

July 25, 2017

Mr. Ken Siong
Technical Director
International Ethics Standards Board for
Accountants (IESBA)
529 Fifth Avenue, 6th Floor
New York
NY 10017, USA

submitted electronically through the IESBA website

Institut der Wirtschaftsprüfer
in Deutschland e. V.

Wirtschaftsprüferhaus
Tersteegenstraße 14
40474 Düsseldorf
Postfach 32 05 80
40420 Düsseldorf

TELEFONZENTRALE:
+49 (0) 211 / 45 61 - 0

FAX GESCHÄFTSLEITUNG:
+49 (0) 211 / 4 54 10 97

INTERNET:
www.idw.de

E-MAIL:
info@idw.de

BANKVERBINDUNG:
Deutsche Bank AG Düsseldorf
IBAN: DE53 3007 0010 0748 0213 00
BIC: DEUTDE33XXX
USt-ID Nummer: DE119353203

Dear Ken,

**Re.: Exposure Draft: “Proposed Application Material Relating to:
(a) Professional Skepticism – Linkage with the Fundamental
Principles; and
(b) Professional Judgment – Emphasis on Understanding Facts and
Circumstances”**

We would like to thank you for the opportunity to provide our comments on the Exposure Draft: “Proposed Application Material Relating to: (a) Professional Skepticism – Linkage with the Fundamental Principles; and (b) Professional Judgment – Emphasis on Understanding Facts and Circumstances” (hereinafter referred to as the “draft”).

We have included our responses to the relevant questions posed in the Exposure Draft in the Appendix to this letter. However, based on those specific comments, we would like to make some general comments on the draft.

We agree with the need for application material to enhance the understandability of the conceptual framework in Section 120 of the proposed restructured Code and with the general direction of the proposed application material. The responses by stakeholders to the ITC of the IAASB showed that the main barrier to the appropriate exercise of professional skepticism appears to be noncompliance with the fundamental principles of the Code, such as with objectivity and integrity. It is therefore very useful for the Code to provide examples in its application material to help explain how compliance with the

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Klaus-Peter Feld, WP StB;
Dr. Daniela Kelm, RA LL.M.

page 2/9 to the comment letter to the IESBA dated July 25, 2017

fundamental principles supports the appropriate exercise of professional skepticism.

We also 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.

However, it seems to us that more care needs to be taken in drafting the application material in both cases. In particular, in relation to the examples of how the fundamental principles support the exercise of professional skepticism, we note that the logic does not appear to work and that in fact the examples in part do not actually explain how the fundamental principles support such exercise.

Furthermore, in relation to the application material on professional judgement, more care is needed to ensure that the words used convey the appropriate level of work effort involved in applying professional judgment when complying with the Code. If IESBA chooses to be active in writing material that has an impact on work effort in relation to compliance with the fundamental principles (in particular, in relation to due care), IESBA needs to ensure that its wording does not appear to draw upon assurance paradigms and consequently suggest a level of work effort that would be inappropriate – particularly for activities that are not assurance engagements.

Related to this, as an additional matter, we would like to comment on the matters relating to the Applicability of Professional Skepticism Beyond the Audit and Assurance Context – Background and Future Considerations section in the Explanatory Memorandum. As pointed out in this section, the concept of professional skepticism as currently defined was designed for audit and other assurance engagements. While we recognize that there may be issues with respect to compliance with the fundamental principles that might need to be resolved in the Code using concepts beyond those principles, simply taking the concept of professional skepticism as currently defined and designed for assurance engagements would involve the inappropriate extension of assurance concepts (and the related work effort and documentation) to other activities of professional accountants. We believe that the approach taken by the IAESB in this case not to be worthy of emulation. Having different definitions of professional skepticism for assurance engagements and for other activities does not appear to be an appropriate solution either. However, we do see room for additional concepts in the Code that might address these needs, such as “critical thinking” and “fortitude”, but these would need to be carefully defined and any requirements and guidance carefully drafted so as to avoid assurance-

page 3/9 to the comment letter to the IESBA dated July 25, 2017

type work effort and documentation being extended beyond assurance engagements. We believe that the term “moral courage” is inappropriate because the Code should not be pronouncing upon “morality”, whereas “fortitude” refers to the mental and emotional strength needed by a professional accountant, which is beyond mere courage.

We hope you found our comments useful and we would be pleased to discuss our comments with you.

Yours truly,

Klaus-Peter Feld
Executive Director

Wolfgang Böhm
Director Assurance Standards,
International Affairs

page 4/9 to the comment letter to the IESBA dated July 25, 2017

Appendix: 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?**

We agree with the need for such application material to enhance the understandability of the conceptual framework in Section 120 of the proposed restructured Code and with the general direction of the proposed application material. The responses by stakeholders to the ITC of the IAASB showed that the main barrier to the appropriate exercise of professional skepticism appears to be noncompliance with the fundamental principles of the Code, such as with objectivity and integrity. It is therefore very useful for the Code in its application material to provide examples to help explain how compliance with the fundamental principles supports the appropriate exercise of professional skepticism.

However, we have a number of concerns with the content and wording of the examples in the bullet points by fundamental principle about whether the examples work (which we address in our response to question 2). We have the following additional wording issue.

Integrity

The second sentence refers to “financial statements being materially false or misleading”. We note that Section 110.2 (a) of the current Code (unchanged as paragraph R111.2(a) of the proposed restructured Code) refers to the professional accountant believing that the information “contains a materially false or misleading statement”. We therefore recommend that the wording in the draft be changed to align with this paragraph in the current Code as follows. “...in the financial statements containing a materially false or misleading statement”.

page 5/9 to the comment letter to the IESBA dated July 25, 2017

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 do not believe that 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 (or application) of professional skepticism, because it appears to us that the examples confuse the underlying logic of the relationship between the fundamental principles and professional skepticism. We address each of the bullet points by fundamental principle below.

Integrity

We do not believe that the example with the reference to “pursuing inquiries or seeking further evidence before reaching a conclusion about a matter of concern is consistent with a questioning mind and the critical assessment of audit evidence involved in exercising professional skepticism” exemplifies how integrity as currently defined in the Code supports professional skepticism. The reference to “pursuing further inquiries or seeking further evidence before reaching a conclusion” is a matter prompted by professional skepticism – not integrity. Furthermore, the fact that this is consistent with a questioning mind and a critical assessment of audit evidence in exercising professional skepticism is not relevant to explaining how integrity supports professional skepticism. In short, the logic applied in the draft of how integrity supports professional skepticism does not appear to work.

Integrity as currently defined would support the application¹ of professional skepticism, for example, by having honesty and straightforwardness drive the auditor to actually pursue further inquiries or seek further evidence before reaching a conclusion when the auditor’s exercise of professional skepticism indicates that pursuing further inquiries or seeking further evidence is necessary before reaching a conclusion. For these reasons, we suggest that wording in the second sentence should read as follows:

¹ In line with the IAASB’s recent ITC, the IAASB makes the distinction between the *exercise* of professional skepticism (that is, what goes on in the auditor’s mind – the attitude) and the judgments made, actions taken and documentation thereof by the auditor that represent the *application* of professional skepticism.

page 6/9 to the comment letter to the IESBA dated July 25, 2017

“Integrity also supports the application of professional skepticism exercised by the auditor by having the auditor’s honesty and straightforwardness drive the auditor to actually pursue further inquiries or seek further evidence before reaching a conclusion, when the auditor’s exercise of professional skepticism indicates that pursuing further inquiries or seeking further evidence is necessary for reaching a conclusion.”

Objectivity

We do not believe that the statement in the second sentence “Self-awareness of the accountant’s own bias when considering evidence relating to a matter material to the client’s financial statements and taking additional steps to evaluate relevant evidence to address such risks of bias are actions consistent with exercising professional skepticism” actually exemplifies how objectivity supports the application of professional skepticism. This is because stating that these actions are consistent with professional skepticism does not really explain how such actions engendered by objectivity support the application of professional skepticism. Furthermore, taking additional steps to evaluate relevant evidence are prompted by the exercise of professional skepticism – not objectivity. Again, the logic applied in the draft does not appear to work.

Objectivity as currently defined would support the application of professional skepticism by causing the auditor to seek to be self-aware about his or her own biases that may impair the exercise of professional skepticism when considering the sufficiency and appropriateness of evidence related to a material matter in the client’s financial statements (please note: given how materiality is defined in ISA 320, a matter is not material to the “audit”, as the current wording in the draft does suggest, but rather the matter is material to the financial statements being audited) and to consider whether additional steps are needed to address such biases. Furthermore, the words used in the example ought to be aligned with the ISAs. For these reasons, we suggest that the second sentence be drafted as follows:

“Objectivity would prompt the auditor to seek to be self-aware of the auditor’s own biases that may impair the exercise of professional skepticism when evaluating the sufficiency and appropriateness of evidence related to a material matter in the client’s financial statements, and to consider whether additional steps are needed to address such biases.

page 7/9 to the comment letter to the IESBA dated July 25, 2017

Professional Competence and Due Care

As with our comments on the examples of integrity and objectivity supporting professional skepticism, we do not believe that the phrase “by diligently pursuing and then critically assessing whether audit evidence is sufficient and appropriate in the circumstances” explains how professional competence and due care support professional skepticism. First, it is unclear to us from the wording what is being diligently pursued. Grammatically it appears that “whether audit evidence is sufficient and appropriate in the circumstances” is being diligently pursued, but that does not make much sense to us. Second, critically assessing whether audit evidence is sufficient and appropriate in the circumstances is a matter that is prompted by the exercise of professional skepticism: the phrase in the draft does not explain how professional competence and due care support such a critical assessment.

Professional competence and due care support the exercise of professional skepticism in that an auditor is only able to critically assess in an adequate manner whether audit evidence is sufficient and appropriate when the auditor is competent in the matters to which the evidence relates and diligently undertakes that critical assessment. We therefore suggest that the second sentence be split into two sentences and drafted as follows:

“... that are relevant to a particular client’s financial statements. Furthermore, only an auditor who is professionally competent in the matters to which evidence relates and who exercises due care by being diligent is able to critically assess in an adequate manner, when exercising professional skepticism, whether audit evidence is sufficient and appropriate.”

**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?**
- 4. Do respondents agree that the proposed application material appropriately emphasizes the importance of professional accountants obtaining a sufficient understanding of the facts and**

page 8/9 to the comment letter to the IESBA dated July 25, 2017

circumstances known to them when exercising professional judgment in applying the conceptual framework? If not, why not?

We have chosen to answer these two questions together, because it proved difficult to answer them separately.

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. However, there are a number substantive matters in the draft wording with which we disagree. Furthermore, we believe that the drafting of the application material could be improved.

In terms of drafting, the use of “taking into account” in the first sentence seems to misuse a gerund. We therefore suggest that the sentence be drafted as follows:

“Professional judgment involves the application of training, knowledge and experience commensurate to the nature and scope of the professional activity being undertaken”.

As a matter of clarity convention, we do not agree with the proposed application material because the wording does not *emphasize* the importance, but *sets forth* the importance, of obtaining a sufficient understanding with wording that suggests a requirement by using the words “it is important that”. The wording therefore needs to be revised so that it does not reflect a “hidden” requirement.

On a more substantive note, unless an activity is an assurance engagement, 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. This paradigm ought to apply to complying with the fundamental principles of the Code, including the fundamental principle of due care, because complying with the fundamental principles of the Code is not akin to an assurance engagement.

We therefore believe that the words “obtaining a sufficient understanding of the facts and circumstances” could be perceived as requiring the professional accountant to seek more information in order to understand, even when the second bullet has been achieved. In IAASB terminology, “obtaining an understanding” involves considerable work effort, and this intimation ought to be avoided. The words “obtaining an understanding”

page 9/9 to the comment letter to the IESBA dated July 25, 2017

also appear to contradict the words “facts and circumstances known to them”, the latter of which appear to indicate that the professional accountant need not seek more information in order to understand the facts and circumstances unless the second bullet point is not achieved. In any case, the drafting needs to be clear as to what the responsibilities of the professional accountant are.

Another substantive issue in the second sentence is the use of the word “evaluate” in this context. At the IAASB the word “evaluate” is defined in its Glossary of Terms as “Identify and analyze the relevant issues, including performing further procedures as necessary, to come to a specific conclusion on a matter.” While we recognize that IESBA does not draw on the IAASB Glossary of Terms, there is nevertheless a danger that the work effort associated with the use of the term “evaluate” in this context will be understood by practitioners as going beyond what IESBA intends – in particular in relation to the potential need to perform further procedures. Any procedures needed to address threats would be covered by the word “address” and if more information is needed, the second bullet point in the draft would cover that consideration. We therefore suggest that the word “evaluate” be replaced with “consider”, which under the IAASB Clarity Conventions means “to apply one’s mind” to the matter in question given the information already obtained, and which we believe accurately reflects the desired work effort. If IESBA chooses to not replace the word “evaluate” with “consider”, we believe it would be important for IESBA to properly delineate the word’s meaning through a definition so that there are no unintended consequences when the Code is applied in conjunction with IAASB engagement standards.

For these reasons, we suggest that the wording of the second sentence be drafted as follows:

“Exercising professional judgment in relation to compliance with the fundamental principles is predicated upon the professional accountant understanding the facts and circumstances known to the accountant to enable to accountant identify, consider and address threats to compliance those principles. In seeking to understand these facts and circumstances, the accountant might consider, among other matters, whether:...”