

July 24, 2017

Chair  
International Ethics Standards Board for Accountants  
45 Fifth Avenue, 14th Floor  
New York, New York 10017

*Re: Exposure Draft, Proposed Application Material Relating to Professional Skepticism and Professional Judgment*

Dear Members of the International Ethics Standards Board for Accountants:

We appreciate the opportunity to provide comments on the exposure draft "*Proposed Application Material Relating to Professional Skepticism and Professional Judgment*" (the "ED") issued May 2017 by the International Ethics Standards Board for Accountants ("IESBA" or "Board"). We note that the objective of issuing the ED is to enhance the profession's understanding of two important concepts in the Code of Ethics for Professional Accountants (the "Code"): professional skepticism and professional judgment. We have concerns that the stated objectives are not being fully met by what is being proposed.

Professional skepticism is an important concept in the auditing and assurance literature and its proper application in practice is foundational to a quality audit. We are supportive of any efforts that will effectively enhance an auditor's understanding of what it means to act with appropriate professional skepticism. The ED attempts to increase this understanding through examples in application material of how compliance with the fundamental principles of the Code supports the exercise of professional skepticism. We are concerned, however, about the effectiveness of the material in meeting the goal.

We are pleased the project did not extend the concept of professional skepticism to all professional accountants; doing so could have had the unintended consequence of confusing the meaning and potentially diluting the importance of professional skepticism for auditors. For that reason, we oppose any future extension of the concept of professional skepticism beyond what is included in the auditing, review and other assurance standards and urge the Board to proceed very carefully with any future projects in this area.

With respect to the changes related to professional judgment, we note that under the Code all professional accountants are required to use professional judgment when applying the conceptual framework. This concept is also implied throughout the Code. We note the proposed changes in the ED emphasize the importance of a professional accountant obtaining a sufficient understanding of the facts and circumstances known to them when applying the conceptual framework. We agree with this need, but the linkage with professional judgment is not clear in the ED.

Finally, we do not feel the changes will be effective in meeting the objectives of the project and do not enhance what is already implicit in the Code. We do not consider that there is any urgent need for these changes at this time. Given the enormous volume of changes currently being made to the Code, we urge the Board to instead explore the topics further in a more thorough and thoughtful manner in order to achieve more substantive incremental benefits from any further changes to the Code.

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## Specific Comments

### 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?**

No, we do not agree the application material enhances the understandability of the conceptual framework. We found the overall aim of the application material to be confusing, overly complicated and at odds with the goal of the restructuring project to make the Code more clear, concise and understandable.

**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?**

We feel the examples are unclear and overly complicated. Specifically:

*Integrity* - If a practitioner is performing an audit, review or other assurance engagement, the practitioner would already be performing procedures on the information that is the subject matter of the engagement in order to be able to conclude and report. Accordingly the notion of being knowingly associated with materially false or misleading information is already in contrast to the purpose of such an engagement and it is not an appropriate example of not exercising professional skepticism. Professional skepticism is most clearly linked with two fundamental principles, objectivity and professional competence and due care. We therefore suggest that the Board delete this example entirely.

*Objectivity* – The example of having an awareness of a personal bias is not intuitive. A better example would be the need to objectively weigh all audit evidence in reaching a conclusion – including evidence that confirms management’s assertions and evidence that conflicts or is contradictory. Evaluating and following up on inconsistencies, and not rationalizing why they may exist, is at the heart of appropriate exercise of professional skepticism.

*Professional Competence and Due Care* - This example should be broader than just identifying risks of material misstatement– exercise of professional skepticism is also important in the assessment of the significance of the identified risks and in the planning and performing of further audit procedures that will result in sufficient appropriate audit evidence being gathered to support the auditor’s opinion. The example also seems to be very audit-centric as it addresses the risk of misstatement to the financial statements, but yet it refers to “accountants.” This wording would not be applicable to a review or other assurance engagements, so we suggest changing the word “accountant” to “auditor” if the example continues to reference the risk of misstatement to the financial statements.

We urge the Board to re-think these examples entirely and use clear, concise wording. The descriptions of objectivity and professional competence and due care in the restructured Code are already quite useful. Rather than giving these proposed examples, it would be more effective to simply refer the reader back to the applicable fundamental principles. This can be achieved by the following:

Auditing, review and other assurance standards, including those issued by the International Auditing and Assurance Standards Board (IAASB), require professional accountants in public practice to exercise professional skepticism when planning and performing audits, reviews and other assurance engagements. Compliance with the fundamental principles of objectivity and professional competence and due care particularly support the exercise of professional skepticism.

What is truly important is guidance for auditors on *how* to exercise professional skepticism, but we consider that this is beyond the remit of the Board and should be undertaken by the IAASB.

**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?**

and

- 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?**

We found the proposal on professional judgment to also be confusing and overly complicated. Starting with the title of the subsection "Exercise of Professional Judgment", it implies the materials will focus on how to exercise professional judgment when applying the conceptual framework. (This is the case with the paragraph 120.5 A2 where the reasonable and informed third party test is described.) However, proposed paragraph 120.5 A1 starts with a statement about using professional judgment during the professional activity, not when applying the conceptual framework. That distracts the reader from the purpose of the application material and should be deleted.

The meaning of the remainder of paragraph 120.5 A1 is also not clear. The second sentence "When exercising professional judgment it is important that the professional accountant obtains a sufficient understanding of the facts and circumstances known to the accountant to identify, evaluate and address threats to compliance with the fundamental principles." is focused on applying the conceptual framework, not exercising professional judgment. Obtaining a sufficient understanding of the facts and circumstances is a necessary starting point for the proper application of the conceptual framework in general. Once an understanding of the facts and circumstances is obtained, then the accountant must exercise professional judgement to consider alternatives, weigh the respective merits and know what conclusions to draw from those facts and circumstances. Professional judgment is a concept that is already embedded in the Code and the proposed paragraph is not enhancing this concept in a meaningful way. As was the case with the proposed changes to paragraph 120.13 A1, the paragraph is overly complex and may add confusion. We suggest that proposed paragraph 120.5 A1 be deleted.

We feel it would better serve the public interest if the Board helps accountants understand *how* to properly apply professional judgment. Comprehensive frameworks in this area have already been published and the Board may wish to consider referring to those in order to create guidance in this area as part of a longer term project.

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We would be pleased to discuss our comments with members of the IESBA or its staff. If you wish to do so, please feel free to contact Wally Gregory, Senior Managing Director of Global Independence, via email (wggregory@deloitte.com) or at +1 203 761 3190.

Sincerely,



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