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**Agenda Item
3**

Committee International Ethics Standards Board for Accountants

Meeting Location: Hilton, Arc de Triomphe, Paris

Meeting Date: June 23-24, 2010

Internal Audit

Objectives of Agenda Item

1. To receive an update on the activities of the IAASB Internal Audit Task Force and how matters that relate to IESBA have been addressed.

Background

The International Auditing and Assurance Standards Board (IAASB) has a project to revise ISA 610 *Using the Work Of Internal Auditors*. The objective of the project is to “revise [the clarified] ISA 610 to reflect developments in the internal audit environment and changes in practice regarding the interactions between external and internal auditors.”

The issues the Task Force is considering include:

- The external auditor’s assessment of the competence and objectivity of the internal audit function; and
- Expansion of the scope of ISA 610 to address instances of internal audit staff providing direct assistance to the auditor.

Given the linkage with the Code of Ethics, the IAASB extended an invitation to the IESBA to appoint a task force member. The IESBA accepted the invitation and Bob Franchini is a correspondent member on Task Force.

The IESBA received an update on the project at its October 2009 and February 2010 meetings. The IAASB plans to approve a draft ISA 610 for exposure at its meeting in the week of June 14, 2010.

Agenda Paper 3-A contains the proposed text that will be considered by the IAASB at their June meeting. If IAASB, when approving the exposure draft, makes any changes that are relevant to the IESBA, an update will be provided to IESBA at the Paris meeting.

Issues

Direct Assistance

The IAASB and Representatives of the IAASB CAG at their March meetings and the IESBA at its February meeting expressed concern about the proposed reference to audit procedures performed by internal auditors as “presumed to provide *less reliable* evidence” although noted that the Task Force had drawn on the concepts regarding audit evidence in ISA 500.¹ However, further changes made by the Task Force to the draft revised ISA 610 have made the reference superfluous as the basis for the external auditor’s judgment on the nature, timing and extent of procedures that is needed to be performed draws on the same requirements and guidance as when using the work of the internal audit function. Accordingly, all references to “less reliable evidence” have been removed.

Internal Auditors and the Engagement Team

The views of the IESBA were sought on the matter of direct assistance at its October 2009 and February 2010 meetings, including whether the extant IESBA Code² prohibits such practices. One question in particular was asked: whether by performing audit procedures on the external audit these individuals may, under the prevailing definitions in the ISAs and the IESBA Code, be deemed to be members of the engagement team?³ The IESBA indicated that it did not intend for the definition of engagement team in the IESBA Code to encompass internal auditors providing assistance to the external auditor, but also noted that some of the wording in the IESBA Code could inadvertently be interpreted to suggest that an internal auditor may not work under the direction of the external auditor.

Section 290.163 of the IESBA Code states that an example of activities that would generally be considered a management responsibility includes directing and taking responsibility for the actions of the entity’s employees. The IESBA considered whether by directing, supervising and reviewing the internal auditors when obtaining their assistance on the audit engagement, the external auditor may be considered to be assuming a management responsibility which is prohibited under the IESBA Code. The IESBA concluded that it is not its intention that the external auditor’s actions in directing, supervising and reviewing of the internal auditors who are providing direct assistance on the audit would be considered as performance of a management responsibility as in this case, the external auditor actions are concerned with matters relating to the audit and therefore within the remit of the external auditor’s responsibilities. In connection with this, the IESBA also considered and decided that clarification of this matter in the IESBA Code or through other means is not required.

¹ ISA 500, “Audit Evidence”

² The IESBA’s *Code of Ethics for Professional Accountants* (IESBA Code).

³ In the ISAs, the engagement team is defined as all partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes external experts engaged by the firm or a network firm. In the Code, the engagement team is defined as all personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.

Separately, the IESBA also drew a parallel between the case of direct assistance and when the external auditor accepts an engagement to provide internal auditing services to an audit client, and the results of those services are used in conducting the external audit. The IESBA discussed the likelihood that in the same way, self-review threats may arise when the direct assistance of internal auditors is obtained on the procedures performed in connection with work of the internal audit function which the external auditor plans to use on the audit engagement.

The Task Force has considered the IESBA's comment and, in light of the self-review threat, recommends that a prohibition be introduced to disallow the external auditor from obtaining the direct assistance of internal auditors in performing procedures for determining the adequacy of the work of the internal audit function that the external auditor plans to use for purposes of the audit engagement. The Task Force believes that this is appropriate because the results of these procedures form the basis for supporting the external auditor's planned use of the work of the internal audit function. Consequently if the procedures are performed by the internal auditors, self-review threats will be generated.

Action requested

IESBA members are asked to determine whether there are any additional matters that they believe should be raised with the IAASB Task Force, for consideration after the exposure process.

Material Presented

Agenda Paper 3

Agenda Paper 3-A

This Agenda Paper

Draft ISA 610 *Using the Work of Internal Auditors*