



**Committee:** IAASB Consultative Advisory Group

**Meeting Location:** Paris

**Meeting Date:** May 11-12, 2006

### Using the Work of an Expert

#### A Objectives of Agenda Item

- A1. To provide input on the Task Force's current thinking prior to the July 2006 IAASB meeting.
- A2. To provide a brief report back on the November 30-December 1, 2005 proposals of Representatives on the issues paper on revision of ISA 620 "Using the Work of an Expert."  
**(See Agenda Item M.1)**

#### B Project Status

- B1. This project was adopted primarily because:
  - (a) A number of former IAASB task forces (e.g., IT, E-com, Environment, Fair Values, and Quality Control) have raised concerns about use of the work of an expert; and
  - (b) Since ISA 620 was last revised in the mid 1990s, two national standard setters (Canada and US) have had active projects on this topic, which cover matters differently from how they are covered in the extant ISA.
- B2. Examples of when an auditor may involve an expert include:
  - Estimating insurance liabilities.
  - Estimating quantities and values of oil and gas reserves.
  - Estimating environmental liabilities, and site clean-up costs.
  - Interpreting contracts, laws and regulations.
  - Estimating the value of financial instruments, land and buildings, plant and machinery, jewelry, works of art and antiques.
  - Complex aspects of information systems.
  - Complex or unusual tax issues.
  - Designing and performing procedures in response to an identified fraud risk.
- B3. Members of the Task Force are:
  - Josef Ferlings, Chair (IAASB member, Germany – supported by Wolf Böhm, IdW)
  - Sukanta Dutt (IAASB member, Malaysia)
  - Craig Crawford (IAASB member, USA)

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- Greg Shields (IAASB Technical Advisor, Canada)
- Cláudio Castello Branco (INTOSAI nominee, Brasil)
- Dale Gislason (IFAC's SMPC nominee, Canada)

The Task Force also maintains active liaison with:

- Jan Munro (IFAC Ethics Committee)
- Jim Milholland and Sam Gutterman (International Actuarial Association)

B4. An Issues Paper, which was considered by CAG at its November-December 2005 meeting, was discussed by the IAASB in December 2005. The Task Force subsequently held a number of physical meetings and conference calls, and has submitted papers to the March and April meetings of the Independence Task Force of the International Ethics Standards Board for Accountants (IESBA). The Task Force will hold a further physical meeting in May, and expects to present a draft for discussion at the IAASB's July 2006 meeting.

### **C Matters for CAG's Consideration**

C1. There are two main issues emerging at this stage:

- (a) The definition of the engagement team, in particular, whether external experts should be part of the engagement team and the implication of this for independence; and
- (b) How best to integrate into the revised ISA 620, the audit risk model embedded in ISAs 200, 315 and 330.

#### DEFINITION OF ENGAGEMENT TEAM

C1. The definition of "engagement team" in the IAASB Glossary of Terms<sup>1</sup> and the IFAC Code is:

All personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.

("Personnel" is defined in the IAASB Glossary of Terms as "Partners and staff")

C2. It is not entirely clear from this definition whether all experts contracted by the firm who have anything to do with an engagement, even if only peripherally involved, should be treated as part of the engagement team. For example, an external lawyer may be asked a reasonably straightforward question about the interpretation of a clause in a contract, perhaps on a hypothetical/no names basis. Does this then mean that the lawyer is part of the engagement team and, therefore, e.g.:

- Subject in full to the independence requirements of the IFAC Code?
- Needs to be covered by the firm's system of quality control per ISQC 1?

1 Originally appeared in ISQC 1 "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements" and ISA 220 "Quality Control for Audits of Historical Financial Information."

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- Required to be included in discussions about the susceptibility of the entity's financial statements to material misstatement per ISAs 240 and 315?
- C3. Various explanations/interpretations of the definition have been offered at Task Force meetings, e.g.:
- (a) “Performing the engagement” means only those experts who are substantially involved in the engagement.
  - (b) “Performing the engagement” means only those experts who perform “audit” procedures.
  - (c) Use of the word “including” means only experts who are personnel (i.e. partners or staff) should be considered part of the engagement team.
- C4. The Task Force believes that to ensure a consistent interpretation, the current wording should be amended, or at least supplemented with explanatory material.
- C5. The Task Force has considered a number of possible approaches to this issue, and is currently of the view that only experts who are personnel (i.e., partners and staff of the firm) should be considered part of the engagement team, i.e. external experts should not be considered part of the engagement team. This approach would likely involve a change to the definition of “engagement team” to something like: “All personnel directly<sup>2</sup> performing an engagement, including any who are ~~experts contracted by the firm in connection with that engagement~~”.
- C6. Implications of this approach include:
- (a) From an audit evidence perspective: The quality control policies and procedures of ISQC 1 and ISA 220 were primarily written for application to a firm’s personnel rather than external experts. All internal experts (personnel) are subject to the quality control policies and procedures of ISQC 1 and ISA 220. However, some external experts work closely with engagement teams and may also be subject to some of the firm’s quality control policies and procedures. The revised ISA would recognize this fact and require that the extent to which an external expert is subject to such policies and procedures be considered when determining the nature, timing and extent of other procedures to be applied to the expert’s work.
  - (b) From an independence perspective: The ISA would require that external experts must adhere to applicable independence requirements. However, the current guidance in the IFAC Code would not apply to external experts (because they would be removed from the definition of engagement team). This seems appropriate since the current provisions of the Code are written primarily from the perspective of a member of the accounting profession. The Task Force is, therefore, liaising with IESBA Independence Task Force about what, if any, guidance should be specifically aimed at the
- 2 Insertion of a word like “directly” seems necessary to differentiate experts who are actually doing the client work, from those who “provide consultation regarding technical or industry specific issues, transactions or events for the assurance engagement” per the definition of “assurance team” in the Code.

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independence of external experts. For example, if a lawyer/engineer/actuary who is a partner in a firm of lawyers/engineers/actuaries, is integrally involved in an audit engagement, which of the following statements should be true:

- The lawyer/engineer/actuary should not hold any shares in the entity subject to audit.
- None of the professional staff in the law/engineering/actuarial firm who work on the engagement should hold any shares in the entity.
- None of those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the lawyer/engineer/actuary should hold any shares in the entity.
- None of the partners in the law/engineering/actuarial firm should hold any shares in the entity.
- None of the professional staff in the law/engineering/actuarial firm should hold any shares in the entity.
- The spouse of the chief executive of the law/engineering/actuarial firm should not hold any shares in the entity
- ... etc ... can the law/engineering/actuarial firm undertake other engagements for the entity; what if a partner retires from the law/engineering/actuarial firm and joins the entity ... etc ...

### **Matter for CAG's Consideration**

1. Does the CAG have any suggestions for the Task Force regarding the definition of engagement team?

### AUDIT RISK MODEL

C7. The Task Force is conscious of the need to ensure the revised ISA is consistent with the audit risk model articulated in ISAs 200, 315 and 330. An important aspect of applying the audit risk model is that the ISA properly distinguishes between:

- (a) The entity's need for expertise in preparing the financial statements (which affects inherent and control risk); and
- (b) The auditor's need for expertise in gathering sufficient appropriate audit evidence (which affects detection risk).

C8. A diagram depicting the flow of the Requirements of the most recent draft considered by the Task Force is included in the Appendix<sup>3</sup>. As well as identifying the intended flow of the revised ISA in terms of the risk model, it indicates how (i) the entity's experts, (ii) in-house (i.e. internal/personnel) experts, and (iii) external experts are expected to be covered.

<sup>3</sup> The diagram in the Appendix has been updated for views expressed at the Task Force meeting and will, no doubt, be revised further as the Task Force continues its deliberations. It is included here as a "work in progress" that illustrates the overall approach only, not as a finished product.

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- C9. A new concept introduced in the diagram is that of “principle evidence.” The Task Force is currently of the view that a cut-off point is required, beyond which certain procedures (evaluation of the expert’s assumptions and methods, source data, and findings) should become mandatory. It is currently using the term “principle evidence” to identify this cut-off point, i.e. if the external expert provides “principle evidence” then those procedures become mandatory.
- C10. While the exact definition is still subject to debate within the Task Force, in general terms “principal evidence” in this context means the primary evidence supporting the auditor’s conclusions regarding (i) a material class of transactions, account balance or disclosure, or (ii) a significant aspect of the financial reporting process. Significant aspect of the financial reporting process is included because the work of the expert may not be directly related to any particular financial statement item, but may be the principal evidence regarding, e.g., the underlying IT system.

### Matters for CAG’s Consideration

2. Does the CAG have any suggestions for the Task Force regarding consistency with the audit risk model, particularly use of the “principal evidence” concept?

### D Report back regarding November 30-December 1, 2005 CAG meeting

- D1. A brief report back is contained in Agenda Item X-1.

### Material presented

Agenda Item M.1

Report Back—Using the Work of an Expert – **IAASB CAG PAPER**

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## Appendix

