



ASIC

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Ms Merran Kelsall
Chairman
Auditing and Assurance Standards Board
Level 7
600 Bourke Street
MELBOURNE VIC 3000

By Email: mkelsall@auasb.gov.au

Dear Merran

ED 02/13 PROPOSED AUDITING STANDARD ASA 610 (REVISED) USING THE WORK OF INTERNAL AUDITORS

I refer to the abovementioned exposure draft. We support the proposed prohibition on the use of internal auditors to provide direct assistance in an independent audit or review conducted in accordance with the Australian Auditing Standards. We also support extending the prohibition an audit or review of a component in the context of a group audit, including an overseas component.

Direct assistance

“Direct assistance” is defined in paragraph 14(b) of the exposure draft as “the use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.”

We understand that in most cases where direct assistance occurs, the internal auditors are employees of the entity. While internal auditors may also be contracted in from organisations such as another audit firm, we understand that direct assistance is less likely to be used in these instances.

We recognise that some organisations may believe that there are benefits in the external auditor using internal auditors to provide direct assistance. These benefits might include internal auditors having a greater knowledge of the business than the external auditors, and possible cost savings in the use of internal auditors compared to external audit fees.

Even though the recently revised international standard (ISA 610) provides some safeguards for the use of internal auditors to provide direct assistance, we believe that it is important that the independence of the external audit process is maintained to ensure confidence of the market and investors in audited financial reports.

We support the proposal not to permit an external auditor to rely on an internal audit to provide direct assistance for the following reasons:

- (a) Even where an internal auditor reports to an audit committee, the internal auditor is employed by the audited entity and would not appear to be independent in fact or appearance. This can affect confidence in the external audit process and the quality of an audited entity's financial report;
- (b) Threats to the actual and apparent objectivity of the internal auditor may arise from internal auditors being remunerated by the audited entity, concerns about future career prospects, and familiarity with management;
- (c) The use of internal auditors employed by an entity would appear to be incompatible with the general auditor independence requirements of the Corporations Act and the Code of Ethics for Professional Accountants (APES 110) issued by the Australian Professional Ethical Standards Board ("the Code"). The Code also has the force of law under the Corporations Act through the auditing standards; and
- (d) To the extent that reliance on internal audit for direct assistance is used to place pressure on external audit fees, there may be a further risk to the quality of external audits.

In addition, direct assistance would appear to be inconsistent with the role of internal audit in focusing on matters such as operational efficiency.

For similar reasons, it is important for the proposed prohibition to include all domestic and foreign components in the context of a group audit.

We note that the UK Financial Reporting Council has decided not to allow direct assistance in the UK and we understand that direct assistance is not permitted in France or Germany.

The use of internal auditors to provide direct assistance to external auditors and similar types of reliance are less pervasive in Australia than in some other countries, we understand that direct assistance and similar arrangements are most common for large financial institutions.

Use of internal audit to perform external audit work

It may be appropriate for an external auditor to rely on the internal audit function as a part of the system of internal control. The external auditor should also review internal audit reports to identify risks that require additional focus by the external auditor. Such reliance is no different from the reliance that could be placed on the work of any other employee of an audited entity.

If the Board decides not to allow an external auditor to rely on direct assistance by an internal auditor, the Board should also consider the extent to which the revised ASA 610 or another guidance document should provide additional clarifying statements specifically addressing other circumstances where an auditor should not rely on internal auditors.

We are aware of other instances where external auditors rely on internal auditors to perform external audit work. These arrangements would not fall under the definition of "direct assistance" in the exposure draft, even though the work performed by the internal auditor is identical to the work performed by the internal auditor in a direct assistance arrangement. It would be inconsistent with the auditor independence requirements for an external auditor to rely on internal audit work in such circumstances. Such work would still be performed by employees whose actual and apparent objectivity may be threatened by being remunerated by the audited entity, concerns about future career prospects, and familiarity with management.

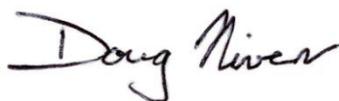
It would be inconsistent to allow such reliance where the work of the internal auditor would be subject to lesser standards than under direct assistance arrangements in that the internal audit work would not be subject to the direction, supervision and review of the external auditor.

While some professional accountants and auditors in Australia appear to believe that such reliance would not be permitted by the proposed revised ASA 610, other professional accountants and auditors in Australia believe that such arrangements would be permitted by the proposed revised ASA 610. There are also differing views as to the application of the provisions for the external auditor to make all significant audit judgements and to ensure that the external auditor is sufficiently involved in the audit.

The Board should ensure that a revised ASA 610 is clear that the external auditor is not permitted to use internal auditors to perform external audit work in substitution for work otherwise undertaken by the external auditor, whether or not the work is performed at the specific request of the external auditor or under the direction, supervision and review of the external auditor.

Please do not hesitate to contact me should you have any questions in relation to the above. My e-mail address is douglas.niven@asic.gov.au and my phone number is (02) 9911-2079.

Yours faithfully

A handwritten signature in black ink that reads "Doug Niven". The signature is written in a cursive, flowing style.

Doug Niven
Senior Executive Leader, Financial Reporting & Audit