

Agenda Item 5



Meeting Location: Hilton, 1335 Avenue of the Americas, New York, United States

Meeting Date: October 17-19, 2011

ISA 610 Using the Work of Internal Audit

Objectives

1. To consider issues raised by the IESBA ISA 610 Task Force and the IAASB's consideration of these issues.

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 IAASB 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 IAASB Task Force.

At previous meetings, the IESBA considered the issue of internal auditors providing direct assistance and whether this was appropriate in consideration that they were not independent of the audit client. The IESBA had concluded that the threats and safeguards approach being proposed by the Task Force, by which the external auditor would perform additional review and supervision on the work of the internal auditors, gave adequate recognition to the fact that internal auditors were not independent of the audit client. In

view of this, the IESBA also concluded that the definition of engagement team¹ did not need clarification.

The IAASB issued an exposure draft in July 2010. A number of respondents to the exposure draft commented on the apparent inconsistency between the use of internal auditors to perform the external audit procedures and the requirement under the Code for external auditors to be independent of the audit client. Some of these respondents noted how internal auditors performing external audit procedures, in effect, would be part of the engagement team and the Code required that the engagement team be independent of the audit client. An extracts of the June 2011 Agenda Paper discussing this issue is contained in the Appendix to this Agenda Paper

The IESBA discussed the IAASB project at its June 2011 meeting and, in light of the comments the IAASB had received on exposure, concluded that an IESBA Task Force should be formed to consider the comments related to direct assistance and the definition of engagement team. The Task Force² met on September 5, 2011 to discuss the comments and possible revisions to ISA 610.

Discussion

The IESBA ISA 610 Task Force discussed the responses received to the IAASB ED in relation to direct assistance. The Task Force was of the view that:

- The definition of engagement team should be modified to explicitly scope out internal auditors providing direct assistance;
- The auditor should be required to communicate to those charged with governance the planned use of direct assistance from internal auditors;
- The requirement regarding the prohibition of using direct assistance when there are significant threats to the objectivity of the internal auditor, should be modified to prohibit an auditor from using direct assistance if the threats to objectivity cannot be reduced to an acceptable level. This would be more consistent with the Code which requires a professional accountant to apply safeguards to eliminate or reduce threats to an acceptable level;

The IESBA also proposed some drafting improvements.

These matters were discussed by the IAASB at its September 2011 meeting. Agenda Paper 5-A outlines the matters raised by the IESBA ISA 610 Task Force and the IAASB's consideration of those matters.

² Bob Franchini (chair), Peter Hughes, Caroline Gardner, Brian Walsh and Diana Hillier (IAASB Correspondent member)

Material Presented

Agenda Paper 5	This Agenda Paper
Agenda Paper 5-A	Issues Raised by Task Force and IAASB Response
Agenda Paper 5-B	Draft Wording of revised ISA 610

Action Requested

1. IESBA members are asked to consider the issues raised by the Task Force and the IAASB's response. IESBA members are asked to consider whether the completeness of the issues raised by the Task Force and the adequacy of the IAASB response.

Appendix

Extract from IAASB Agenda Paper – Comments Relating to Direct Assistance and the Definition of Engagement Team

Fifty-seven comment letters have been received (representing the views of a total of 72 organizations and individuals). Responses belong broadly to the groups shown below:

<i>Respondents (By Main Groupings)</i>	<i>Number</i>
<i>Regulators and Oversight Authorities³</i>	<i>9</i>
<i>National Auditing Standard Setters</i>	<i>3</i>
<i>Public Sector Organizations</i>	<i>8</i>
<i>Accounting Firms</i>	<i>8</i>
<i>IFAC Member Bodies & Other Professional Bodies</i>	<i>21</i>
<i>Others (including individuals)</i>	<i>8</i>
<i>Total Responses</i>	<i>57</i>

A list of respondents is contained at the end of this Appendix.

The Exposure Draft asked respondents for their views on the following:

4. *Do respondents believe that it is desirable for the scope of ISA 610 to be expanded to address the matter of direct assistance? If so, do respondents believe that when obtaining the direct assistance of internal auditors the external auditor should be required to:*
 - (a) *Consider the factors that have been proposed in determining the work that may be assigned to individual internal auditors; and*
 - (b) *Direct, supervise, and review the audit procedures performed by the internal auditors in a way that recognizes they are not independent of the entity?*

Almost all the respondents agreed that it is undesirable for the ISAs to continue to be silent on the matter of direct assistance. These respondents expressed that the IAASB should remove the ambiguity regarding whether or not external auditors are permitted to use internal auditors to provide direct assistance on the audit, and if so, provide appropriate direction on the procedures that need to be performed by the external auditor.

³ Responses included: (i) Audit Inspection Unit & Auditing Practices Board, Financial Reporting Council, UK; (ii) Basel Committee on Banking Supervision; (iii) Committee of European Banking Supervisors; (iv) Committee of European Securities Regulators; (v) Canadian Public Accountability Board; (vi) Federal Audit Oversight Authority, Switzerland; (vii) International Organization of Securities Commissions; (viii) Independent Regulatory Board for Auditors, South Africa; and (ix) 14 independent European audit regulators/oversight bodies: Bulgaria, Estonia, Finland, Greece, Lithuania, Luxembourg, Malta, the Netherlands, Norway, Portugal, Slovakia, Slovenia, Spain and Sweden (referred to as 14AR).

Respondents' views on whether the ISAs should permit direct assistance were, however, polarized. This is as expected and consistent with the views heard by the IAASB during the development of the ED. Regulators and oversight bodies⁴ expressed the least support for permitting external auditors to use internal auditors to provide direct assistance on the audit. Those who accept the use of internal audit in this way, generally expressed that if permitted, direct assistance should be restricted to more limited circumstances than the ED allowed and, in some cases, respondents indicated being comfortable with its use in only very limited circumstances.⁵

Respondents who disagreed that external auditors should be permitted to use internal auditors to provide direct assistance on the engagement broadly argued one or more of the following:

- (a) The distinct differences between the external audit team and the internal audit function are blurred under these circumstances. It is argued that since internal auditors are employees of the entity, this could negatively impact on the perceived independence of the external audit. Some argued that the independence of the external auditor may also be compromised in fact because the internal auditor is permitted to work at such close proximity with external auditors in these circumstances.*
- (a) Involving internal auditors who are not independent of the entity in the performance of audit procedures for purpose of the engagement seems incompatible with the IESBA Code which requires members of the external audit engagement team to be independent. For this reason, several respondents also noted that it should be made clear whether internal auditors are considered to be members of the engagement team in such circumstances. Some of these respondents suggest that the IESBA Code could be revised to clarify that they are not considered part of the engagement team, which is something that has been done in some jurisdictions.*
- (b) Because internal auditors are employed by the entity, they are ultimately accountable to management or those charged with governance as opposed to the external auditor, even though they are "seconded" to the external auditor to provide assistance on the audit. Therefore, as their first loyalty is to management or those charged with governance, the seconded internal auditors may share confidential information regarding the audit with them that could undermine the external audit.*
- (c) The external auditor may engage in inappropriate use (that is, over or due use) of internal auditors to provide direct assistance on the audit as a result of pressure from management. These scenarios typically arise when management is attempting to lower audit fees.*

⁴ 14AR, CEBS, CESR and FAOA. Other stakeholders who did not support permitting direct assistance include, IDW, D. Juvenal and SNAO.

⁵ AAA, AIU & APB, BCBS, CPAB, FEE, IOSCO, IRBA, JICPA, LS and NZICA

Respondents⁶ felt that should the IAASB decide to permit direct assistance, the safeguards to be applied by the external auditor would need to be strengthened in any case (for example, through requiring a minimum level of procedures (such as that which is required in ISA 600)⁷ and re-performance on the work performed by internal auditors). Of these, there was the view that external auditors should only be permitted to obtain direct assistance in a limited range of circumstances which should be clearly outlined in the ISA. In particular, it was indicated that it is essential that the external auditor gives consideration to the assessed risk of material misstatement when determining the nature and extent of work to assign to the internal auditors.

The following enhancements to the ED were also suggested:

- (a) Formalizing arrangements with the entity prior to obtaining the direct assistance of internal auditors.⁸*
- (b) Providing examples of specific situations or audit procedures where it is appropriate to engage the direct assistance of internal auditors, and where it would be inappropriate to do so.⁹*

IAASB Task Force's Recommendations

The Task Force believes that there are two options that the IAASB may consider: either (i) further limiting the circumstances in which external auditors can use internal auditors to provide direct assistance on the audit and strengthening the framework for the external auditor's judgment in this regard; or (ii) prohibiting direct assistance in all circumstances.

This will be a finely balanced decision that the IAASB needs to make. It will require carefully weighing the deeply-divided views that exist, the possible impact that introducing requirements regarding direct assistance may have in practice (particularly in jurisdictions where direct assistance is not well established), and the implications for practice globally if such practices were to be prohibited in the ISAs.

Views have also been expressed that direct assistance appears to be in conflict with the IESBA Code. The IESBA had debated this matter during the development of the ED and concluded that is not the case. It believed that the threats and safeguards approach proposed in the ED was appropriate and dealt with the issue sufficiently such that no further clarification in the IESBA Code was required. Some respondents disagreed,¹⁰ and either asked for further clarification in the IESBA Code (for example, amend the IESBA Code to allow for direct assistance), or, if they did not support direct assistance, argued

⁶ 14AR, ACCA, AIU & APB, AICPA, BCBS, CESR, CPAB, FEE, FSR, HC, IOSCO, IRBA, JICPA, KPMG, NZICA and SAICA

⁷ ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

⁸ AIU & APB, FAR, FEE, FSR, ICAEW, JICPA and NIVRA

⁹ AAA, AUAASB, BCBS, CEBS, CESR, IRBA and LS

¹⁰ 14AR, AIU & APB, ACCA, BCBS, BDO, CEBS, CESR, CNCC & CSOEC, D. Juvenal, FAOA, FARSRS, FEE, FSR, ICPAK, IDW, IOSCO, IRBA, NIVRA and P. Angulo

that the ISA not allow it. These matters will be raised with the IESBA for discussion at its June 15–17, 2011 meeting. Given the importance of IESBA's views to the IAASB's own decisions regarding direct assistance, the IESBA's discussions at its June 2011 meeting will be referred to during the IAASB's discussion of the related matters. It is however likely that, in view of the significance of the comments received, the IESBA will require additional time to discuss this issue before it reaches a conclusion.

If a decision is made that it is permissible, the Task Force accepts that, at a minimum, further limiting the circumstances (beyond the restrictions already in the ED) in which external auditors can use internal auditors to provide direct assistance on the audit is necessary to address reservations that some respondents have expressed over permitting such practices.

The Task Force proposes the following amendments to the ED to strengthen the framework for the external auditor's judgments when determining the nature and extent of work that may be assigned, and the nature, timing and extent of direction, supervision and review that is appropriate:

- (a) Prohibiting external auditors from using internal auditors to provide direct assistance to perform procedures that:*
 - Are designed to respond to a significant risk of material misstatement; and*
 - Relate to areas on which the internal audit function have already reported on to management or those charged with governance with which the internal auditors have been involved.*
- (b) Requiring external auditors to formalize arrangements with the entity prior to obtaining the direct assistance of internal auditors including:*
 - Obtaining agreement from an appropriate representative of the entity that the internal auditors will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor; and*
 - Obtaining agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and will inform the external auditor of any threat to their objectivity.*
- (c) Strengthening the safeguards—external auditors' review of the work performed by internal auditors—through inclusion of a requirement for external auditors to check back to the underlying audit evidence for some of such work performed.*
- (d) Removing ambiguity in the ISA by clarifying the circumstances in which internal auditors may be used to provide direct assistance, and those in which it would be inappropriate to do so.*

The Task Force felt that these amendments would also go a long way towards safeguarding against over or undue use of internal auditors on the audit as a result of

management pressure. However, the Task Force is aware that they are unlikely to go far enough for some respondents.

The Task Force is cognizant that varying practices exist today regarding the use of internal auditors to provide direct assistance on the audit. Some jurisdictions¹¹ have elected to disallow such practices entirely for one or more of the reasons discussed in paragraph 25, and the fact that the practice may be prohibited was clearly recognized in the ED.

In other jurisdictions, however, it is widely practiced. The Task Force has not been made aware of circumstances when direct assistance has negatively impacted audit quality. It is aware, however, that some believe it could impact the perception of audit quality because overuse may undermine perceptions that it is an independent external audit. Views have also been expressed that external auditors may be facing increasing pressure to use more direct assistance to help reduce audit fees, which some believe could pose a risk to audit quality in future.

In those jurisdictions where direct assistance is currently allowed and used in practice, prohibition in the ISAs would impact on audit cost, although this should, of course, not be a decisive factor if stakeholders believe it is warranted because they perceive a commensurate increase in audit quality. In addition, however, introduction of a prohibition in international standards but not in national auditing standards would create a conundrum for auditors who are members of the Forum of Firms (FoF).¹² This may explain why some, although not supporting direct assistance, thought the ISAs should allow it, albeit in limited circumstances and with robust safeguards.

The IAASB's view on the possible risks to audit quality (or perceptions thereof) and whether those risks outweigh the potential benefits from increased audit efficiency is essential in determining the way forward.

The Task Force also considered it may be possible that the combination of (i) introducing further limitations of the circumstances in which external auditors can use internal auditors to provide direct assistance on the audit and (ii) requiring strengthened safeguards to be applied when using internal auditors on the audit would help address the initial reservations that some may have over permitting such practices (including the view that such use is driven purely by cost considerations).

¹¹ For example, France, India and Japan

¹² Member of the FoF are obliged, as a condition of their membership, to apply the ISAs in their respective methodologies to the extent practicable.

List of Respondents to the Exposure Draft

#	Abbreviation	Respondent (Total)
Regulators and Oversight Authorities (9)		
1.	14 AR	14 Independent European Regulators
2.	AIU & APB	Audit Inspection Unit & Auditing Practices Board, Financial Reporting Council, United Kingdom
3.	BCBS	Basel Committee on Banking Supervision
4.	CEBS	Committee of European Banking Supervisors
5.	CESR	Committee of European Securities Regulators
6.	CPAB	Canadian Public Accountability Board
7.	FAOA	Federal Audit Oversight Authority (Switzerland)
8.	IOSCO	International Organization of Securities Commissions
9.	IRBA	Independent Regulatory Board for Auditors (South Africa)
National Auditing Standard Setters (3)¹³		
10.	AUAASB	Australian Auditing and Assurance Standards Board
11.	CAASB	Canadian Auditing and Assurance Standards Board
12.	NZICA	New Zealand Institute of Chartered Accountants (Professional Standards Board)
Public Sector Organizations (8)		
13.	AAA	American Accounting Association (Auditing Standards Committee)
14.	ACAG	Australasian Council of Auditors-General
15.	DGRV	Deutscher Genossenschafts- und Raiffeisenverband e. V. (German Cooperative and Raiffeisen Confederation)
16.	GAO	United States Government Accountability Office
17.	MOFBC	Ministry of Finance British Columbia
18.	PAS	Provincial Auditor Saskatchewan
19.	SNAO	Swedish National Audit Office
20.	WAO	Wales Audit Office
Accounting Firms (8)		
21.	BDO	BDO Global Coordination B.V.
22.	DTT	Deloitte Touche Tohmatsu
23.	EYG	Ernst & Young Global
24.	GT	Grant Thornton International
25.	KPMG	KPMG
26.	LS	Levi & Sinclair
27.	PwC	PricewaterhouseCoopers
28.	RSM	RSM International Limited

¹³ For the purpose of this table only, the joint response letter from the AIU & APB has been listed only once under the “Regulators and Oversight Authorities” category.

IFAC Member Bodies & Other Professional Bodies (21)		
29.	ACCA	Association of Chartered Certified Accountants
30.	AICPA	American Institute of Certified Public Accountants
31.	CIPFA	Chartered Institute of Public Finance and Accountancy
32.	CNCC & CSOEC	Compagnie Nationale des Commissaires aux Comptes & Conseil Supérieur de l'Ordre des Experts-Comptables
33.	DnR	Norwegian Institute of Public Accountants (Revisorforeningen)
34.	FARSRS	Svenska Revisorsamfundet SRS
35.	FEE	Federation des Experts Comptables Europeens
36.	FSR	Foreningen af Statsautoriserede Revisorer
37.	HKICPA	Hong Kong Institute of Certified Public Accountants
38.	ICAEW	Institute of Chartered Accountants in England and Wales
39.	ICAI	Institute of Chartered Accountants in Ireland
40.	ICPAK	Institute of Certified Public Accountants of Kenya
41.	ICPAS	Institute of Certified Public Accountants of Singapore
42.	IDW	Institut der Wirtschaftsprüfer
43.	IIA	Institute of Internal Auditors
44.	ISACA	Information Systems Audit and Control Association
45.	JICPA	Japanese Institute of Certified Public Accountants
46.	MIA	Malaysian Institute of Accountants
47.	NIVRA	Koninklijk Nederlands Instituut van Registeraccountants
48.	NYSSCPA	New York State Society of Certified Public Accountants
49.	SAICA	South African Institute of Chartered Accountants
Others (including individuals) (8)		
50.	C. Barnard	Chris Barnard
51.	D. Juvenal	Denise Silva Ferreira Juvenal
52.	H. Jaegtnes	Harald Jaegtnes
53.	HC	Hunter College
54.	J. Maresca	Joseph Maresca
55.	P. Angulo	Paulino Angulo
56.	R. Ramchurun	Rajnish Ramchurun
57.	R. Mahadevan	Ramachandran Mahadevan