

AGENDA PAPER

Item Number: 13
Date of Meeting: 8-9 May 2013
Subject: Update on IESBA's proposed amendments to the definition of Engagement Team

Action Required **For Information Only**

Purpose:

To provide an update to the Board on:

- Current status of AUASB's ASA 610 project to incorporate international amendments to ISA 610 *Using the Work of Internal Audit* to incorporate provisions dealing with direct assistance;
- International views on Internal Auditors providing direct assistance; and
- Technical Staff's views on IESBA's proposed amendments to the definition of Engagement Team in the Australian context.

Background

In June 2010 after working on a project to clarify the responsibilities of internal audit, IAASB issued the Exposure Draft, ISA 610 *Using the Work of Internal Audit*. This included consideration of circumstances where it is appropriate for external audit to use the work of internal audit and in particular it introduced a discussion of the use of internal auditors to provide direct assistance on the external audit.

During the IAASB exposure process, the position submitted by the AUASB was that it was not best practice in Australia for external audit to use direct assistance from internal auditors and that IAASB should provide additional guidance on safeguards and parameters that will be in place should this be allowed.

In 2011, IESBA issued the ED on *Proposed Change to the Definition of "Engagement Team"* in the Code which excluded Internal Audit from the definition of Engagement Team in the external audit context.

APESB made a submission to this ED and was supportive of the exclusion of internal audit from the definition of Engagement Team subject to APESB's concerns that this will lead to the use of internal audit for direct assistance. At that time APESB raised concerns that the proposed amendment to ISA 610 may result in external auditors more frequently using internal auditors to complete their audit work and recommended that IESBA consider making amendments to the Code to address potential threats arising from these arrangements.

IESBA

In January 2013 the IESBA met via teleconference regarding significant comments received on the ED, *Proposed Change to the Definition of "Engagement Team"*, and to approve the final revised definition.

IAASB

The IAASB held its 56th Board meeting on 12-14 February 2013 in Brussels, Belgium. The covering agenda paper with the objective to approve ISA 610 (Revised 2013) *Using the Work of Internal Auditors* and the proposed amendments to the definitions of engagement team in ISA 220 *Quality Control for an Audit of Financial Statements* and ISQC1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*.

The proposed change to the definition of Engagement Team is shown below:

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 an auditor's external expert engaged by the firm or by a network firm.

The term "engagement team" also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013), Using the Work of Internal Auditors.

The IAASB has now approved ISA 610 (Revised) to permit the use of internal audit staff as members of the external audit engagement team to perform audit procedures (referred to as 'direct assistance'). The IAASB has indicated that its requirements and guidance in respect of direct assistance will not be applicable in jurisdictions where this practice is prohibited.

International views and developments

The use of internal audit to perform work to support the external audit is a US practice and there have been criticisms from other jurisdictions who do not favour this approach due to the impact it has on the external auditor's independence. For example, the UK FRC Board has recently announced that because using internal audit staff as members of the audit engagement team is contrary to the principle of independence, direct assistance by internal audit staff should no longer be permitted. The UK FRC's announcement notes that this approach was also recommended by its Audit and Assurance Council.

The use of internal auditors for direct assistance is not a practice favoured in Europe either and when responding to the IESBA ED countries such as France, Italy and Spain did not favour this approach.

Additionally 11 European Audit Regulators wrote a joint letter to the IAASB and IESBA stating that they do not favour direct assistance due to:

- The independence of the external auditor cannot be ensured as the internal auditors providing direct assistance to the external auditor are not independent of the audit client, as they are employed by the audit client;
- The competence and objectivity of internal auditors providing direct assistance are not subject to the same level of regulation that applies to external auditors; and
- There is a risk that management of the audit client puts undue pressure on the external auditor to utilise the client's internal audit personnel resources, in order to reduce the audit fee.

They also noted that:

"We believe that it is conceptually inappropriate to exclude internal auditors from the engagement team definition, when apparently their work is expected to be subject to the same direction, supervision and review (ref. ISA 220) as the work performed by the ordinary engagement team members. Thus, since the IAASB in this way requires internal auditors providing direct assistance to be treated in the same way as ordinary engagement team members, it is a contradiction in terms to exclude them from the engagement team definition. In any case, excluding internal auditors that provide direct assistance from the engagement team definition doesn't resolve the lack of independence of these individuals."

AUASB

The highlights of the AUASB's 25th February 2013 meeting note that the AUASB received an update on the decision taken by the IAASB at its February 2013 meeting that approved the release of the revised ISA 610 *Using the Work of Internal Auditors*, which includes new provisions allowing direct assistance by internal auditors on external audits.

The AUASB highlights note that after considerable discussion, the AUASB formed the view that the IAASB's amendments to ISA 610 to allow direct assistance by internal auditors on external audit engagements are inappropriate in the context of independent external audits undertaken in Australia. Accordingly, the AUASB agreed, by majority vote, not to adopt the IAASB's direct assistance provisions in the recently-issued ISA 610, but to incorporate the other revisions in a revised ASA 610 to be released later this year following exposure.

AUASB will be considering an Exposure Draft of the proposed ASA 610 at its meeting on the 29th of April 2013. The relevant AUASB agenda papers are attached for the Board's information. Technical Staff will provide an update on the outcomes of this meeting at the APESB meeting to be held on 8-9 May 2013.

Technical Staff Analysis

In accordance with the APESB Due Process, the Board will need to expose the proposed amendments to the IESBA Code. Subject to the Board's views on internal auditors providing direct assistance to external auditors, the Board has two options to consider:

- Expose IESBA's amendments and invite stakeholder comments; or
- Expose the existing APES 110 definition of Engagement Team and invite stakeholder comments;

If the Board is of the view that direct assistance should be permitted in Australia then the first option should be considered. If the Board is of the view that direct assistance should not be permitted then option two should be considered.

Technical Staff recommendation

Given the APESB's submission to the IESBA and the direction taken by the AUASB in its proposed approach to update ASA 610, it can be argued that the amendment to the definition of Engagement Team is redundant in the Australian context and should not be incorporated in APES 110. Accordingly, Technical Staff recommend option 2.

Material Presented

- Attachment 12 (a) APESB's submission to the IESBA;
- Attachment 12 (b) AUASB Board Meeting Summary Paper April 2013 (Confidential);
and
- Attachment 12 (c) Attachment to AUASB Board Meeting Summary Paper
(Confidential).

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