PROPOSED REVISIONS TO INTERNATIONAL STANDARDS ON AUDITING (UK and IRELAND) TO ADOPT CHANGES TO INTERNATIONAL STANDARDS ON AUDITING ADDRESSING THE USE OF INTERNAL AUDIT:

315 (REVISED) IDENTIFYING AND ASSESSING THE RISKS OF MATERIAL MISSTATEMENT THROUGH UNDERSTANDING THE ENTITY AND ITS ENVIRONMENT

610 (REVISED) USING THE WORK OF INTERNAL AUDITORS CONFORMING AMENDMENTS TO OTHER ISAs (UK and IRELAND)

RESPONSE FROM ICAS TO THE FRC

31 AUGUST 2012
Background

1. ICAS welcomes the opportunity to comment on the FRC’s consultation paper “Proposed Revisions to International Standards on Auditing (UK and Ireland) to adopt changes to International Standards on Auditing addressing the use of internal audit”. Our CA qualification is internationally recognised and respected. We are a professional body for over 19,000 members who work in the UK and in more than 100 countries around the world. Our members represent different sizes of accountancy practice, financial services, industry, the investment community and the public sector. Almost two thirds of our working membership work in business, many leading some of the UK’s and the world’s great companies.

2. Our Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members’ views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Key Points

ICAS is supportive of the key objective to enhance the external auditor’s performance by providing a more robust framework for evaluating and using the work of an entity’s internal audit function. We are supportive of guidance on how the internal audit function and its findings can usefully inform the external auditor’s risk assessments and the related conforming amendments required to other ISAs.

Our response to the specific consultation questions

Q1  Do you agree that the ISAs (UK and Ireland) should be updated to adopt the revised ISAs 315 and 610 and the related conforming changes to other ISAs? If not, please give your reasons and explain what action, if any, that you believe should be taken to update the ISAs (UK and Ireland) in relation to the use of internal audit.

We agree that the ISAs (UK and Ireland) should be updated to adopt the revised ISAs 315 and 610 and the related conforming changes to other ISAs.

Q2  If you agree that the ISAs (UK and Ireland) should be updated to adopt the revised ISA 315 (Q1 above), do you agree that APB supplementary material can be limited to that shown in the exposure draft? If not, please give your reasons and explain what supplementary material, if any, you believe should be added.

We agree that the proposal to limit APB supplementary material to that shown in the exposure draft is appropriate.

Q3  If you agree that the ISAs (UK and Ireland) should be updated to adopt the revised ISA 610 (Q1 above), do you agree that APB supplementary material can be limited to that shown in the exposure draft and as described? If not, please give your reasons and explain what supplementary material, if any, you believe should be added.

We agree that the APB supplementary material should be limited to that shown in the exposure draft and that the description is appropriate.
Q4 Do you agree that it is acceptable to use internal auditors to provide direct assistance in appropriate, limited, areas as set out in proposed revised ISA (UK and Ireland) 610? If not, please give your reasons.

We agree that it is acceptable to use internal auditors to provide assistance in the areas listed provided that appropriate safeguards are in place.

Q5 If, following the eventual conclusion of the related IESBA consultation, the IAASB does not reissue ISA 610 with the material on direct assistance included, do you believe that the revised ISA (UK and Ireland) 610 should nonetheless be finalised to include that material? If not, please give reasons and explain how you believe direct assistance should be addressed in the revised ISA (UK and Ireland) 610.

We agree that the revised ISA (UK and Ireland) 610 should nonetheless be finalised to include the material on direct assistance.

Q6 If you agree that the ISAs (UK and Ireland) should be updated to adopt the revised ISAs and related conforming changes to other ISAs (Q1 above), do you agree that it is not necessary to add APB supplementary material in relation to these conforming changes? If not, please give your reasons and explain what supplementary material you believe should be added.

We agree that it is not necessary to add APB supplementary material in relation to the conforming changes to other ISAs.

Q7 Is the proposed effective date, which is consistent with the effective date of the IAASB’s revised ISAs, appropriate? If not, please give reasons and indicate the effective date that you would consider appropriate.

We believe that the proposed effective date is appropriate.

Q8 Do you agree that the associated impact of these revised standards on work effort should not be disproportionate in relation to total audit work effort? If not, please give reasons and your estimate of the level of impact.

We agree that the associated impact of these revised standards on work effort should not be disproportionate in relation to total audit work effort.

Q9 Do you agree that any related increase in work effort will be justified by the benefits of the proposed changes? If not, please give reasons.

We agree that any related increase in work effort will be justified by the benefits of the proposed changes.

Q10 Do you agree that this overarching approach is the right one for the APB/FRC to adopt in dealing with any new/revised ISAs finalised by the IAASB? If not, please describe the approach you believe should be taken.

We agree that this approach is the right one for the APB/FRC to adopt in dealing with any new/revised ISAs finalised by the IAASB.
Q11 Do you agree that we should seek the views of interested parties in the UK and Ireland on IAASB exposure drafts to inform our response to the IAASB consultation? If not, please explain why and whether you believe there are other, more appropriate, ways for us to seek the views of interested parties.

We agree that the APB/FRC should seek the views of interested parties in the UK and Ireland on IAASB exposure drafts.

Other matters:

Within the body of the revised ISAs. We have also made the following observations and comments:

**Proposed International Standard on Auditing (UK and Ireland) 315 (Revised)**

Identifying and assessing the risks of material misstatement through understanding the entity and its environment:

**The Required Understanding of the Entity and Its Environment, Including the Entity’s Internal Control**

Monitoring of controls: Paragraph 23 – this has not actually changed any wording, just changed the format. It is not clear whether “obtain an understanding of the … activities performed” involves reading the reports issued by Internal Audit or not.

**Application and Other Explanatory Material**

Risk Assessment Procedures and Related Activities

Inquiries of Management, the Internal Audit Function and Others within the Entity: Paragraphs A6/A9 – there is no distinction/definition made as to the business model for Internal Audit, i.e. whether Internal Audit is “in-sourced” i.e. permanent staff employed by the company, “outsourced” – where responsibility for the management of the entire function is contracted to a professional services firm, or “co-sourced” - a mixture of the 2. This may affect the nature of the enquiries, and the availability of working papers and other data.

**Application and Other Explanatory Material**

Risk Assessment Procedures and Related Activities

Inquiries of the Internal Audit Function: Paragraph A10: “may consider it appropriate” is a bit weak. If there are relevant findings raised by Internal Audit, especially if they relate to financial reporting, they should be reviewed by the external auditor.

1. Whilst we note that it is perhaps impractical to read them all, specific audits of the Finance function and other areas are directly relevant to downstream financial reporting.
2. The use of a database to store all findings which are classified according to the type of issue would make it easy to search to identify issues which are relevant to Financial Reporting. Where such issues are found, these should be shared with auditors. Further, the data can be cut in several different ways to identify potential issues in other categories if desired.
3. Management information summarising the various reports issued could be produced, e.g. how many reports were ‘A’ rated (highest) vs ‘D’ rated (lowest). These metrics would also be useful in the assessment of a company’s control environment.

**Application and Other Explanatory Material**

Risk Assessment Procedures and Related Activities

Inquiries of the Internal Audit Function: Paragraph A11: Again, “if the internal audit function provides information to the auditor regarding any actual, suspected or alleged fraud” is quite weak. Surely this should be a specific enquiry? If there has been a fraud, then the internal audit department are likely to know about it.
Application and Other Explanatory Material
The Entity’s Internal Control
Audit Evidence for Elements of the Control Environment: Paragraph A79: This is a bit vague, as it doesn’t specify whether this is only for findings which the auditor was interested in (per para A10) or generally management’s approach towards remediating internal audit findings.

Application and Other Explanatory Material
The Entity’s Internal Control
Considerations Specific to Smaller Entities & The Entity’s Internal Audit Function: Paragraphs A108 – A113: There is no specific mention of assessing the independence and objectivity of the internal audit function. For example, at Enron the internal audit function reported directly into the Chief Executive, whereas normal good governance would be for the internal audit department to report into the Audit Committee.

Further, one of The Institute of Internal Auditors (IIA) requirements is that internal audit functions should perform regular benchmarking of their practices against their peers, and against the IIA Professional Standards Framework. This would be a valuable input for the external auditor in assessing the need for and nature of enquiries of the internal audit function.

Appendix 2: Given all of the amendments to the standard above, should something along the lines of “internal audit findings relevant to …” be included.

Proposed International Standard on Auditing (UK and Ireland) 610 (Revised) - Using the work of Internal Auditors:

Determining Whether, in Which Areas, and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance
Determining the Nature and Extent of Work that Can Be Assigned to Internal Auditors Providing Direct Assistance: Paragraph 30c “relate to work with which the internal auditors have been involved” is a bit vague, as the Internal Audit department should (at some point or another) have dealt with every area of the business. Perhaps a more sensible comment here would be “relate to work which has been within the scope of an internal audit project within the past 2 years”. Also, internal audit work will always have a specific scope, so it would be possible to maintain independence while working on an area which is “related” to a previous engagement but was not included in the scope of that engagement.

Application and Other Explanatory Material Determining Whether, in Which Areas, and to What Extent the Work of the Internal Audit Function Can Be Used
Evaluating the Internal Audit Function: Paragraphs A5 to A11 – these are the sorts of evaluation that should also come into ISA 315. Clearly the existence of a competent, independent, objective internal audit function is a consideration for ISA 315 (as is now being recognised), and as such these things should be considered whether or not the external auditor plans to rely on their work.

Also within paragraphs A5 to A11 - There is no mention of Internal Audit’s own self-assessment/benchmarking exercises (required to perform periodically by IIA).

General – There is no reference to the Institute of Internal Auditors in the document. Unlike in the CA space, the IIA is effectively the undisputed authority over Internal Audit. Many internal audit departments make efforts to adhere to all of their standards (collectively the “Professional Practices Framework”) and regularly benchmark against these standards.