

IAASB CAG PAPER



International Federation of Accountants

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Agenda Item

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Committee: IAASB Consultative Advisory Group

Meeting Location: Toronto

Meeting Date: September 11-12, 2006

Using the Work of an Expert

Objectives of Agenda Item

1. To provide a brief report back on the May 11-12, 2006 comments received from Representatives on the first draft of the proposed exposure draft of proposed ISA 620, "Using the Work of an Expert."
2. To obtain the views of Representatives on key issues discussed by the IAASB at its July 2006 meeting.

May 11-12, 2006 CAG Comments

Below are extracts from the minutes¹ of the May 11-12, 2006 CAG meeting and an indication of how the IAASB Task Force or the IAASB responded to the Representatives' comments.

Representatives' comments	IAASB task force or the IAASB response
Definition of Engagement Team	
Mr. Lamoureux suggested that the examples of when an auditor may involve an expert include estimating non-marketable assets. He was also concerned about experts who claim that they are independent when in fact they are not. He referred to compensation consulting as an example. Mr. Gathinji asked whether lawyers, who estimate the likely outcome of legal cases, and translators, who translate financial reporting and audit related matters, are considered to be experts.	<p>The Task Force intends including experts who value non-marketable assets.</p> <p>The IAASB noted that the IESBA, rather than IAASB, may develop guidance for the independence of experts, however, the IAASB agreed that the ISA should require compliance with relevant ethical requirements, including any applicable independence rules, and should also require the auditor to evaluate an expert's objectivity.</p> <p>Lawyers who estimate the likely outcome of legal cases would be experts. Translators may also be experts, depending on the circumstances.</p>
Mr. Gathinji noted that SMPs may not have in-house experts and that this should be taken into account in	The IAASB Task Force is consulting with the IFAC SMP Committee on the draft. (The Task Force

¹ The minutes will be approved at the September 11-12, 2006 IAASB CAG meeting.

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developing the requirements and guidance.	includes a nominee of that Committee.)
<p>Referring to the fact that the auditor has to evaluate the external expert's objectivity, Mr. Popham noted that the independence rules for auditors provide a benchmark for evaluating auditors' objectivity, while such benchmark may not exist for evaluating the objectivity of external experts.</p> <p>Mr. Lamoureux suggested that auditors obtain written representations from external experts about their independence.</p> <p>Ms. Koski-Grafer noted that, if the requirements for in-house experts are more stringent than those for external experts, it may create an incentive to hire external experts to achieve the lowest requirement</p>	<p>The IAASB noted that the IESBA Independence Task Force is considering whether the Code should provide guidance on the independence of experts.</p> <p>The IAASB agreed that a representation from an expert may often assist the auditor in evaluating the expert's objectivity, which affects the reliability of the evidence the expert provides.</p> <p>This was considered an unlikely consequence for economic and quality control reasons, nonetheless, it was noted that the definition of "firm" in the Code would include "captive" firms of experts.</p>
<p>Mr. Rabine was of the view that the external expert's report is likely to indicate his or her responsibilities and the professional standards applied in fulfilling them. It is not relevant to require the external expert to state again his or her independence. If the auditor has to be convinced of the external expert's independence, the starting point could be the external expert's report. Mr. Popham was of the view that independence considerations are particularly important in the case of external experts. The auditor makes a public statement about the financial statements – he or she should therefore be convinced of the external expert's independence.</p>	<p>The IAASB considered that a representation from the expert should not be required in all cases. When an external expert provides a report that includes an appropriately worded statement about the expert's independence, then that would constitute a representation of the kind envisaged.</p>
<p>Ms. Rand noted that the PCAOB Standing Advisory Group had similar discussions about the independence / objectivity of experts who are part of the engagement team and those who are not, and came to the same conclusion as the Task Force. The United States have rigorous independence rules for auditors; the PCAOB staff was of the view that it would be difficult to impose the auditor independence requirements on external experts. The PCAOB staff was of the view that objectivity may be a better evaluation for external experts. Mr. White noted that,</p>	<p>The IAASB agreed with these comments.</p>

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from the stand point of the user community, it is important to maintain a clear distinction between independence and objectivity; independence is a very high standard. Professional service firms outside the accounting community may not have systems in place to meet the independence rules for auditors.	
Mr. Edwards was of the view that the flowchart should include a minimum requirement for external experts that provide "principle evidence;" that is, such experts should not have financial relationships that could impair their objectivity. A written representation may be one way of obtaining such information.	The IAASB decided to remove the principle evidence category, and instead base evidence considerations on a "sliding scale" according to such factors as the importance of the expert's work to the auditor's evidence and the risk of material misstatement. Therefore, there will not be a minimum requirement such as "no financial relationships", unless they are included in independence rules that apply to the audit engagement or to the expert under their own professional standards.
Mr. Sekiguchi asked whether the Task Force has considered how the auditor could utilize the fact that some external experts are required to comply with independence / objectivity requirements of their professions / industries. Ms. Koski-Grafer suggested that the Task Force expand the concept of considering the expert's commitment to ethical principles, as described in the flowchart.	<p>The Task Force considers that where an expert is required to comply with independence / objectivity requirements of their professions / industries, that this should be a minimum requirement for using their work.</p> <p>The Task Force will consider further the ambit of the expert's commitment to "ethical principles."</p>
Audit Risk Model	
Mr. Asmelash noted that an expert is used because the auditor does not have a certain expertise. The auditor, however, is responsible for evaluating the expert's work. He asked what level of expertise the auditor needs to make such evaluation. Ms. Koski-Grafer agreed that it will be difficult for the auditor to evaluate the work of an expert. Mr. Scicluna noted that the auditor would have evaluated the expert. He asked whether, based on the evaluation of the expert, the auditor could limit his evaluation of the expert's work to identifying whether anything may be wrong.	<p>The IAASB made the point that the more removed is the expert' field of expertise from that reasonably expected of an auditor, the more the auditor's procedures may be weighted toward the expert's objectivity, integrity, competence and reputation, and considering whether the expert objectively challenged management's work.</p> <p>The IAASB is of the view that, in the absence of evidence to the contrary, and having exercised professional skepticism and followed the requirements of the ISA, the auditor is entitled to accept the expert's judgments in the expert's field of expertise.</p>

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Ms. Rand asked how far the auditor has to go. She noted that this was also discussed at the PCAOB Standing Advisory Group. She was concerned about the auditor evaluating experts and then accepting their reports without evaluating their work. Currently, auditors in the United States are not required to consider the reasonableness of the experts' work. Rather, the auditors' obligation is to determine that the experts' findings are not unreasonable.	The IAASB decided that the nature, timing and extent of the auditor's procedures should be determined by such factors as the importance of the expert's work to the auditor's evidence and the risk of material misstatement in the matter to which it relates. The Task Force is revising the draft ISA to adopt this approach
Mr. Gathinji suggested that the written representations include a requirement for management to consider when to contract an expert and confirmation that it has done so.	The IAASB asked that the Task Force review ISA 315's coverage of the risks of material misstatement due to management's need for expertise in preparing the financial statements, rather than dealing with this topic in ISA 620
Ms. Sucher noted that this may be a matter for liaison with the International Accounting Education Standards Board (IAESB). Ms. Todd McEnally was of the view that the level of standards of education for auditors in different areas ought to be considered at a general level.	The Task Force is reviewing the IAESB's <i>Competence Requirements for Audit Professionals</i> to ensure compatibility with the revised ISA and will feedback to the IAESB any matters that arise that the Task Force considers requires their attention.

Main issues discussed at the July IAASB meeting

ENGAGEMENT TEAM AND INDEPENDENCE

The Agenda Papers considered by the IAASB at its July meeting explained that it was not entirely clear to the Task Force whether, under the existing definition of "engagement team" in ISQC 1, all internal and external experts involved in an audit engagement, including those who are only peripherally involved, should be considered a part of the engagement team. **Refer to the Issues Paper at section A Definition of "Engagement Team," and Independence (Agenda Item K.1).** As well as affecting the application of ISQC 1 and those ISAs that use this term (e.g., ISAs 220, 240 and 315), it was noted that this definition has significant independence implications since it appears in the IFAC Code of Ethics. The task force has therefore commenced liaison with the independence task force of the International Ethics Standards Board for Accountants (IESBA) in this regard.

The IAASB debated the Task Force's suggestion of differentiating between internal and external experts by excluding external experts from the definition of engagement team and, therefore, from ISQC 1 and the ISAs except ISA 620. It was noted that the effect of this approach would be consistent with some national equivalents of ISA 620 that deal only with external experts because

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internal experts are dealt with under quality control standards. The IAASB questioned whether the contractual/employment relationship with the expert should be a primary criterion for determining how the auditor is to deal with an expert's work, or whether other criteria, such as the importance of the expert's work to the auditor's evidence and the risk of material misstatement in the matter to which it relates, should be the overriding determinants. It was noted that differentiating between internal and external experts appeared inconsistent with the IAASB's decision in an analogous situation in ISA 600 not to distinguish between related and unrelated auditors. It was also noted that ISQC 1 and ISA 220 are sufficiently flexible to allow for the necessary differences of approach to the auditor's review, supervision and direction of an external expert versus an internal expert.

The IAASB agreed that ISA 620 should essentially treat internal and external experts in the same way, but that the extent to which the expert is subject to quality control procedures under ISQC 1 and ISA 220 would influence the nature, timing and extent of procedures the auditor will perform with respect to the expert's work.

Also, while the IAASB was of the view that the definition of "engagement team" does not need to be changed for the purpose of ISQC 1 and the ISAs, it acknowledged that IESBA may need to change it for the purpose of the Code. The Task Force was, therefore, asked to continue liaising with the IESBA's independence task force and to consider how any change to the definition that IESBA may consider necessary for the Code would affect ISQC 1 and the ISAs.

Matters for Consideration by the IAASB CAG:
The Representatives are asked for their views on:
1. The role of the contractual/employment relationship between the auditor and the expert in determining how the auditor is to deal with an expert's work?
2. The role of other criteria such as the importance of the expert's work to the auditor's evidence and the risk of material misstatement in the matter to which it relates?

ENGAGEMENT TEAM AND INDEPENDENCE

The IAASB debated the Task Force's proposal to introduce a new concept of "principal evidence" to identify a cut off point beyond which certain procedures would be required to be performed by the auditor – refer to the Issues Paper at section C *Principal Evidence* (Agenda Item K.1). The task force defined principal evidence as evidence that is critical to support the auditor's conclusions regarding a significant risk.

The IAASB concluded that the concept of "principal evidence" was an unnecessary complication. It was agreed that instead, the ISA should adopt a "sliding scale" approach whereby the nature, timing and extent of the auditor's procedures would be determined by such factors as the importance of the expert's work to the auditor's evidence and the risk of material misstatement in the matter to which it relates.

It was also agreed that many of the procedures required by the draft to be performed only when the expert provided "principal evidence" [refer paragraph 17 of the draft (Agenda Item K.2)]

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should actually be performed in nearly all cases where an expert is used; however, the emphasis to be given to different procedures and the extent to which they are performed will vary significantly with the circumstances. The Task Force was asked to consider how ISAs 600 (Revised), “The Audit of Group Financial Statements” and 330, “The Auditor's Procedures in Response to Assessed Risks.” have dealt with similar concepts, and to be consistent with them where possible.

The IAASB agreed that a sliding scale approach is also appropriate to the nature and extent of documentation, and that the ISA should require specific documentation only when involvement of the expert is significant to the auditor’s conclusions on a material matter.

Matters for Consideration by the IAASB CAG:

The Representatives are asked for their views on whether:

1. The ISA should identify a cut off point beyond which certain procedures would be required to be performed by the auditor, or whether a “sliding scale” approach should be adopted, whereby the auditor’s procedures would be determined by such factors as the importance of the expert’s work to the auditor’s evidence and the risk of material misstatement in the matter to which it relates?
2. The procedures identified in paragraph 17 of the draft (Agenda Item K.2) should be applied in nearly all cases where an expert is used, with the emphasis to be given to different procedures and the extent to which they are performed varying significantly according to the “sliding scale”?
3. A sliding scale approach is appropriate to determine the nature and extent of documentation, and whether the ISA should require specific documentation only when involvement of the expert is significant to the auditor’s conclusions on a material matter?

Material Presented – IAASB CAG REFERENCE PAPERS ONLY

Agenda Item K.1 Issues Paper (July 2006 IAASB Agenda Item 7-A)

Agenda Item K.2 “First Read” Draft Revised ISA 620 (July 2006 IAASB Agenda Item 7-B)

The remainder of the July 2006 IAASB meeting material is available from <http://intranet.ifac.org/Agendas.php?mode=view&item=4059&CID=0009>.