism in making such evaluations may vary depending on the circumstances of the engagement; for example, where the subject matter is complex or subject to a high degree of measurement uncertainty, a high degree of assurance competence and skills as well as an appropriate degree of competence in the subject matter are likely to be needed to be able to exercise professional judgment and professional skepticism in assessing the risks involved and in determining an appropriate course of action to

address the assessed risks.

145. Where there is a high degree of measurement uncertainty associated with the subject matter, in addition to having an appropriate degree of competence in the subject matter, the practitioner may also need significant assurance skills and experience as well as knowledge of the entity and its business to be able to consider whether there could be pressures or incentives for management to misstate the subject matter information or apply bias when measuring the subject matter, and to be able to question whether the expert has considered all the evidence expected to be available to them, whether the assumptions and methods used to measure the subject matter are reasonable, and to determine the nature and extent of further procedures that may be needed to understand and assess the work of that expert.

Assurance skills and competence

146. Practitioners without significant assurance experience may not have acquired the level of competence to apply a critical, questioning and objective mindset to all aspects of the planning or performance of the engagement, including in reviewing the work of others. For example, they may have insufficient confidence to question or challenge the judgments and assumptions of a preparer or management or practitioner's expert, particularly where they lack the necessary level of subject matter competence.
147. To address this impediment, engagement team members with appropriate levels of competence should be assigned to those areas of the engagement for which their skills are appropriate, and the direction, supervision and review of their work flexed accordingly. Assigning direction, supervision and review responsibilities to members of the engagement team will require consideration of the competence of those performing the direction, supervision and review, as well as the competence of the engagement team member performing the tasks.

Other factors influencing the ability to apply professional judgment and

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| <p>professional skepticism</p> <p>148. Other impediments to the exercise of professional judgment or professional skepticism in EER engagements may include:</p> <ul style="list-style-type: none"> a) Immature reporting frameworks for the EER subject matter information, such that there may be a broad range of possible approaches and acceptable criteria that could be applied by preparers of the subject matter information, necessitating a greater degree of skill and competence by the practitioner in applying professional judgment and professional skepticism in making decisions about the course of action that is appropriate in the circumstances, particularly in relation to the entity's materiality process and assessing the suitability of the criteria. b) Fee pressures that may arise as a result of differences in circumstances between EER and audit engagements, which may be an impediment to being able to apply the appropriate resource to the engagement or to perform the engagement in accordance with applicable technical and professional standards and due care, including those needed to apply professional judgment and professional skepticism. | |
| <p>A framework for applying professional judgment and professional skepticism</p> <p>149. To help practitioners address the needs and impediments identified above, the Task Force proposes developing guidance around the thought processes for considering where professional judgment and professional skepticism may need to be applied, from the acceptance decision and throughout the engagement process. The Task Force proposes to develop examples to illustrate how the practitioner's actions in exercising professional judgment and professional skepticism may need to be flexed depending on the nature of the subject matter, the stage in accepting or performing the engagement, the level of assurance applicable in the circumstances of the engagement,</p> | <p>Some examples included in the draft guidance in the various areas where the exercise of PS and PJ is needed. Further consideration to be given to including an example that more explicitly considers the preconditions and the level of work effort involved, and the exercise of PS/PJ in that context.</p> |

and other factors.

150. While professional skepticism is required to be exercised throughout the process, the Task Force is of the view that it is useful to provide guidance on where and how professional skepticism and professional judgment may need to be applied during the decision-making relating to each of:

- a) The acceptance or continuance decision;
- b) Assessing risk and materiality;
- c) Designing evidence-gathering procedures and obtaining evidence; and
- d) Evaluating the sufficiency and appropriateness of evidence.

Applying professional skepticism in the acceptance or continuance decision

151. In determining whether to accept or continue an engagement, the practitioner considers whether the preconditions for assurance are met, including whether the engagement has a rational purpose,¹² and considers whether the team, collectively, have the appropriate competence and skills to perform the engagement and to enable an assurance report that is appropriate in the circumstances to be issued¹³.

152. Considering whether the engagement has a rational purpose, of necessity, involves being able to understand the intended users' perspective and to make judgments about what is likely to influence the decisions of those intended users. The Task Force believes that it will therefore be important, in developing the guidance, to link the application of professional skepticism to the assessment of criteria, including the 'materiality process' the preparer has applied in developing suitable criteria, and to the assessment relating to the proposed scope of the engagement,

¹² ISAE 3000 (Revised) paragraph 24(b)(vi)

¹³ ISAE 3000 (Revised) paragraph 32a

as discussed in relation to challenge 1: *Determining the Scope of an EER Engagement Can Be Complex.*

153. Before accepting or continuing the engagement, the engagement partner exercises professional judgment to be satisfied that there is no reason to believe that relevant ethical requirements, including independence, will not be satisfied and that those persons who are to perform the engagement collectively have the appropriate competence and capabilities to perform the engagement.¹⁴ This may require an overall stand back to consider a broad range of matters, such as:

- a) The reputation of the entity and its management;
- b) The purpose of the engagement;
- c) The intended users;
- d) Whether there may be fee or time pressures and the effect those may have on the quality of the assurance engagement;
- e) Whether or not there is a well-developed reporting framework;
- f) The complexity of the subject matter and its measurement;
- g) Whether there is sufficient knowledge, experience and ability to perform the engagement;
- h) Whether and where additional expertise may be needed; and
- i) Whether there are other factors that may contribute to the decision to either accept or decline the engagement.

154. The acceptance decision may also involve considerations, by the engagement partner, of whether the practitioner's firm has developed a methodology to help support the performance of an EER engagement and reinforce expectations around the

¹⁴ ISAE 3000 (Revised) paragraph 22(a) and (b)

exercise of good judgment.

155. When developing the guidance, careful consideration will be needed to avoid suggesting that different levels – higher or lower – of professional skepticism are needed in the context of EER engagements, but that, rather, the nature, extent and timing of actions taken in exercising professional skepticism may vary, depending on the nature and complexity of the subject matter, the extent to which experts or other practitioners are to be used, and other factors. The Task Force also proposes to consider the ED of ISQM 1 and whether it may be useful to make linkages to that material.

Assessing risk and materiality

156. During the planning stage of an engagement, the appropriate exercise of professional skepticism is likely to be enhanced by a practitioner's knowledge and understanding of the industry and environment in which the entity operates, its business processes, supply chain, customers and other factors. With such knowledge and understanding, the practitioner will be better placed to ask questions that need to be asked.
157. For example, a practitioner, with their knowledge of the business, and sufficient competence in the criteria, may be able to ask whether the subject matter information is complete, whether there is a heightened risk of misstatement of the subject matter information due to fraud, non-compliance with laws and regulations, lack of preparer competence or management bias. An experienced assurance practitioner has the ability to recognise what could create challenges in preparing the subject matter information and to ask the 'right' questions to obtain an understanding of where the risks may lie, the possible causes of those risks, and to design assurance procedures to address those risks.
158. The exercise of professional judgment and professional skepticism also assists in obtaining an understanding of who the users are and what is likely to influence their decisions when

assessing materiality for the engagement.

159. The Task Force is of the view that it will be helpful to illustrate, through the use of examples, where the assessment of risks and the application of the concept of materiality may require greater or different skills in being able to apply professional judgment and professional skepticism in the context of an EER engagement. It will also be important to take account of the material being developed in relation to ISA 315, and included in ISA 540 (Revised) that requires the practitioner to design and perform risk assessment procedures in a manner that is not biased towards obtaining evidence that may be corroborative or towards excluding evidence that may be contradictory.¹⁵

Designing and performing evidence-gathering procedures

160. Having understood who the users of the subject matter information are, and what is likely to influence their decisions, and having assessed the risk of the subject matter information being materially misstated, the practitioner uses their judgment to consider whether the risk assessment procedures performed provide an appropriate basis for the design of further assurance procedures.
161. During the evidence-gathering stage of the engagement, assurance skills are applied, for example, in assessing information that may bring into question the reliability of documents and responses to inquiries to be used as assurance evidence, or whether there are circumstances that suggest the need for additional assurance procedures, and to reduce the risks of overlooking unusual circumstances, using inappropriate assumptions in determining the nature, timing and extent of assurance procedures and over generalizing when drawing conclusions from assurance observations.
162. The Task Force considers that it will be helpful to illustrate the exercise of professional judgment and professional skepticism

¹⁵ ISA 540 (Revised) paragraph 18

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| <p>through the use of examples to illustrate the type of questions a practitioner might ask at different stages of the engagement or in relation to different engagement circumstances.</p> <p>Evaluating the sufficiency and appropriateness of evidence</p> <p>163. At the conclusion of the engagement the application of professional judgment includes consideration of the sufficiency and appropriateness of assurance evidence obtained to support the assurance conclusion. A critical self-assessment of the work done in the light of the circumstances allows the practitioner to stand back and, again, to consider the subject matter information and the evidence obtained from the perspective of what would be likely to influence the users' decision-making, considering both evidence that supports the conclusion and evidence that may be contradictory to that conclusion.</p> | |
| <p>Other considerations</p> <p>164. This material will also be discussed by the Professional Skepticism Task Force ahead of this agenda item at the IAASB Board meeting in June.</p> <p>165. Reporting considerations identified during the March 2019 Board meeting breakout sessions are considered further in relation to challenge 10: <i>Communicating Effectively in the Assurance Report</i>.</p> | <p>IAASB-IESBA-IAESB paper on Professional Skepticism has been considered and some of the concepts to do with the need for professional skills and business acumen in order to exercise PS; importance of tone at the top, and some of the impediments that arise as a result of personal traits have been included.</p> <p>Examples of PJ in Reporting to be further considered in Chapter 14.</p> |