August 2016
An international guide for preparers, auditors, audit committees, regulators and standard setters across business and not-for-profit sectors

A professional judgement framework for financial reporting decision making

First published August 2012
2nd edition published August 2016
ICAS

ISBN: 978-1-909883-22-2
EAN: 9781909883222

This document is published by the Technical Policy Board of ICAS (The Institute of Chartered Accountants of Scotland). The views expressed in this publication are those of the authors and do not necessarily represent the views of the Council of ICAS. ICAS would like to express its gratitude to those ICAS members involved in the 1st and 2nd editions of this Framework (for further details see Appendix 1).

This booklet can be downloaded without charge from icas.com or by contacting accountingandauditing@icas.com

Contents

Confidence in financial reporting and in principles-based standards requires us to demonstrate collectively that, as professionals, we are capable of making sound judgements. I believe that this professional judgement framework is vital for the future of the profession.

Sir David Tweedie,
former Chair of the IASB and ICAS President 2012

A professional judgement framework - user guide

Introduction

ICAS originally published A professional judgement framework for financial reporting in 2012. It was primarily targeted at accountants (both preparers and auditors) determining the appropriate accounting treatment for particular transactions.

This new edition has been broadened to make it more universally applicable to decision makers involved in financial reporting, whether accountants or non-

accountants, in the private or not-for-profit sectors. It also includes a new section on audit committees and further context on ethical decision making.

Purpose of a professional judgement framework

Professional judgement is a key skill for preparers[1], auditors, audit committee members and regulators of financial statements, especially under a principles-based accounting regime. However, making a judgement can be difficult and there is not necessarily one correct answer.

This professional judgement framework identifies core principles and provides a structured process to guide decision makers through how to make, assess and document significant judgements[2]. It targets significant judgements across narrative and financial reporting including accounting treatment, materiality, estimates and disclosures. It is designed to fit within the context provided by applicable accounting standards. This includes both judgements in the process of applying accounting policies (as per IAS 1 para 122) as well as assumptions and other major sources of estimation uncertainty (IAS 1 para 125). However, these principles can be easily adapted for other judgements where there is a degree of uncertainty and subjectivity involved.

A principles-based approach

The professional judgement framework uses a principles-based approach. ICAS believes that a principles-based approach better serves the needs of users of narrative reports, financial statements and the public interest[3].

Principles-based standards provide a framework within which the regulatory intention can be met, and the economic substance of transactions faithfully represented, without the need for detailed rules. This approach provides scope for professional opinion. It relies on the application of sound judgement by preparers, auditors, audit committees and regulators.

A clearly articulated principle is a more powerful driver of consistency, simplicity and quality than a series of rules which can create unnecessary complexity and stimulate avoidance. This is particularly important in a complex and changing environment.

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[1] 'Preparers' represent all those parties in the company who are involved in judgements on accounting matters for the purpose of financial reporting, including financial accountants, financial controllers, CFOs, finance directors. Audit committees, who advise the full board, are considered separately.
[2] In an ICAS survey, issued to those members of ICAS with an interest in corporate reporting in May 2016, 95% of respondents agreed that a professional judgement framework would be useful. For further details contact accountingandauditing@icas.com.
[3] See Chinese accounting reform: Towards a principles-based global regime (ICAS, 2010, pg 13) for a definition of a professional judgement framework - available at: icas.com. For a fuller argument on the ICAS case for principles-based standards, see Principles not Rules: A Question of Judgement (ICAS, 2006) - available at: icas.com.

The role of standard setters is crucial to the process. As argued in earlier ICAS publications[4], standard setters should create standards which allow judgement within a principles-based framework.

Recommendations to standard setters in maintaining and producing principles-based standards are set out at the end of this document.

Who a professional judgement framework can assist

This professional judgement framework applies internationally to different sizes and types of organisations, whether listed or unlisted, across the private and not-for-profit sectors.

It identifies principles for:

- Preparers - Making and documenting the judgement.
- Auditors - Assessing and challenging the judgement.
- Audit committees - Considering, reviewing and concluding on the judgement.
- Regulators - Assessing the judgement.

The framework is designed to help preparers, auditors and audit committee members (or boards where no audit committee exists) to form an opinion on significant financial reporting matters. It aims to support those assessing the judgement to understand why key judgements have been made and the appropriateness of judgements based on the facts determinable at the time. The framework is also intended to assist regulators' judgement process by ensuring that there is appropriate documentation by preparers, audit committee members and auditors to justify key judgements.

By aiding judgement in financial reporting, the framework supports informed decision making and improved accountability to stakeholders including users and the wider public interest.

It is assumed that judgements are made by those with an appropriate level of knowledge, experience and objectivity. Whilst to some the process of making a judgement may be intuitive, to others it may be new. This framework can assist the training process for those who are new to making professional judgements and enable individuals to recognise situations where they need to seek assistance from others.

The context within which professional judgements are made

Ultimate responsibility

Ultimately the board, or equivalent, is responsible for the annual report and financial statements as well as setting the 'tone at the top' for a sound ethical culture and cascading the company values across all levels of the organisation. There should be a clear escalation and approval procedure so that decisions are made and endorsed at the appropriate level.

Ethical decision making

Good ethics across an organisation lie at the heart of sound decision making. The importance of the 'tone at the top' of an organisation, its integrity, and a sound ethical culture cannot be underestimated in the effective operation of principles-based standards and the quality and integrity of judgements made. Decision makers should not be swayed by any undue pressures or conflicts of interest when making a judgement. Such ethical considerations should be considered when making key judgements and are therefore incorporated into this framework.

Where specific ethical dilemmas arise ICAS has produced an Ethical decision making framework[5]. This ethical framework follows the approach outlined in this professional judgement framework. Where ethical dilemmas arise it is advisable to seek a second opinion from your network, colleagues or where appropriate your professional body. You should also consult your professional body's Code of Ethics – see ICAS Code

[4] Principles not Rules: A Question of Judgement (ICAS, 2006) and Chinese accounting reform: Towards a principles-based global regime (ICAS, 2010) - both available at icas.com.
[5] Ethical decision making framework (ICAS, 2015) - available at icas.com.

of Ethics - and/or the International Ethics Standards Board for Accountants (IESBA) code. Ethical case studies can also provide a useful resource[6].

Judgements on accounting treatment

Judgements should be made within the context provided by existing applicable accounting standards, regulations and law. Principles-based standards inherently require significant judgement in their application to a particular set of circumstances.

This framework has been prepared to assist in determining the appropriate accounting treatment for a particular transaction or group of transactions or an event, where:

- there is no specific standard covering the transaction; or
- there is a standard but no detailed provision of how to deal with its implementation in practice; or
- there are accounting principles in a standard but no detailed provision of how to deal with a specific principle in practice; or
- the standard provides sufficient detail and implementation guidance but still requires significant judgement in its application to the particular circumstances as the appropriate conclusion is highly context- specific; or
- there is more than one set of accounting principles that may apply to the transaction.

IAS 8 (paragraphs 10-12) covers the situation where there is an absence of an IFRS that specifically deals with a transaction. The standard states that when making a judgement the aim should be that the resulting information is relevant and reliable. IAS 8 outlines the other sources which should be referred to in such an instance. IAS 1 (paragraph 122) requires that any judgements made which have a significant effect on the financial statements should be disclosed. The ICAS professional judgement framework incorporates these requirements but takes them forward by including them in a set of principles to be followed by preparers and auditors.

The framework has been prepared on the assumption that IFRSs are being followed, however, this could easily be adapted to other principles-based national generally accepted accounting practices (GAAPs).1

How to use the framework

When using this framework, the following should be borne in mind:

- The framework does not substitute for specialist advice.
- It is assumed that the decision maker is at an appropriate level and suitably experienced to make the judgement.
- The framework has been prepared for guidance and is not intended to be used as a pure 'box ticking' exercise; judgement should be used to ensure that the procedures followed are appropriate to the individual circumstances.
- It is recommended that this framework is used for significant judgements or those which would have a material effect on the financial statements, it is not designed for every judgement made.
- Judgements made may fall within a range of possible outcomes. Due to the subjectivity involved in making a judgement, the framework cannot be relied upon to prevent judgements falling outside the range of acceptable outcomes or otherwise being perceived as 'incorrect'.
- It is assumed that the transactions entered into are genuine and substantive transactions permitted by law; if this appears not to be the case expert advice should be sought.
- The illustrative actions (outlined in the detailed guidance) which you might undertake to apply the principles, is not intended to be prescriptive or exhaustive. Some of the actions may be undertaken concurrently, or will not be relevant, depending on the specific situation.

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[6] ICAS has produced a number of ethical dilemma case studies. The following are available at icas.com:
Molyneaux, D., What do you do now? Ethical issues encountered by chartered accountants (ICAS, 2008)
Shades of Grey: Ethical dilemmas (ICAS, 2009)
Brennan, N., Shades of Grey: Directors' dilemmas (ICAS, 2016)

How to navigate

Each group has a summary of the key principles and detailed guidance. You can go directly to the section you need using the following links:

- Preparers – summary of principles & detailed guidance.
- Auditors – summary of principles & detailed guidance.
- Audit committees – summary of principles & detailed guidance.
- Regulators – summary of principles & detailed guidance.

The principles of a professional judgement framework

Summary of principles

A summary of the key principles on which to base a professional accounting judgement, relevant to each stage in the process, is shown in the following diagrams. More detailed guidance on applying each principle, in the form of illustrative lists of actions, are provided in the subsequent section.

Preparers – Making and documenting the judgement

Preparers, including directors, should ensure that appropriate papers and other documents are prepared and retained to record the process of making key judgements and support the judgements made. The preparer has responsibility for assessing and mitigating the risk of material misstatements. The onus is on the individual to identify all relevant and determinable facts at the time a decision is made.

Stages in the preparation process

Knowledge gathering and analysis

Assessment of accounting guidance

Process for making a judgement

Documentation of judgement

Principles – a professional accounting judgement can only be made:

Principle 1
Once all relevant and determinable information has been collected and analysed.

Principle 2
In the context of the applicable accounting framework, accounting standards, and other relevant literature.

Principle 3
After undertaking appropriate due process.

Principle 4
If the basis of the judgement is suitably documented.

Auditors – assessing and challenging the judgement

Auditors are the first line of external challenge for preparers' judgements. Under the International Standards on Auditing (ISAs) auditors are required to apply professional scepticism when undertaking an audit and evaluating a client's judgements[7]. The ISAs define professional scepticism as 'an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence'[8]. This professional judgement framework will assist auditors in applying professional scepticism – a corner stone of a high quality audit and essential to the application of professional judgement[9].

Stages in the audit process

Knowledge gathering and analysis

Assessment of accounting and auditing guidance

Process for assessing and challenging the client's judgement

Documentation of judgement

Principles – a professional auditing judgement can only be made:

Principle 1
Once all relevant and determinable information has been collected and analysed.

Principle 2
In the context of the applicable accounting framework, accounting and auditing standards, and other relevant guidance/literature.

Principle 3
After undertaking appropriate due process to assess and challenge the client's judgement.

Principle 4
If the auditing judgement and the assessment and challenge of the client's judgement is suitably documented.

[7] Professional Skepticism in an Audit of Financial Statements (IFAC, 2012, pg 1 and 3).
[8] ISA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing - paragraph 13(1), in IFAC Handbook of International Quality Control, Auditing, Review, Other Assurance, and Related Services Pronouncements (2015 or current version).
[9] Professional Skepticism in an Audit of Financial Statements (IFAC, 2012, pg 1 and 4).

Audit committees - considering, reviewing and concluding on the judgement

Audit committees are responsible for providing an independent assessment to the board on accounting affairs and the financial position of the entity. The committee's role includes monitoring and reviewing the integrity of financial statements, the effectiveness of internal control and risk management systems, internal audit function and providing oversight of external audit. This professional judgement framework will help audit committee members to challenge and assess the information and opinions provided by both management and auditors.

Stages in the process

Creating the right environment to effectively review and challenge the judgement → **Review of preparer and auditor papers** → **Decision**

Principles – a professional judgement can only be made:

Principle 1
If at the meeting the facts are clearly laid out, the right people are in attendance, there is enough time for a full debate and the culture of the meeting is conducive to debate and challenge.

Principle 2
After undertaking due process to assess and constructively challenge the preparer's judgement and the auditor's analysis of it.

Principle 3
After assessing and concluding on the judgement, based on the facts available and the responses given to the audit committee.

Regulators - assessing the judgement

Regulators[10] have a role to consider and, if appropriate, challenge preparers', audit committees' and auditors' judgements. This framework aims to assist regulators in understanding why key judgements have been made and in assessing whether judgements were appropriate given the facts available at the time. Regulators are urged to only challenge judgements based on the determinable facts available at the time of the decision rather than using hindsight.

Stages in the assessment process

Review of financial statements → **Review of preparer and auditor documentation** → **Decision**

Principles – a professional accounting judgement can only be made where:

Principle 1
The judgement has been appropriately disclosed in the financial statements or other document.

Principle 2
The accounting and auditing judgement has been suitably documented.

Principle 3
Based on the facts and circumstances available at the time the judgement was made.

[10] Within this report 'regulators' are specifically those responsible for reviewing the financial statements of organisations and the work undertaken by an auditor, such as the Financial Reporting Council in the UK for public interest entities. Arrangements for this vary across sectors and jurisdictions. There are also other regulators who set policy and regulatory frameworks which organisations are required to comply with. These will need to be integrated into the organisation's internal control framework so as to ensure it can meet and abide by the rules established by the regulator.

The principles of a professional judgement framework

Detailed guidance

Detailed guidance in the form of illustrative lists of actions which you might undertake to apply the principles of this professional judgement framework are provided in the following sections. The lists are not intended to be prescriptive or exhaustive. Some of the actions may be undertaken concurrently, or will not be relevant, depending upon the specific situation.

Preparers - Making and documenting the judgement

Principle 1 - knowledge gathering and analysis

A professional accounting judgement can only be made once all relevant and determinable information has been collected and analysed.

Understand the purpose, legal terms and economic substance of the transaction(s):

- Read all relevant documentation, including contracts, agreements, correspondence, etc.
- Consider the expected cash flows from the transaction and the impact on the entity's cash position.
- Consider why each party is undertaking the transaction in order to understand its substance/commercial reality.
- Identify if there are any related or linked transactions which need to be considered in determining the economic substance.
- Consider the uncertainties and range of possible outcomes of the transaction.
- Consider the effect of the transaction, once completed, on the entity's assets, liabilities and operational capabilities.
- Prepare a risk and reward analysis. Consider who bears the risk and who receives the benefits under a range of scenarios governed by the transaction.
- Ask probing questions of those parties who set up the transaction – apply appropriate scepticism.

Principle 2 - assessment of accounting guidance

A professional accounting judgement can only be made in the context of the applicable accounting framework, accounting standards and other relevant literature.

Consider what would be the expected/common sense approach of accounting for the transaction.

Consider if the transaction is covered by existing standards and the extent to which judgement is required.

In the absence of a relevant standard or specific guidance within a standard, or where there are conflicting standards or principles, refer to IAS 8 (paras 10-12), as appropriate, and proceed as follows:

- Consider the treatment of similar transactions under the relevant accounting framework.
- Refer to the conceptual framework for broad principles on definition, recognition and measurement of assets, liabilities, income and expenses.
- Refer to available authoritative accounting texts, for additional guidance.
- Consider if there is a generally accepted accounting practice in either the home or other countries.
- Consider if there is an accepted industry practice.
- Consider if there are other precedents for identical or similar transactions.
- Consider pronouncements of other standard-setting bodies with similar conceptual frameworks.
- Consider if the resulting financial information is both relevant and reliable and gives a fair presentation of the transaction.

Principle 3 - process for making a judgement

A professional accounting judgement can only be made after undertaking appropriate due process.

After obtaining the above information:

- Consider and assess the range of alternative accounting treatments.
- Allow sufficient time to consult with experts and make your decision.
- Obtain appropriate advice from experts, where necessary.
- Identify any self-interest and conflicts of interest to ensure the objectivity of the judgement.
- Ensure that you act ethically when making your decision and are not subject to undue pressures.
- Discuss with colleagues and professional advisers, where appropriate.
- Discuss your initial judgement with your auditors.
- Discuss with audit committee and other board members, where appropriate.
- Discuss with your professional institute, where appropriate.
- Discuss with the regulator and enforcer (pre-clearance), where appropriate and possible.
- Consider whether your proposal is one which you would be happy to defend against any possible reputational risk.
- Make your judgement.
- Consider the possibility of bias in the judgement process and reassess the judgement as appropriate.
- Identify the resultant accounting treatment and entries and ensure they make sense.
- Identify the appropriate note disclosures.
- Follow approval/escalation procedure for key judgements to ensure that material judgements have been endorsed, for example, by the audit committee or board.
- Identify points in time where reassessment of judgement will be required – for example period ends or trigger points in the initial contract.

Principle 4 - documentation of judgement

A professional accounting judgement can only be made if the basis of the judgement is suitably documented.

- The following should be documented in the entity's paperwork:
- Overview of the transaction.
- Relevant accounting literature considered.
- The final judgement made/decision reached.
- Information known at that point in time.
- The timing of the decision.
- The alternative options considered and why the final solution was chosen and the reasons the other options were discounted.
- Any uncertainties in the decision.
- The sensitivity of the judgement to changes in the assumptions made or circumstances of the transaction.
- The process followed in making the decision:

– sources used and relied upon

– discussions held and with whom

– the decision maker and date of the decision.

- The approval process for the decision – who approved it and when.
- Whether reassessment is required, and if so, the date of this review.
- Any shortcomings in the decision making process, for example, if the decision was subject to time pressures or specific expert advice could not be obtained.
- Make disclosure of key, material or significant judgements in the financial statements as required by IAS 1 (paras 122 and 125).

Auditors – Assessing and challenging the judgement

Principle 1 - knowledge gathering and analysis

A professional auditing judgement can only be made once all relevant and determinable information has been collected and analysed.

Read all relevant documentation, including contracts, agreements, correspondence, etc. Obtain additional information from elsewhere, as appropriate or necessary.

Understand the client's process for determining the judgement, including an assessment of competence and review/approval processes in place and whether such procedures have been followed.

Assess the risk of material misstatement in the financial statements.

Understand/analyse the purpose, legal terms and economic substance of the transaction(s):

- Review and challenge the expected cash flows from the transaction and the impact on the cash position of the client.
- Consider why each party is undertaking the transaction in order to understand its substance /commercial reality.
- Identify the other parties to the transaction and consider if they are related parties.
- Identify if there are any related or linked transactions which need to be considered in determining the economic substance.
- Review and challenge the expected effect of the transaction, once completed, on the client's assets, liabilities and operational capabilities.
- Assess the risk and reward analysis prepared by the client. Confirm who bears the risk and who receives the benefits under a range of scenarios governed by the transaction.

Principle 2 - assessment of accounting and auditing guidance

A professional auditing judgement can only be made in the context of the applicable accounting framework, accounting and auditing standards, and other relevant guidance/ literature.

Consider whether the transaction is covered by existing accounting standards, and the extent of judgement required.

Identify and review other relevant accounting literature. Identify and review relevant auditing standards and guidance.

Consider what would be the expected/common sense approach of accounting for the transaction.

If any conflicts of interest or bias are identified, relating to the transaction, reference should be made to the relevant ethical guidance and standards.

Principle 3 - process for assessing and challenging the client's judgement

A professional auditing judgement can only be made after undertaking appropriate due process to assess and challenge the client's judgement.

Consider the uncertainties and range of possible outcomes of the transaction and compare with the client's assessment of these.

Review the client's assessment of alternative treatments and the reasons for rejection. Evaluate whether significant assumptions made by the client are reasonable.

Assess the client's proposed accounting treatment. If the transaction is covered by existing standards, is the proposed treatment in accordance with the appropriate standard? If there is an element of judgement, refer to IAS 8 (paras 10-12), as appropriate, and assess the client's proposed treatment, as follows:

- Is the resulting financial information both relevant and reliable and does it give a fair presentation of the transaction?
- Is it consistent with the treatment of similar transactions under the relevant accounting framework?
- Is it consistent with the conceptual framework for broad principles on definition, recognition and measurement of assets, liabilities, income and expenses?
- Is it consistent with authoritative accounting texts?
- Is it consistent with generally accepted accounting practice in either the home or other countries?
- Is it consistent with accepted industry practice?
- Is it consistent with pronouncements of other standard-setting bodies with similar conceptual frameworks?
- Is there any evidence which would contradict the client's proposed treatment?

Stand back and review the overall picture - consider the interaction with other judgements and the cumulative impact. Individual client judgements may appear reasonable in isolation but cumulatively may result in a higher risk of misstatement.

Discuss with the client – apply appropriate professional scepticism and challenge.

Obtain appropriate advice from experts within the audit firm or externally, where necessary.

Identify any client conflicts of interest or bias to ensure the objectivity of judgements. If there are possible conflicts of interest or bias, reassess the above considerations with a greater degree of scepticism.

Be aware of any undue pressures from the client or within the audit firm and maintain your objectivity and an open mind.

Make your own judgement on the appropriate accounting treatment.

Assess whether the client's judgement on the accounting treatment is similar to your own or within acceptable limits. If not, discuss with your client and consider the implications for the audit and audit report (refer to appropriate ISAs).

Consider whether your decision is one which you would be happy to defend against any possible reputational risk.

Ensure approval/escalation procedure for key judgements have been followed to ensure that material judgements have been endorsed, where appropriate.

Check the resultant accounting treatment and entries and ensure they make sense. Check the resultant note disclosures.

Identify points in time where reassessment of judgement will be required – for example period ends or trigger points in the initial contract.

Principle 4 - documentation of judgement

A professional auditing judgement can only be made if the auditing judgement and the assessment and challenge of the client's judgement is suitably documented.

Documentation of significant matters arising during an audit, the conclusions reached thereon, and significant professional judgements made in reaching those conclusions is required by ISA 230 (para 8(c)).

Record all key information reviewed, supporting evidence obtained and work performed.

Include copies of relevant client schedules relating to significant judgements in the audit file. Ensure that there is also evidence of the audit assessment and challenge of those judgements. This should include:

- How, and by whom, the audit judgement has been made.
- The rationale for the client and audit judgement.
- The alternative options considered and any uncertainties regarding the audit judgement.
- Evidence of any consultation and endorsement of the audit judgement within the firm.
- Evidence of verification of facts and figures to underlying documents or external sources.
- Discussions held with the client to consider the accounting treatment.
- The impact of any disagreement about the accounting treatment on the audit report.
- Whether reassessment is required, and if so, the date of this review.
- Any shortcomings or difficulties in the assessment of the client's judgement, and how these have been overcome.

Audit the disclosure of key, material or significant judgements in the financial statements as required by IAS 1 (paras 122 and 125).

Audit committees - considering, reviewing and concluding on the judgement

Principle 1 - creating the right environment to effectively review and challenge the judgement

A professional judgement can only be made if at the meeting the facts are clearly laid out, the right people are in attendance, there is enough time for a full debate and the culture of the meeting is conducive to debate and challenge.

Ensure the committee has created the right environment to allow professional judgements to be effectively reviewed and challenged.

The committee should have appropriate terms of reference to give it the platform to challenge the judgement. The terms of reference should include a commitment to being independent and maintaining objectivity.

The committee should be independent and be seen to be independent, including the appointment of members, managing conflicts of interest and avoiding bias in decision making.

The committee should maintain an objective approach in assessing and challenging the judgement.

The meeting should be structured to ensure there is appropriate time set aside to review the judgement.

Effective challenge can only be exercised if the papers documenting the judgement are of high quality and available well before the meeting to allow time for consideration.

The development of mutual respect and trust between the committee members, the executives and the auditors is essential if a proper debate is to ensue.

There should be an opportunity for the auditor to meet the audit committee without executive present.

The audit committee should have balanced membership with an appropriate blend of skills and the required level of financial expertise.

Principle 2 - review of preparer and auditor papers

A professional judgement can only be made after undertaking due process to assess and constructively challenge the preparer's judgement and the auditor's analysis of it.

Do the papers presented to the audit committee set out the process taken in coming to the decision?

Have the reasons for the judgement been properly and fully set out?

Was the range of possible outcomes set out and is it clear why one outcome is recommended?

Is the treatment consistent with relevant accounting standards and consistent with accepted industry practice? If not, undertake further scrutiny of the reasons for this departure and consider if appropriate.

Have the preparers and auditors properly considered all information available to them? Is there evidence that the auditors have exercised sufficient scepticism and challenge?

Are the auditors satisfied that the judgement is reasonable? If not, there must be clarity over the difference in views to allow the audit committee to come to a decision on how to resolve the difference. The audit committee should be aware of any undue pressures on the auditors.

Principle 3 - decision

A professional judgement can only be made after assessing and concluding on the judgement, based on the facts available and the responses given to the audit committee.

The audit committee should assess the judgement based on the facts presented to it by the preparers and auditors.

After due consideration of all the facts and following challenge both to the preparers and the auditors, the audit committee needs to conclude on the judgement and proposed accounting treatment presented to it, either accepting, amending or rejecting it.

The audit committee should consider the clarity and completeness of any financial statement disclosures related to the judgement.

The audit committee should ensure that the key points in making their decision are appropriately recorded in the minutes.

Regulators - assessing the judgement

The degree of regulatory assessment of accounting and auditing judgements varies between jurisdictions, therefore, these guidelines may not be relevant in all circumstances.

Principle 1 - review of financial statements

A professional accounting judgement can only be made where the judgement has been appropriately disclosed in the financial statements or other document.

Is there appropriate disclosure of key, material or significant judgements as required by IAS 1 (paras 122 and 125) included in the financial statements?

Is the treatment in line with extant standards or otherwise appears reasonable?

Are the corresponding disclosures in line with the extant standards or otherwise appear reasonable?

What is the preparer's record of compliance with accounting standards?

Was there an earlier approach to the regulator to discuss the treatment - if so, assuming that the facts did not change, is the treatment in line with earlier guidance or pre-clearance provided?

Is it considered necessary to contact the preparers and auditors to seek clarification or obtain documentation in relation to the decision?

Principle 2 - review of preparer and auditor documentation

A professional accounting judgement can only be made where the accounting and auditing judgement has been suitably documented.

Was an appropriate professional judgement framework followed? Is there evidence:

- Of the process undertaken to make or audit the decision?
- That the preparers/auditors understood the transaction?
- That all the facts and circumstances at the date the financial statements were prepared/ signed were considered?

Have the reasons for the judgement been properly and fully set out?

If the treatment is not covered by existing standards, consider whether the procedure followed was appropriate:

- Was reference made to IAS 8 (paras 10-12) in order that the resulting information is both relevant and reliable and gives a fair presentation of the transaction?
- Was the treatment of similar transactions under the relevant accounting framework considered?
- Was reference made to the conceptual framework for broad principles on definition, recognition and measurement of assets, liabilities, income and expenses?
- Was reference made to available authoritative accounting texts?
- Is the treatment consistent with general accounting practice (GAAP) in either the home or other countries?
- Is the treatment consistent with accepted industry practice?
- If necessary, has there been consideration of pronouncements of other standard-setting bodies with similar conceptual frameworks?

Was there an earlier approach to the regulator to discuss the treatment - if so, assuming that the facts did not change, is the treatment in line with earlier guidance or pre-clearance provided?

Were the uncertainties at the time of the decision and range of possible outcomes and their probabilities fully considered?

Did subsequent events render the judgement made inappropriate? If so, to what extent should these post balance sheet events have been foreseen by the decision makers based on the facts available at the time of the decision?

Have the preparers, auditors and audit committees properly considered all information available to them at the time of their decision and were their judgements reasonable in that context?

Is there evidence that people with the appropriate experience and seniority have made or approved the decisions?

Is there evidence that the auditors have exercised sufficient scepticism and challenge? Are there local or cultural factors which may affect the quality of the judgement made?

Principle 3 - decision

A professional accounting judgement can only be made based on the facts and circumstances available at the time the judgement was made.

After consideration of the above factors, assess the extent to which reliance may be placed on the judgement.

Reach a decision on the acceptability of the judgement, based on the facts and circumstances available at the time the judgement was made.

Recommendations for standard setters

Financial reporting should be based upon principles- based standards which provide the scope for professional judgement.

- There should be a clear hierarchy of overarching concepts, principles which reflect the overarching concepts, with the minimum additional guidance necessary to make the standards operational.
- Standards should contain principles which are consistent with the conceptual framework and minimum additional guidance to apply those principles in practice.
- Principles should take precedence over any conflicting guidance/rules.
- Anti-abuse provisions and 'bright-lines'[11] should be avoided if at all possible in accounting standards. Standards should be written on the assumption that the majority of management are trustworthy and seek to provide the best quality information to their stakeholders.
- Guidance should be restricted to what is necessary to make a standard operational.
- Guidance should not be so voluminous or prescriptive so that it effectively becomes a set of rules, which may on occasion, therefore, conflict with the concepts or principles.
- Interpretations should focus on significant issues rather than detailed matters. Detailed matters should be left to the judgement of preparers and auditors with clear disclosure of how that judgement has been exercised.

[11] 'Bright lines are for example, fixed percentages within standards that are used as a surrogate for a broader assessment of an issue, thereby taking away any element of a judgement', Principles not Rules: A Question of Judgement (ICAS, 2006, pg 10).

Appendix 1 - Acknowledgements

This revised second edition has been led by members of the ICAS Business Policy and Public Sector Committees. ICAS wishes to specifically thank the following members of the Business Policy Working Group who produced a new section on audit committee judgement:

Alan Ferguson

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ICAS would also like to thank the members of the ICAS Audit and Assurance, and Corporate Reporting Committees who reviewed and commented on this second edition. Finally, ICAS acknowledges the members of the original Professional Judgement Framework Working Group who produced the first edition of this report in 2012:

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It should be noted that the members involved were acting in their personal capacity and were not representing the organisations for which they work.

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