

Note to the IESBA: Comments in italics indicate discussions that took place at the September 2011 IAASB meeting and at other recent meetings of IAASB leadership with regulators and audit inspection bodies.

IESBA Task Force Observations

1. In June 2011, the International Ethics Standards Board for Accountants (IESBA) agreed to set up a task force (“IESBA Task Force”) to consider respondents’ comments relating to ethical matters received on the IAASB’s ISA 610 Exposure Draft (ED).¹ Chair of the ISA 610 Task Force has been invited to participate as a correspondent member on the IESBA Task Force.
2. The IESBA Task Force met for the first time on September 5, 2011. The following summarizes the matters noted by the IESBA Task Force for purpose of input to the September 2011 IAASB meeting.

Updates to the IESBA:

The IAASB discussed the recommendations of the IESBA Task Force at their 19-23 September 2011 meeting. The IAASB’s responses are noted below. In addition, IAASB leadership also had the opportunity for dialogue on the proposed ISA 610 with regulators and audit inspection bodies. Discussions that took place during these meeting are also noted below.

In September 2011, prior to the IAASB meeting, IAASB Chairman Prof. Arnold Schilder, and IAASB Deputy Chair and Chair of the ISA 610 Task Force Diana Hillier met with the European Audit Inspection Group (EAIG) at their meeting in Oslo, Norway. The EAIG, members of whom had significant reservations with the ED, had requested an update on the status of the IAASB’s revision of ISA 610. Draft revised ISA 610 was provided in advance to the EAIG together with an overview of how the IAASB has addressed ED comments received.

The general view of the EAIG was that the IAASB had been responsive to the concerns expressed by regulators on the ED and there was broad support for the revised draft ISA 610 as provided to the EAIG. A similar message was reinforced in a subsequent meeting that the IAASB Chairman and IFAC Executive Director Jim Sylph had with the International Forum of Independent Audit Regulators (IFIAR).

Nonetheless some members of the EAIG expressed residual unease about the risk that, in the current economic environment, there would be increased pressure on external auditors to use direct assistance to reduce audit fees. Whilst the comment was made that the safeguards now reflected in the requirements in the draft ISA 610 appeared sound, there was a worry about possible misuse. Some regulators and representatives of the IAASB Consultative Advisory Group continue to be concerned about the perceived conflict of direct assistance with independence requirements and there was interest in receiving feedback on the outcomes of

¹ Proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* and proposed ISA 610 (Revised), *Using the Work of Internal Auditors*

the IESBA deliberations.

The IAASB will be reviewing a revised draft ISA 610 at in December 2011 with a view to final approval. The IAASB will take into account the regulatory community's satisfaction with the proposed draft revised ISA, as well as the outcome of IESBA's deliberations. At that time, a decision will be made regarding whether or not re-exposure is necessary.

Safeguards Relating to the External Auditor's Use of Internal Auditors to Provide Direct Assistance

3. The IESBA Task Force observed that responses to the ED that were the most critical noted that the ED appeared to permit direct assistance to such a wide extent that it endangered the independence of the external auditor and, accordingly, raised questions with regard to its compatibility with the IESBA Code. These respondents looked to direct assistance, if to be permitted, being used only in limited circumstances. The IESBA Task Force noted that proposed revised ISA 610, since the ED, had been strengthened to address these concerns.
4. Respondents also pointed out that the use of internal auditors for direct assistance seemed to be inconsistent with the definition of "engagement team" in the IESBA Code.² The IESBA Code contains the following definition of "engagement team":

All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform assurance procedures on the engagement. This excludes external experts engaged by the firm or a network firm.
5. Having considered the responses to the ED, the IESBA Task Force is of the view that the definition of "engagement team" in the IESBA Code should be modified to scope out internal auditors providing direct assistance. This could be achieved by including in the definition an explicit statement that internal auditors providing direct assistance are excluded. However, any such recommendation by the IESBA Task Force to the IESBA would be premised on the IESBA Task Force being wholly satisfied with the adequacy of the safeguards contained in proposed revised ISA 610 relating to direct assistance.
6. The IESBA Task Force was broadly comfortable that the threats and safeguards approach adopted in the September 2011 version of draft revised ISA 610 (see Agenda Item 9-C) is appropriate. However Task Force members were of the view that when communicating with those charged with governance an overview of the planned scope and timing of the audit in accordance with ISA 260,³ because of the nature of direct assistance, external auditors should be *required* to communicate their planned use of direct assistance from internal auditors.⁴ Further, it was felt that it is important that the external auditor seek the concurrence of those charged with governance prior to engaging the direct assistance of internal auditors.
7. This matter has previously been debated by the IAASB. At the time of its discussion, the IAASB was supportive of the inclusion of application material to reference the

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

³ ISA 260, *Communication with Those Charged with Governance*, paragraph 15

⁴ This could be achieved by elevating paragraph A33 in Agenda Item 9-C to a requirement.

communication requirement of ISA 260. However the IAASB did not believe that it would be appropriate to require in *all* cases communication with those charged with governance the external auditor's planned use of direct assistance. While it may be seen as a safeguard, there may be cases where it may result in unintended consequences such as pressure on the external auditor to justify its use of internal audit resources which in turn may, inadvertently, introduce pressures on the external audit to use internal auditors to a greater extent when it may be inappropriate to do so.

Update to the IESBA:

The IAASB discussed this proposal at length. There were mixed views on whether this would be as robust a safeguard as suggested based on experiences in practice. This was reinforced by a comment made at the EAIG meeting that some of the regulators have observed pressure on fees coming from audit committees.

However, the IAASB did agree that dialogue with the audit committee about planned use of both the work of the internal audit function and any planned use of direct assistance is consistent with the overarching concepts in ISA 260, Communication with Those Charged with Governance.

The Board did not support a requirement for external auditors to seek pre-approval of those charged with governance, but believed that communication of planned use would facilitate the appropriate dialogue. The Task Force was asked to present proposed wording for the IAASB's consideration in December 2011.

8. The IESBA Task Force also questioned whether prohibiting the use of direct assistance if there are *significant* threats to the objectivity of the internal auditor sets the bar too high. In their view, the bar should be set in relation to the proposed safeguards (as articulated in paragraphs 27–30), that is, when there are threats to the objectivity of internal auditors that cannot be addressed adequately by the proposed safeguards.

Update to the IESBA:

While agreeing with the objective of this comment, the IAASB did not agree that it was necessary to change the wording of the requirement for the following reasons:

- *Requirements in the ISAs, while often giving effect to a threats and safeguards approach, have not directly introduced the concept nor used that terminology. Thus, it would be a more significant undertaking than just amending the wording of this particular requirement, as the whole concept would need to be properly explained in the ISAs.*
- *However, the IAASB believes that paragraph 26, when taken together with paragraphs 27, 28 and 30 collectively would achieve the same result.*
- *The purpose of the threshold in paragraph 26 is to define the circumstances when direct assistance can never be used. Although not stated explicitly, these are circumstances when*

the IAASB did not believe that any safeguards could adequately mitigate the threat to objectivity (or at least could not adequately mitigate the perception that any safeguards would not be adequate). This requirement is not, however, intended to define all circumstances when direct assistance should not be used. The requirements in paragraphs 27 and 28 provide additional boundaries which will result in direct assistance being limited to lower risk areas involving less judgment. Paragraph 30 requires safeguards (that is, the nature and extent of direction, supervision and review) to be commensurate with the evaluation of the threats to objectivity (that is, the higher the threats, the more direction, supervision and review required). Review, in all circumstances, is also expected to include checking back to the underlying audit evidence.

Matter for IAASB Consideration

1. The IAASB is asked at this time to share its thoughts on the following:
 - (a) Requiring the external auditor to communicate with those charged with governance the external auditor's planned use of direct assistance from internal auditors; and
 - (b) Setting the boundary for use of internal auditors to provide direct assistance in relation to the proposed safeguards (per paragraphs 27–30).

The IAASB's further reflection on the matter will be shared with the IESBA for its consideration.

Drafting Improvements

9. The IESBA Task Force also made drafting suggestions to further improve draft revised ISA 610 as follows:
 - *Alignment to the Wordings in the IESBA Code.* It was identified that in some areas in draft revised ISA 610, the wordings may be revised to better align with the IESBA Code. The IESBA Task Force suggested conforming language in some cases including for example, amending “*compromise* professional judgment” to “*override* professional judgment,” and amending “evaluation of threats to the objectivity of an internal auditor” to “evaluation of *the existence and significance* of any threats to the objectivity of an internal auditor.”⁵

Update to the IESBA:

The IAASB supported aligning the wording as suggested by the IESBA Task Force.

⁵ Refer to paragraph A35 of Agenda Item 9-C.

- *Clarification of Language.* It was felt that draft revised ISA 610 may be further enhanced by clarifying the language used in some areas. For example, in the list of examples of activities and tasks that would not be appropriate for external auditors to use internal auditors to provide direct assistance, the IESBA Task Force questioned whether the example of “discussion of matters relating to audit opinion” is too broad and whether this is the intention of the IAASB.⁶ Also, in relation to the external auditor directing internal auditors who are engaged to provided direct assistance, the IESBA Task Force questioned whether the reference to external auditors directing internal auditors to bring all *significant* accounting and auditing issues identified during the audit to the attention of the external auditor sets too high a bar. It was suggested that it may be more appropriate for *any* of such matters to be raised with the external auditor.⁷

Update to the IESBA:

The IAASB agreed with the observations of the IESBA Task Force on these paragraphs and supported making amendments to clarify the wordings.

10. The ISA 610 Task Force will further consider the IESBA Task Force’s observations at its next meeting for developing a revised draft ISA 610 (Revised) for the IAASB’s consideration with a view to final approval in December 2011.

⁶ Refer to paragraph A38 of Agenda Item 9-C.

⁷ Refer to paragraph A41 of Agenda Item 9-C.