

Agenda Item 6



Meeting Location: Conrad Ballroom, Conrad Hotel, Dublin, Ireland

Meeting Date: February 20-22, 2012

ISA 610 Using the Work of Internal Audit

Objective

1. To approve for exposure a proposed change to the definition of “Engagement Team”.

Background

The International Auditing and Assurance Standards Board (IAASB) had a project to revise ISA 610 *Using the Work of Internal Auditors*. The objective of the project was 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 considered included:

- 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 was a correspondent member on IAASB Task Force.

At previous meetings, the IESBA has 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 IAASB 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 team 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 expressed the view that 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.

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 Force¹ met on September 5, 2011 to discuss the comments and possible revisions to ISA 610.

The IESBA discussed the IAASB project at its October 2011 meeting, attended by Diana Hillier, chair of the IAASB ISA 610 Task Force. The IESBA considered the issues raised by the IESBA Task Force and the IAASB's response from its meeting in September 2011. The IESBA recommended the following changes should be made to the ISA:

- The auditor should be required to communicate to those charged with governance the planned use of direct assistance from internal auditors;
- The definition of engagement team should be modified to explicitly scope out internal auditors providing direct assistance; and
- 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.

Ms Hillier reported that, at the IAASB September meeting, the IAASB supported most of the proposals made by the IESBA Task Force. With respect to the last recommendation, however, the IAASB noted that the requirements in the ISAs, while often giving effect to a threats and safeguards model, have not directly introduced that concept nor used that terminology. However, in the IAASB's view, the effect of the requirements regarding the use of internal auditors to provide direct assistance collectively achieve the same objective.

After discussion, the IESBA agreed that the definition of engagement team should be modified to explicitly scope out internal auditors providing direct assistance. The IESBA also agreed that the auditor should be required to communicate to those charged with governance the planned use of direct assistance from internal auditors.

The IESBA also provided some drafting suggestions.

¹ Bob Franchini (chair), Peter Hughes, Caroline Gardner, Brian Walsh and Diana Hillier (IAASB Correspondent member)

Activities since the last IESBA discussion

The IAASB met on December 5-9, 2011 and considered the IESBA's comments and other issues. The IAASB approved the following paragraphs in revised ISA 610 (see Agenda Paper 6-A for a marked final version of the ISA, with responses to IESBA recommendations highlighted):

28. The external auditor shall not use an internal auditor to provide direct assistance if:
 - (a) There are significant threats to the objectivity of the internal auditor; or
 - (b) The internal auditor lacks sufficient competence to perform the proposed work. (Ref: Para. A32–A33)

Determining the Nature and Extent of Work that Can Be Assigned to Internal Auditors Providing Direct Assistance

29. In determining the nature and extent of work that may be assigned to internal auditors and the nature, timing and extent of direction, supervision and review that is appropriate in the circumstances, the external auditor shall consider:
 - (a) The amount of judgment involved in:
 - (i) Planning and performing relevant audit procedures; and
 - (ii) Evaluating the audit evidence gathered;
 - (b) The assessed risk of material misstatement; and
 - (c) The external auditor's evaluation of the existence and significance of threats to the objectivity and level of competence of the internal auditors who will be providing such assistance. (Ref: Para. A34–A38)
30. The external auditor shall not use internal auditors to provide direct assistance to perform procedures that:
 - (a) Involve making significant judgments in the audit; (Ref: Para. A19)
 - (b) Relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited; (Ref: Para. A37)
 - (c) Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or
 - (d) Relate to decisions the external auditor makes in accordance with this ISA regarding the internal audit function and the use of its work or direct assistance. (Ref: Para. A34–A38)

31. The external auditor shall, in communicating with those charged with governance an overview of the planned scope and timing of the audit in accordance with ISA 260,² communicate the nature and extent of the planned use of internal auditors to provide direct assistance so as to reach a mutual understanding that such use is not excessive in the circumstances of the engagement. (Ref: Para. A38)

Using Internal Auditors to Provide Direct Assistance

32. Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:
- (a) Obtain written agreement from an authorized 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
 - (b) Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.
33. The external auditor shall direct, supervise and review the work performed by internal auditors on the engagement in accordance with ISA 220.³ In so doing:
- (a) The nature, timing and extent of direction, supervision, and review shall recognize that the internal auditors are not independent of the entity and be responsive to the outcome of the evaluation of the factors in paragraph 29 of this ISA; and
 - (b) The review procedures shall include the external auditor checking back to the underlying audit evidence for some of the work performed by the internal auditors. (Ref: Para. A39–A40)

Application Material:

- A38. Notwithstanding the direction, supervision and review by the external auditor, excessive use of internal auditors to provide direct assistance may affect perceptions regarding the independence of the external audit engagement.

IAASB approved the revisions to ISA 610 and decided to submit it to PIOB for their consideration of due process without the proposed requirements and guidance on direct assistance, pending IESBA's due process regarding the definition of the engagement team. This will avoid any risk of perception of the ISAs and the Code being in conflict when the revision is released.

Therefore the IESBA Task Force proposes the following change to the definition of engagement team to make it clear that internal auditors providing direct assistance are not

² ISA 260, *Communication with Those Charged with Governance*, paragraph 15

³ ISA 220, *Quality Control for an Audit of Financial Statements*

considered to be part of the engagement team under the Code, and to avoid any apparent incompatibility between the Code and the ISAs:

Engagement team—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 and internal auditors providing direct assistance on the engagement.

A similar amendment would also be made to the definition of engagement team in the ISAs and ISQC 1 so as to align with the IESBA Code.

Action Requested

IESBA members are asked to review the proposed text in Agenda Paper 6-B and provide comment on any matters to be addressed before approving the proposed changes for release as an exposure draft.

Exposure Draft

Due process requires the IESBA to expose changes for a period of no less than 90 days. The Task Force is of the view that the standard period of exposure is appropriate.

An affirmative vote of two-thirds of IESBA members (twelve) is necessary to approve an exposure draft.

Effective date – The proposals do not call for any changes in systems and a relatively short transition period is, therefore appropriate. It is recommended that the changes become effective three months after approval of the final standard.

Action Requested

IESBA members are asked to approve the proposed change for exposure.

Explanatory Memorandum

Each exposure draft is accompanied by an explanatory memorandum. This document is not approved by the IESBA but it is provided to Board members for comment. The explanatory memorandum, which includes the impact analysis is included in Agenda Paper 6-B.

Action Requested

IESBA members are asked to provide any comments they have on the explanatory memorandum to staff.

Material Presented

Agenda Paper 6	This Agenda Paper
Agenda Paper 6-A	Extracts from approved wording of revised ISA 610. Marked from September 2011 to final version. Responses to IESBA recommendations highlighted.
Agenda Paper 6-B	Draft ED, Explanatory Memorandum and Impact Analysis.