

Professional Skepticism – IESBA WG Proposed Text (Short Term)

IESBA December 2016 Meeting Agenda Material for Reference

Note to Meeting Participants: The proposals developed by the IESBA PS Working Group to respond to calls for emphasizing PS in the Code is shaded in gray. A discussion of issues and explanations for those proposals are set out in **Agenda Item 5Ref.1-A**. Certain extracts of the current draft of Section 120, *The Conceptual Framework* (not shaded) are included for context and informational purposes only.

Part 1 – Complying with the Code, Fundamental Principles and the Conceptual Framework

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Section 120

The Conceptual Framework

Introduction

- 120.1 The circumstances in which professional accountants operate might create threats to compliance with the fundamental principles. Section 120 sets out requirements and application material, including a conceptual framework, to assist accountants in complying with the fundamental principles and meeting their responsibility to act in the public interest. Such requirements and application material accommodate the wide range of facts and circumstances, including the various professional activities, interests and relationships, that create threats to compliance with the fundamental principles. In addition, they deter an accountant from concluding that a situation is permitted solely because that situation is not specifically prohibited by the Code.
- 120.2 The conceptual framework specifies an approach for the professional accountant to:
- (a) Identify threats to compliance with the fundamental principles;
 - (b) Evaluate the threats identified; and
 - (c) Address the threats by eliminating or reducing them to an acceptable level.

Requirements and Application Material

- R120.3** The professional accountant shall apply the conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles set out in Section 110.
- 120.3 A1 Additional requirements and application material that are relevant to the application of the conceptual framework
- R120.4** *Reserved for Part C Applicability proposal.*
- 120.4 A1 *Reserved for Part C.*

Proposal – Subject to IESBA Consideration for Approval for Exposure

The proposed text in paragraphs R120.5 to 120.5 A2 seeks to emphasize the need for a measure of review/reflection by all professional accountants to achieve compliance with all aspects of the Code (not just in an audit and assurance context). See also paragraphs 120.13 A1 – 120.13 A3.

R120.5 When applying the conceptual framework, the professional accountant shall:

- (a) Apply a critical mindset in order to understand the facts and circumstances being considered and their implications with respect to the accountant's compliance with the fundamental principles.
- (b) Exercise professional judgment in reaching a conclusion on a reasoned basis;
- (c) Remain alert for new information and to changes in facts and circumstances; and
- (d) Use the reasonable and informed third party test as described in paragraph 120.6 A1.

Critical Mindset

120.5 A1 The professional accountant's application of a critical mindset might involve considering whether:

- The information is inconsistent with other relevant information and whether additional information is needed to draw an informed conclusion.
- Other conclusions could be drawn from the information being considered.
- Preconception or bias might be affecting the accountant's judgment.
- The accountant's own expertise and experience are sufficient, or whether others with a particular expertise or experience might need to be consulted.

120.5 A2 The following examples illustrate how a professional accountant might apply a critical mindset to understand the implications of a particular set of facts and circumstances in relation to compliance with the fundamental principles of:

- Integrity –By diligently considering whether previous judgments made or conclusions reached about a particular situation remain appropriate in light of new information that may imply an outcome that is inconsistent with the objective of the activity or the interests of the entity.
- Objectivity – In forming a judgment about a particular matter, a professional accountant considers whether the accountant's background, familiarity with specific individuals involved or with previous outcomes relating to the matter, or other contextual factors, might unduly influence how the accountant forms that judgment.
- Professional competence and due care – Before undertaking a professional activity, a professional accountant obtains a thorough understanding of the nature, scope and requirements of the activity to determine whether the accountant has the necessary competence, time and resources to undertake that activity.
- Professional behavior – Upon facing a challenging ethical matter involving difficult decisions, a professional accountant considers the implications of the particular situation

for the accountant's conduct and what that might mean for the reputation of the profession.

- Confidentiality – When contemplating disclosure of confidential information, a professional accountant obtains an understanding of the context for making the disclosure and the surrounding circumstances, and what the disclosure might mean with respect to the accountant's compliance with the Code.

Reasonable and Informed Third Party

120.5 A3 The reasonable and informed third party test is a consideration by the professional accountant about whether the same conclusions would likely be reached by another party. Such consideration is made from the perspective of a reasonable and informed third party, who weighs all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time the conclusions are made. The reasonable and informed third party does not need to be an accountant, but would possess the relevant knowledge, experience and impartiality, to understand and evaluate the appropriateness of the accountant's conclusions.

Identifying Threats

R120.6 The professional accountant shall identify threats to compliance with the fundamental principles.

120.6 A1 An understanding of the facts and circumstances, including professional activities, interests and relationships that might compromise compliance with the fundamental principles, is a prerequisite to the professional accountant's identification of threats to such compliance. Certain conditions, policies and procedures established by the profession, legislation, regulation, the firm, or the employing organization that can enhance the professional accountant acting ethically, might also impact the identification of threats to compliance with the fundamental principles.

120.6 A2 Threats to compliance with the fundamental principles might be created by a broad range of facts and circumstances. It is not possible to define every situation that creates threats. In addition, the nature of engagements and work assignments might differ and, consequently, different types of threats might be created.

120.6 A3 Threats to compliance with the fundamental principles ...

Addressing Threats

R120.10 If the professional accountant determines that the identified threats to compliance with the fundamental principles are not at an acceptable level...

Consideration of Significant Judgments Made and Overall Conclusions Reached

R120.11 The professional accountant shall form an overall conclusion about whether the actions that the accountant takes, or intends to take, to address the threats created ...

Considerations for Audits, Reviews and Other Assurance Engagements

Independence

- 120.12 A1 Professional accountants in public practice are required to be independent when performing audits, reviews, or other assurance engagements. Independence is linked to the fundamental principles of objectivity and integrity. It comprises:
- (a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, and exercise objectivity and professional skepticism.
 - (b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude that a firm’s or an audit or assurance team member’s integrity, objectivity or professional skepticism has been compromised.
- 120.12 A2 Part 4 of the Code comprise the *International Independence Standards*. This part set out requirements and application material on how to apply the conceptual framework to maintain independence when performing audits, reviews or other assurance engagements, as the case may be. Professional accountants and firms are required to comply with these standards in order to be independent in relation to such engagements. The conceptual framework to identify, evaluate and address threats to compliance with the fundamental principles applies in the same way to compliance with independence requirements. The categories of threats to compliance with the fundamental principles described in paragraph 120.7 A3 are also the categories of threats to compliance with independence.

Proposal

This proposed text in paragraphs 120.13 A1 – 120.13 A3 is intended to reinforce professional skepticism in the audit and assurance context by explaining how the fundamental principles underpin the effective application of professional skepticism.

Professional Skepticism

- 120.13 A1 As noted in paragraph 120.12(a), independence of mind (and compliance with the International Independence Standards) allows a professional accountant in public practice to act with integrity, and exercise objectivity and professional skepticism when performing audits, reviews, or other assurance engagements.
- 120.13 A2 Complying with the fundamental principles, other than confidentiality, reinforces a professional accountant’s ability to apply appropriate professional skepticism when performing audits, reviews and other assurance engagements. Accordingly, threats to compliance with the fundamental principles are also threats to the accountant’s appropriate application of professional skepticism when performing such engagements.
- 120.13 A3 The following examples illustrate how compliance with the fundamental principles, other than confidentiality, when performing audits, reviews and other assurance engagements reinforces the appropriate application of professional skepticism:
- Integrity – In being alert to facts and circumstances that might lead a professional

accountant to be knowingly associated with materially false or misleading information, the accountant adopts a questioning mind and critically assesses evidence when reaching conclusions.

- Objectivity – In approaching facts and circumstances, without bias or undue influence, a professional accountant critically assesses the evidence, and takes appropriate action in response to that assessment, in forming a judgment or reaching a conclusion based on the evidence.
- Professional Competence and Due Care – In undertaking an engagement with the requisite professional knowledge and skill and appropriate diligence, a professional accountant analyses and critically assesses evidence to the extent that the circumstances demand, and raises questions that are relevant to those circumstances.
- Professional Behavior – In taking steps to avoid conduct that could discredit the profession, a professional accountant critically assesses evidence that is advanced in support of a position that appears contradictory or inconsistent with the accountant's understanding of the particular situation.