

26 July 2017

Mr. Ken Siong
Technical Director
International Ethics Standards Board for Accountants (IESBA)
International Federation of Accountants (IFAC)
529 Fifth Avenue, 6th Floor
New York, New York 10017 USA
By email: kensiong@ethicsboard.org

Dear Mr. Siong,

RE: IESBA's Exposure Draft *Proposed Application Material Relating to:*
(a) *Professional Skepticism – Linkage with the Fundamental Principles; and*
(b) *Professional Judgement – Emphasis on Understanding Facts and Circumstances*

Accounting Professional & Ethical Standards Board Limited (APESB) welcomes the opportunity to make a submission on the IESBA's Exposure Draft *Proposed Application Material Relating to: (a) Professional Skepticism – Linkage with the Fundamental Principles; and (b) Professional Judgement – Emphasis on Understanding Facts and Circumstances* (the Exposure Draft).

APESB is governed by an independent board of directors whose primary objective is to develop and issue, in the public interest, high-quality professional and ethical pronouncements. These pronouncements apply to the membership of the three major Australian professional accounting bodies (Chartered Accountants Australia and New Zealand, CPA Australia and the Institute of Public Accountants). In Australia, APESB issues APES 110 *Code of Ethics for Professional Accountants* which includes the Australian auditor independence requirements, as well as a range of professional & ethical standards that deal with non-assurance services.

Overall comments

APESB is supportive of the IESBA's project to clarify the concepts of professional scepticism and professional judgement. We commend the IESBA for collaborating with the International Auditing and Assurance Standards Board (IAASB) and the International Accounting Education Standards Board (IAESB) in this initiative to enhance the exercise of professional scepticism.

APESB is generally supportive of the proposed amendments in respect of assurance practitioners. However, we believe the proposed guidance on professional scepticism and professional judgement does not clearly explain the relationship between these concepts and the conceptual framework. In addition, we believe that in practice a certain level of professional scepticism is applied by all professional accountants and that it is not limited to assurance practitioners.

Whenever a professional accountant performs a professional activity in compliance with the fundamental principle of objectivity, the professional accountant will inherently apply a level of professional scepticism to the evaluation of information and any professional judgements made in relation to the matter.

For professional activities that need to be performed in an independent manner a high level of professional scepticism must be applied by the professional accountant.

While the *Code of Ethics for Professional Accountants* (the Code) does not explicitly state the manner in which professional scepticism is used by professional accountants when they exercise professional judgement, we believe that many accountants would apply professional scepticism in practice without formally recognising it as such.

Incorporating these concepts into the Code will make professional accountants more cognisant of these concepts and their importance in the professional activities they perform for clients and employers.

Therefore, APESB recommends that:

- the proposed guidance on professional judgement be revised to clarify the relationship between professional judgement and professional scepticism;
- the proposed application guidance on professional scepticism is not incorporated into the Code in the current format that limits it to assurance engagements. The application guidance should be included in a section of the Code that is applicable to all professional accountants;
- professional scepticism is described as a continuum that ranges from when professional activities need to be performed in compliance with the fundamental principle of objectivity to when they need to be performed in an independent manner; and
- further consultation is undertaken with stakeholders who provide a range of professional services such as professional accountants who act as independent experts, forensic accountants and insolvency practitioners on how they apply professional scepticism.

Details of our recommendations including our specific comments and editorial suggestions are included in Appendix A for the IESBA's consideration.

In developing APESB's response to the Exposure Draft, we have taken into consideration feedback received from Australian stakeholders including the Australian Auditing and Assurance Standards Board (AUASB). The feedback was gathered through submissions to APESB.

Concluding comments

We trust you find these comments useful in your final deliberations. Should you require any additional information, please contact APESB's Chief Executive Officer, Channa Wijesinghe at channa.wijesinghe@apesb.org.au.

Yours sincerely



The Hon. Nicola Roxon
Chairman

Appendix A

APESB's Comments

In developing a response to this Exposure Draft, APESB has included a general overview of the concepts discussed in the proposed application material. The general overview is then referred to in our comments on the specific matters raised in the Exposure Draft.

APESB's general overview of the proposals

The concepts of professional scepticism and professional judgement are important elements in guiding the professional and ethical behaviour of professional accountants.

APESB supports the addition of application material to the Code to clarify the link between the fundamental principles, professional judgement and professional scepticism. However, we believe that the proposed application material does not adequately address the link between professional scepticism and professional judgement, or how these concepts relate back to the conceptual framework.

We are also of the view that the proposed guidance on professional scepticism is inappropriately limited in its application to assurance engagements.

These points are considered in further detail in the sections below.

Professional scepticism and Independence

The International Accounting Education Standards Board's (IAESB's) standards include professional scepticism as an important aspect of professional skills and professional values, ethics and attitudes that need to be included in the professional education programs for professional accountants. The concept is applied broadly and is not restricted to certain types of professional accountants (i.e. public practice vs business) or the provision of specific activities such as assurance engagements.

We acknowledge that the concept of professional scepticism is often associated with assurance engagements, as there are specific requirements in the auditing and assurance standards to apply this concept when performing auditing procedures.

APESB is of the view that the application of professional scepticism is not limited to assurance engagements. Professional accountants in business and public practitioners who perform other services also exercise professional scepticism in their professional activities albeit in different levels, depending on the extent of professional judgement involved, the type of professional activity performed, and whether the fundamental principle of objectivity or independence is applicable to the relevant circumstances.

Where a professional accountant needs to perform a professional activity in compliance with the fundamental principle of objectivity, the professional accountant will apply a certain level of professional scepticism to the evaluation of information and any professional judgements in respect of the relevant subject matter. However, in instances where the professional activity needs to be performed in an independent manner (i.e. Independent Expert or Liquidator) then professional scepticism of the professional accountant should be at the highest level in a similar manner to an auditor performing an assurance engagement.

For professional accountants in public practice this would apply to certain services such as forensic accounting, valuation services and insolvency services. In most of these engagements, professional accountants will be expected to act in an independent manner,

and therefore the application of the appropriate level of professional scepticism, is key to ensuring that the evidence obtained is appropriately assessed, judgements are made objectively and conclusions are reached and reported in an independent manner. We believe that in some of these engagements the evidence obtained by a professional accountant to form their conclusions is at a comparable level or higher than assurance engagements.

In Australia, APESB has released professional standards that relate to the provision of [forensic accounting](#), [valuation services](#) and [insolvency services](#).

Accordingly, we are of the view that there is a continuum of professional scepticism ranging from when professional activities need to be performed in compliance with the fundamental principle of objectivity to when they need to be performed in an independent manner.

In certain circumstances, professional accountants in business are also required to act independently. For example, when a professional accountant in business act as an independent non-executive director or as a member of an Audit Committee. In these circumstances independence is crucial in performing these roles successfully.

Professional Scepticism and Professional Judgement

APESB is of the view that exercising professional judgement inherently involves the application of an appropriate level of professional scepticism. The exercise of professional judgement entails the application of training, knowledge and experience in making informed decisions, while professional scepticism represents an enquiring mindset and a probing and critical consideration of information intrinsically involved in forming a judgement. Application of professional scepticism enables a professional accountant to suspend judgement until all appropriate evidence or information have been obtained and considered, and then to form a judgement without bias or compromise.

APESB favourably notes that the International Organization of Securities Commissions (IOSCO) have previously stated that professional accountants in business (PAIB) who are responsible for their organisation's financial reporting need to apply professional scepticism throughout the process of preparing their financial statements. PAIBs particularly need to exercise an increased level of professional scepticism when forming judgements involving complex estimates reported in their financial statements.

APESB is of the view that whenever a professional accountant exercises professional judgement, a certain level of professional scepticism is invariably applied. Applying the appropriate level of professional scepticism when exercising professional judgement enables an accountant to comply with the fundamental principle of objectivity or in certain circumstances the requirement to be independent.

Applicability of Professional Scepticism

APESB strongly believes that the applicability of professional scepticism extends to all professional accountants and is not limited to assurance practitioners. As noted above professional scepticism is applied, when a professional accountant is exercising professional judgement in a continuum ranging from circumstances where the professional accountant needs to be objective to when a professional accountant is required to be independent.

APESB favourably notes that the IOSCO and the participants in a 2014 Public Interest Oversight Board (PIOB) Workshop (referred to in the Appendix of the Exposure Draft) expressed similar views regarding the applicability of professional scepticism to all professional accountants.

Therefore, APESB is of the view that the concept of professional scepticism should not be limited in the Code for assurance practitioners. Professional scepticism is an integral part of the process for exercising professional judgement, which is applicable to all professional accountants.

We believe the content on professional judgement can be enhanced by including content on professional scepticism. This will also then make it clear that a certain level of professional scepticism needs to be applied by all professional accountants.

Specific Matters

APESB's responses to the specific matters raised by the IESBA in the Exposure Draft are as follows:

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?**

The APESB does not agree that the proposed application material enhances the understandability of the conceptual framework as it does not clearly define the link between the conceptual framework and professional scepticism.

As noted in the general overview section above APESB believes that whenever a professional accountant performs a professional activity in compliance with the fundamental principle of objectivity, the professional accountant needs to apply a certain level of professional scepticism. We believe that any application guidance included in the Code. should therefore not be limited to assurance engagements.

APESB believes that there is an opportunity for the IESBA to highlight that professional scepticism is an integral part of exercising professional judgement. This could be done by incorporating the concept of professional scepticism into the proposed application material on professional judgement, as discussed in our response to questions 3 and 4.

- 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?**

The proposed listed examples do not assist in describing how compliance with the fundamental principles supports the exercise of professional scepticism and it is not clear that the examples listed are not exhaustive.

Please refer to our comments in the general overview and our response to question no. 1 above for further clarification.

**Proposed Application Material Relating to Professional Judgement
(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?

Subject to our proposed changes below, we agree that the proposed application material on professional judgement improves the understandability of the conceptual framework in the Code. However, as outlined in our general overview on page 3, we feel the material would be enhanced if it included the interrelated concept of professional scepticism.

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 judgement in applying the conceptual framework? If not, why not?

APESB agrees that the application material emphasises the importance of exercising professional judgement in applying the conceptual framework. However, this guidance could be strengthened by incorporating the related concept of professional scepticism, as we have noted in our general overview comments above.

APESB also believes that the application material is appropriately placed in Section 120 *The Conceptual Framework* as the exercise of professional judgement including the application of professional scepticism is relevant to all professional accountants.

Based on this view, APESB propose the following revisions to clarify the relationship of professional judgement with professional scepticism.

- R120.5** When applying the conceptual framework, the professional accountant shall:
- (a) Exercise professional judgement, incorporating an appropriate level of professional scepticism;
 - (b) Remain alert for new information and to changes in facts and circumstances; and
 - (c) Use the reasonable and informed third party test as described in paragraph 120.6 A1.

Exercise of Professional Judgment with Professional Scepticism

- 120.5 A1 Professional judgement involves the application of training, knowledge and experience taking into account the nature and scope of the professional activity being undertaken. When applying professional judgment, professional accountants should apply it with a level of professional scepticism applicable to the professional activity. Professional scepticism should be higher for professional activities that require independence compared to professional activities that require objectivity.

When exercising professional judgement, it is important that the professional accountant obtains a sufficient understanding of the known facts and circumstances and applies an appropriate level of professional scepticism known to the accountant to identify, evaluate and address threats to

compliance with the fundamental principles. In obtaining this understanding, the accountant might consider, among other matters, whether:

- There is an inconsistency between the known facts and circumstances and the accountant's expectations.
- There is potential that key information may be missing from the facts and circumstances known to the accountant.
- The information provides a reasonable basis on which to reach a conclusion.
- Other reasonable conclusions could be drawn from the information being considered.
- The accountant's own preconception or bias might be affecting the accountant's judgment.
- The accountant's ~~own~~ expertise and experience are sufficient, or whether there is a need to consult with others with relevant expertise or experience.

General Comments

APESB's responses to the general matters raised by the IESBA are as follows:

(a) *Small and Medium Practices (SMPs)*

Not applicable.

(b) *Regulators and Audit Oversight Bodies*

Not applicable.

(c) *Developing Nations*

Not applicable.

(d) *Translations*

Not applicable.