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Basis for Conclusions

ASA 610 Using the Work of Internal Auditors and ASA 2013-2 Amendments to Australian Auditing Standards

Prepared by the **Auditing and Assurance Standards Board**



Australian Government

Auditing and Assurance Standards Board

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**Basis for Conclusions ASA 610 *Using the Work of Internal Auditors* and
ASA 2013-2 *Amendments to Australian Auditing Standards***

Basis for Conclusions ASA 610 *Using the Work of Internal Auditors* and ASA 2013-2 *Amendments to Australian Auditing Standards* has been developed by the Auditing and Assurance Standards Board (AUASB) to provide a background to, and rationale for the development and approval of the Standards by the AUASB. The Basis for Conclusions relates to, but does not form part of, ASA 610 or ASA 2013-2.

No responsibility is taken for the results of actions or omissions to act on the basis of any information contained in this document or for any errors or omissions in it.

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BASIS FOR CONCLUSIONS

ASA 610 Using the Work of Internal Auditors and ASA 2013-2 Amendments to Australian Auditing Standards

This Basis for Conclusions is issued by the Auditing and Assurance Standards Board (AUASB). It provides a background to, and rationale for the development and approval of the Standards by the AUASB. The Basis for Conclusions relates to, but does not form part of, *ASA 610 Using the Work of Internal Auditors* and *ASA 2013-2 Amendments to Australian Auditing Standards*, and is not a substitute for reading the Standards.

Background

ASA 610

The AUASB has revised Auditing Standard *ASA 610 Using the Work of Internal Auditors*. The revised Standard will be operative for financial reporting periods commencing on or after 1 January 2014, with early adoption permitted. *ASA 610* conforms with International Standard on Auditing *ISA 610 Using the Work of Internal Auditors* which was revised by the International Auditing and Assurance Standards Board (IAASB) and issued in March 2013.

The revised Standard *ASA 610* reflects recent developments in the internal auditing environment and provides a more robust framework for the evaluation and, where appropriate, use of the work of the internal audit function. The revised Standard also prohibits the use of internal auditors to provide direct assistance in an independent audit or review conducted in accordance with the Australian Auditing Standards.

The main proposals in the revised Auditing Standard are:

1. Revised requirements relating to the external auditor:
 - (a) Determining whether, in which areas, and to what extent, the work of the internal audit function can be used; and
 - (b) Determining the adequacy of the work of the internal audit function for the purposes of the audit.
2. New requirements for the external auditor, if planning to use the work of the internal audit function, to:
 - (a) Evaluate whether using the work of the internal audit function would still result in the external auditor being sufficiently involved in the audit;
 - (b) Communicate with those charged with governance the planned use of the work of the internal audit function;
 - (c) Communicate with the internal audit function, to co-ordinate the relevant activities of the internal and external auditors; and
 - (d) Re-perform some of the work of the internal audit function that is planned to be used.
3. A clear link between *ASA 610* and *ASA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* (as amended), which contains a new requirement for the auditor's risk assessment procedures to include enquiries of appropriate individuals within the internal audit function (if the function exists), whether or not the auditor expects to use the work of that function.

4. A prohibition on the use of internal auditors to provide direct assistance in an audit or review conducted in accordance with the Australian Auditing Standards. For a group audit, this prohibition extends to the use of internal auditors to provide direct assistance in an audit or review of a component, including an overseas component, conducted in accordance with the Australian Auditing Standards.

In considering whether or not to prohibit direct assistance, the AUASB considered the views of all stakeholders and concluded that a prohibition on direct assistance is justified as it reinforces the principle of auditor independence, which is critical to overall audit quality and the integrity of the external audit process. The AUASB is of the view that internal auditors are not independent of the audit client and are not subject to the same independence requirements as external auditors. A prohibition on the use of internal auditors to provide direct assistance creates a clearer division of responsibility between internal and external audit teams to safeguard against conflicts of interest and supports stakeholders' expectations that external auditors should be free from threats to their independence.

This prohibition on direct assistance does not represent a divergence from ISA 610, as the IAASB makes it clear that its requirements and guidance in this area will not be applicable in jurisdictions where the use of internal auditors to provide direct assistance is prohibited.

Consultation

The AUASB conducted roundtable discussions in March 2013 with a wide range of stakeholders, in order to elicit views and concerns regarding the revision of ASA 610.

The AUASB issued an exposure draft of the proposed Standard (ED 02/13) in August 2013, with a comment deadline of 30 September 2013 (60 day exposure period). Submissions were received from professional accounting and other membership bodies, accounting firms, a professional services firm and a regulator. The AUASB considered all submissions received before finalising the revised Standard.

ASA 2013-2

ASA 2013-2 Amendments to Australian Auditing Standards makes changes to Australian Auditing Standards comprising:

- (a) Consequential changes arising from the revision of Auditing Standard ASA 610 (see above); and
- (b) Changes to Auditing Standard ASQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, and Other Assurance Engagements* arising from a decision taken by the AUASB to incorporate related services engagements into the application and scope of ASQC 1.

The main proposals covered by these amendments are:

Consequential changes arising from the revision of ASA 610

- (a) A new requirement in ASA 315 for the auditor's risk assessment procedures to include enquiries of appropriate individuals within the internal audit function (if the function exists);
- (b) New and revised application and other explanatory material in ASA 315 relating to:
 - (i) How enquiries of the internal audit function may inform the external auditor's risk assessment;
 - (ii) Procedures for evaluating the internal audit function; and

- (iii) How the work of the internal audit function may be used in obtaining audit evidence; and
- (c) Consequential amendments to other Auditing Standards that do not have an impact on the requirements of the Standards.
- (d) Changes necessary to align paragraph and footnote numbering with the equivalent international standard.

Changes to ASQC 1 to include related services engagements

- (a) Changes to the title, which is now *Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, Other Assurance Engagements and Related Services Engagements*;
- (b) Changes to the requirements and related application and other explanatory material to incorporate related services engagements into the application and scope of ASQC 1 and to ensure consistency with the international standard ISQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* issued by the IAASB.

Consultation

The AUASB issued an exposure draft of the proposed consequential amendments arising from the revision of ASA 610 (ED 03/13 *ASA 2013-2 Amendments to Australian Auditing Standards*) in August 2013, with a comment deadline of 30 September 2013 (60 day exposure period).

The AUASB issued a further exposure draft of the proposed changes to ASQC 1 (ED 04/13 *ASA 2013-4 Amendments to Auditing Standard ASQC 1 Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, and Other Assurance Engagements*) in September 2103, with a comment deadline of 21 October 2013 (30 day exposure period).

Subsequent to ED 04/13, the AUASB decided to also amend the title of ASQC 1 to include related services engagements in the title. In issuing ED 04/13, the AUASB stated its intention to combine the changes proposed in ED 03/13 and ED 04/13 into one amending Standard.

Submissions were received from professional accounting bodies, accounting firms and a regulator. The AUASB considered all submissions received before finalising ASA 2013-2.

Note: The amendments discussed in ED 03/13 *ASA 2013-2 Amendments to Australian Auditing Standards* and ED 04/13 *ASA 2013-4 Amendments to Auditing Standard ASQC 1 Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, and Other Assurance Engagements* have been combined in a single amending standard, *ASA 2013-2 Amendments to Australian Auditing Standards*.

Scope

ASA 610

ASA 610 deals with the external auditor's responsibilities if using the work of internal auditors and prohibits the use of internal auditors to provide direct assistance in an audit or review conducted in accordance with the Australian Auditing Standards.

ASA 2013-2

ASA 2013-2 makes consequential changes to Australian Auditing Standards arising from the revision of ASA 610 and changes to ASQC 1 to include related services engagements in the scope and application of the Standard.

Major Issues Raised by Respondents on Exposure

The following summarises major issues raised by respondents to the following exposure drafts:

- (a) ED 02/13 ASA 610 *Using the Work of Internal Auditors*;
- (b) ED 03/13 ASA 2013-2 *Amendments to Australian Auditing Standards*; and
- (c) ED 04/13 ASA 2013-4 *Amendments to Auditing Standard ASQC 1 Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, and Other Assurance Engagements*.

and how the AUASB has addressed them.

ED 02/13 ASA 610 *Using the Work of Internal Auditors*

Conformity with International Standards on Auditing and the AUASB Principles of Convergence and Harmonisation

Some respondents expressed a view that the prohibition of direct assistance by the AUASB in ASA 610 *Using the Work of Internal Auditors* would result in non-compliance with International Standard on Auditing ISA 610 *Using the Work of Internal Auditors* issued by the IAASB in March 2013 and the AUASB's published *Principles of Convergence to the International Standards of the International Auditing and Assurance Standards Board (IAASB) and Harmonisation with the Standards of the New Zealand Auditing and Assurance Standards Board (NZAuASB)* (AUASB Principles of Convergence and Harmonisation).

The AUASB considers that the prohibition of direct assistance in ASA 610 is in compliance with both ISA 610 and the AUASB Principles of Convergence and Harmonisation for the following reasons:

1. The IAASB specifically acknowledges that, in some jurisdictions, direct assistance may not be permitted. Paragraph 5 of ISA 610 states, "*In some jurisdictions, the external auditor may be prohibited, or restricted to some extent, by law or regulation from using (...) internal auditors to provide direct assistance.*"
2. The IAASB further states in paragraph 5 of ISA 610 that, "*The ISAs do not override laws or regulations that govern an audit of financial statements. Such prohibitions or restrictions (on direct assistance) will therefore not prevent the external auditor from complying with the ISAs.*"
3. Paragraph 10 of the AUASB Principles of Convergence and Harmonisation specifically allows for modifications to IAASB standards being considered for adoption in Australia in the public interest where the international standard does not reflect, or is not consistent with, principles and practices that are considered appropriate in Australia.

Existing ASA 610 (October 2009) does not provide for direct assistance. Paragraph 2 states that "*This Auditing Standard does not deal with instances when individual internal auditors provide direct assistance to the external auditor in carrying out audit procedures.*" The AUASB considers that direct assistance is therefore not permitted under existing Australian Auditing Standards. In addition, the AUASB considers that direct assistance is not permitted under the Code of Ethics for Professional Accountants issued by the Accounting Professional & Ethical Standards Board (APESB). Accordingly, the use of internal auditors to provide direct assistance on an external audit engagement should not be common practice in Australia.

The AUASB considers it is in the public interest to confirm and clarify the existing position in relation to direct assistance by explicitly prohibiting its use in an audit or review conducted in accordance with Australian Auditing Standards. A prohibition on the use of internal auditors to provide direct assistance on an external audit engagement reinforces the principle of auditor independence, which is critical to overall audit quality and the integrity of the external audit process. Internal auditors are not independent of the audit client and are not subject to the same independence requirements as external auditors. A prohibition on the use of internal auditors to provide direct assistance creates a clearer division of responsibility between internal and external audit teams and supports stakeholders' expectations that external auditors should be free from threats to their independence.

Further, the AUASB considers it is clearer, in the public interest, to omit non-applicable requirements and application and other explanatory material from ASA 610.

To permit direct assistance, would not be in the public interest, as it would not reflect, and would be inconsistent with, existing principles and practices regarding auditor independence that are considered appropriate within Australia.

Audit Quality

One respondent considered that the IAASB decision to permit direct assistance, subject to appropriate safeguards, would not undermine audit quality and there is no reason for the AUASB to adopt a different approach in the Australian Auditing Standards. Another respondent considered that the prohibition on direct assistance would not promote audit quality.

The AUASB is of the view that audit quality will be enhanced by a prohibition on direct assistance in the Australian Auditing Standards, as it reinforces the principle of auditor independence and the actual and perceived integrity of the external audit.

In Australia, based on anecdotal evidence, direct assistance is not common practice and evidence exists that audit quality is well regarded.¹ Accordingly, the AUASB sees no reason to change Australian Auditing Standards to now explicitly permit direct assistance. However, the AUASB considers it is in the public interest to confirm and clarify its position regarding direct assistance by stating clearly and explicitly in the Australian Auditing Standards that direct assistance is prohibited.

In addition, external auditors are subject to legally enforceable requirements regarding independence, professional judgement, professional scepticism, skills and experience, which do not apply to internal auditors providing direct assistance on an external audit engagement. Accordingly, it could be argued that not allowing direct assistance will contribute to audit quality, as the auditors performing audit procedures on the external audit engagement are subject to legally enforceable standards relating to auditor independence, professional scepticism, professional judgement, and external audit skills, competence and experience.

Cost Impacts

Two respondents expressed concern that cost increases may arise from a prohibition on direct assistance, particularly in group audits where direct assistance may have been used previously in the audit of component entities in jurisdictions which permit direct assistance.

In approving the revised Standard ASA 610, the AUASB acknowledged that there may be some practical and commercial issues arising from the prohibition on direct assistance, particularly in group audits, and that these should be limited to a relatively small population of audit engagements. The AUASB agreed to develop and issue a guidance statement on the application of ASA 610, including the prohibition on direct assistance. It is intended that the guidance statement will be developed in consultation with accounting firms and other interested stakeholders and issued as soon as possible.

¹ For example, see *Audit Quality in Australia A Strategic Review* issued by The Treasury in March 2010.

Inadvertent Breach of the *Corporations Act 2001*

One respondent considered that auditors may inadvertently breach Section 307(A)(1) of the *Corporations Act 2001*, which requires auditors to conduct their audit in accordance with the auditing standards, if direct assistance is banned. This respondent cited potential breaches where the Australian component auditor unknowingly relies on audit evidence relating to a shared service centre provided by a group auditor who uses direct assistance and where the Australian auditor of an entity that uses a shared service centre unknowingly relies on audit evidence provided by the auditor of the shared service provider and that auditor has used direct assistance.

The AUASB expects that firms will have processes and procedures to identify, to the extent possible, instances where direct assistance has been used by a group auditor or the auditor of a shared service provider in another jurisdiction and avoid reliance on audit evidence from such sources. In addition, it is application issues such as these that may be addressed in the proposed guidance statement regarding the application of ASA 610.

ED 03/13 ASA 2013-2 *Amendments to Australian Auditing Standards*

There were no issues raised by respondents in relation to the proposals in ED 03/13.

ED 04/13 ASA 2013-4 *Amendments to Auditing Standard ASQC 1 Quality Control for Firms that Perform Audits and Reviews of Financial Reports and Other Financial Information, and Other Assurance Engagements*

There were no major issues raised by respondents in relation to the proposals in ED 04/13.

Conclusion

ASA 610

The AUASB voted unanimously to approve and issue ASA 610 on 28 October 2013.

ASA 2013-2

The AUASB voted unanimously to approve and issue ASA 2013-2 on 28 October 2013.

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