

July 25, 2017

**IFAC Small and Medium Practices (SMP) Committee Response to the International Ethics Standards Board for Accountants (IESBA) Exposure Draft: *Proposed Application Material Relating to Professional Skepticism and Professional Judgment***

**INTRODUCTION**

The SMP Committee (SMPC) is pleased to respond to the IESBA (the Board) on this Exposure Draft (ED). The SMPC is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small-and medium-sized entities (SMEs). The constituents of the SMPC are small-and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members of the SMP Committee have substantial experience within the accounting profession, especially in dealing with issues pertaining to SMEs, and are drawn from IFAC member bodies representing 22 countries from all regions of the world.

**GENERAL COMMENTS**

The SMPC has followed this particular project since its inception and has provided comment letters for the Board and Professional Skepticism Working Group's consideration as it has progressed. We appreciate the importance of professional skepticism and note the intention for the effective date for the changes in this ED to be the same as that for the restructured Code.

In general, if the Code is to be implemented effectively once the Structure project has been completed, we believe that the IESBA should refrain from making further changes for a sufficient period of time. Therefore, the IESBA's commitment that any new changes to the Code after the completion of the restructuring project will not take effect until after June 15, 2020, unless there is an urgent need to respond to new or unforeseen circumstances is welcomed. This anticipated pause will allow time for accountancy firms, national standard setters, IFAC member organizations and professional accountants (PAs) to consider and implement the necessary changes.

We support the focus on guidance in the Code to PAs undertaking audit, review and other assurance engagements to explain how compliance with the fundamental principles supports the exercise of professional skepticism in the context of such engagements.

We note that IESBA intends to consider whether, and if so, how to extend the concept of professional skepticism to all PAs in the longer term. However, it is our opinion that the concept of professional skepticism as defined in the ISAs had not been designed for activities beyond assurance services. By seeking to extend this concept, it would involve extending the assurance paradigm to other activities of PAs where such a concept may not be appropriate.



The SMPC acknowledges the concerns raised about the potential dilution of meaning and importance of profession skepticism in the audit and assurance context if its applicability were to be extended. In this context, we strongly support the continued coordination between the tripartite Professional Skepticism Working Group. Furthermore, if professional skepticism is extended, enforcement from professional accountancy organizations or other regulators would be expected, but may be difficult to implement in a consistent manner across the globe.

## **SPECIFIC COMMENTS**

We have outlined our responses to each question (*in italics*) in the ED below.

1. *Do respondents agree that the proposed application material enhances the understandability of the conceptual framework in Section 120 of the proposed restructured Code – this is on Professional Skepticism?*

To the extent that a lack of understanding about how compliance with the fundamental principles supports a professional accountant's exercise of professional skepticism when performing audits, reviews and other assurance engagements may be causing issues in practice, we agree with the IESBA's proposal to add clarification in the form of application material within Section 120.

However, the SMPC believes that the text proposed needs to be clearer, better aligned to technical language elsewhere in the Code, and more logical in illustrating how the compliance to a particular fundamental principle supports the application of professional skepticism. We are not convinced that the changes as proposed will be able to influence a noticeable change of behavior among practitioners as intended by the Board.

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?*

In our view, the proposed application material does not 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. We have provided detail under the header of each bullet point below.

### **Integrity**

It should be clear that when – having exercised professional skepticism – the practitioner believes there are indications that more work is required. It is actually the practitioner's honesty and straightforwardness that will drive the practitioner to act (whereas a lack of integrity would result in the practitioner disregarding such indications although they did exercise professional skepticism in the first place).

A technical correction is also needed to the wording regarding false or misleading financial statements. This should be aligned to section 110.2(a) of the extant Code (or R111.2(a) of the draft restructured Code),



which refer to information that contains a materially false or misleading statement, rather than financial statements that are themselves materially false or misleading.

### **Objectivity**

It should be clear that a practitioner's own bias can impair the exercise of professional skepticism, and could therefore influence the practitioner's evaluation of whether the evidence obtained is sufficient and appropriate i.e. it is seeking to being aware of, and addressing, personal bias that is what needs to be emphasized as supporting the exercise of professional skepticism.

A technical correction is needed to the wording "material to the audit", since the ISAs relate materiality to the financial statements and not to the audit.

### **Professional Competence and Due Care**

It is the SMPC's position that without the appropriate level of professional knowledge and skill, the professional accountant will not be appropriately equipped to use professional skepticism in evaluating whether the evidence obtained is sufficient and appropriate. In our view, the phrase "diligently pursuing evidence" is awkward. Reference to the professional accountant being professionally competent and exercising due care by being diligent in performing audit or assurance procedures as a necessary prerequisite for the proper exercise of professional skepticism would be clearer.

- 3. Do respondents agree that the proposed application material enhances the understandability of the conceptual framework in Section 120 of the proposed restructured Code – this is on Professional Judgment?*

We agree with the general direction of the proposed application material in seeking to enhance the understandability of the conceptual framework in Section 120 of the proposed restructured Code dealing with the notion of professional judgment, subject to the following edit - see Question no. 4 below.

- 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?*

The SMPC's concern is that when the Code includes the wording "It is important to ....." in the second sentence, it implies that the IESBA is setting a requirement despite the placement within an application material. We have also noted such anomalies in our Safeguards and Structure Phase II EDs comment letters that were previously submitted.

In addition, obtaining an understanding of already known facts and circumstances in the context of complying with the fundamental principles is not the same as obtaining an understanding in the context of assurance engagements. It therefore needs to be clear that a professional accountant exercising due care would consider the information known to him or her and would need to gather more information only if the second bullet ("the information provides a reasonable basis on which to reach a conclusion") is not fulfilled. The matters listed are "tests" of a different nature in the ED.



**CONCLUDING COMMENTS**

We hope the IESBA finds this letter helpful in informing the Board's deliberations on the ED. Please do not hesitate to contact me should you wish to discuss the matters raised in this submission.

Sincerely,

*Monica Foerster*

Monica Foerster  
Chair, SMP Committee