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IAASB CAG Agenda (April 2007)

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Appendix

Using the Work of an Auditor's Expert - Issues

A. Definition of engagement team

- A1. At previous meetings, the IAASB has discussed proposals being developed by IESBA (the Ethics Board) to revise the definition of “engagement team.” The definition currently in the Code is the same as that in [proposed] ISQC 1 (Redrafted) and [proposed] ISA 220 (Redrafted):

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

The task force has observed that this definition can be interpreted to mean that all internal and external experts, regardless of the magnitude of their involvement with the audit, would need to meet the independence requirements applicable to public accountants under the Code. This may not be practicable in some circumstances, and could result, for example, in the auditor not being able to obtain the assistance needed from experts in certain fields.

- A2. The task force has been liaising with IESBA's Independence Task Force (ITF) on this matter recognizing that any change to the definition that IESBA may consider necessary for the Code could affect [proposed] ISQC 1 (Redrafted) and the ISAs.
- A3. Liaison with the ITF resulted in the ITF agreeing with the task force that the definition in the Code should exclude external experts. However, despite the ITF's recommendation to the contrary, IESBA included the following definition in the exposure draft of the Code that it approved in December:

All partners and staff performing the engagement, and any individuals contracted by the firm who provide services on the engagement that might otherwise be provided by a partner or staff of the firm.

- A4. The Explanatory Memorandum accompanying the ED says:

The IESBA understands that the existing definition may have unintended consequences because “any experts contracted by the firm” is broad. In an audit there are potentially many different “experts” who could be contracted by the firm, ranging from an individual who works closely with the team throughout the audit to an individual, usually on behalf of the organization they represent, who has no contact with the engagement team but does provide information about a particular matter (for example, an external lawyer who provides a legal opinion about a particular matter). The IESBA is of the view that it would be inappropriate to treat all such experts as members of the engagement team.

The IESBA is of the view that the definition of engagement team should be broader than partners of the firm and staff employed by the firm who serve on the team. Firms engage individuals (who may themselves be an expert in a particular field, such as a valuations

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specialist) to perform audit support activities that might otherwise be performed by partners or staff of the firm. Also, firms often contract with outside audit professionals at times of peak activity to supplement staff levels. The IESBA is of the view that such individuals should be considered to be part of the engagement team because they are performing functions that would otherwise be performed by a partner or staff of the firm. The individual's legal relationship with the firm should not be the factor that determines whether or not he or she has to comply with independence requirements.

Accordingly, the IESBA proposes amending the definition to read:

“All partners and staff performing the engagement and any individuals contracted by the firm who provide services on the engagement that might otherwise be provided by a partner or staff of the firm.”

- A5. The task force agrees that “the existing definition may have unintended consequences,” e.g. it appears to *include* contracted experts as part of “personnel” when, in fact, personnel is defined as “partners and staff,” which *excludes* contracted experts.
- A6. The task force also agrees with the principle that an “individual’s legal relationship with the firm should not be the factor that determines whether or not he or she has to comply with independence requirements.”
- A7. The task force does, however, have significant difficulties with the proposed definition. For example, assume an audit firm has an in-house lawyer whom it consults on legal questions, but the in-house lawyer happens to be unavailable, e.g. during a busy period, and an auditor in the firm consults a partner in a large law firm on a single, minor legal matter regarding an audit client. Because the service provided by the partner in the large law firm “might otherwise be provided by a partner or staff of the (audit) firm” the partner in the large law firm falls under the definition and is part of the engagement team. While this appears to be particularly problematic from an independence point of view (e.g., is it intended that all partners in the large law firm should be prevented from owning shares in the audit client), that is a matter for IESBA and is not the direct concern of the task force. If, however, this definition were to be adopted by the IAASB for the sake of consistency, then the partner in the large law firm would form part of the engagement team for the purposes of the ISAs, which is not consistent with the task force’s understanding of the IAASB’s intention when drafting ISAs (and [proposed] ISQC 1 (Redrafted)).
- A8. The exposure period for the proposed Code finishes on 30 April. A verbal report will be provided to the IAASB on further developments.

B. Sliding scale

- B1. At the October meeting, the IAASB asked the task force to reconsider the structure of the draft as it relates to application of the “sliding scale,” i.e., the notion that the nature, timing and extent of procedures to comply with a number of the requirements can vary greatly depending on the circumstances, e.g., whether the expert is internal or external and the materiality of the matter the expert’s work relates to.

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B2. In the October draft, the task force included a specific requirement (old paragraph 7) to implement the sliding scale. Having further considered the views expressed at the October meeting, the task force has moved the text relating to the sliding scale into the application material. While an overview is included as paragraph A4, further elaboration is included in relation to each relevant requirement (see, e.g. A10, A22 and A25). This allows the requirements to stand on their own, and recognizes that the nature, timing and extent of procedures is a matter of implementation or application.

C. Using the work of management's expert

C1. At the October meeting, the IAASB reconfirmed that this ISA should not deal with experts employed or engaged by management, and asked that:

- (a) The ISA clearly state this fact - this has been done in paragraph 2; and
- (b) The task force consider whether conforming amendments to other ISAs will be necessary to address the auditor's consideration of the work of experts employed or engaged by management, particularly the potential for over-reliance on the work of outside experts engaged by management, which was noted as an important issue in practice. It was noted in this context that while applying procedures similar to those identified in the draft to experts employed or engaged by management will be appropriate in some circumstances, it will not always be so. The task force has sought to address these issues in footnote 2, and the conforming amendments to ISAs 315 (Redrafted) and 330 (Redrafted) at the end of the draft. The task force believes the conforming amendments are particularly important to ensure the rigor of the ISAs is not eroded by the decision to remove consideration of the work of management experts from the scope of [proposed] ISA 620 (Revised and Redrafted).

D. Accounting and auditing experts

D1. The definition of "auditor's expert" in the current draft excludes accounting and auditing experts. This follows a decision the IAASB made early in the life of this project to exclude such experts on the grounds that public accountants are expected to have accounting and auditing expertise. The IAASB did, however, ask the task force to reconsider the implications of this decision from time to time as the project progresses.

D2. In reconsidering this matter now, the task force agrees that it is very difficult to clearly define the level of expertise needed by "generalist" auditors versus those with "specialized" knowledge of particular accounting and auditing matters, and to include accounting and auditing experts in the ambit of the ISA would not be appropriate because it would treat all partners and staff on the audit as "experts." However, the task force is conscious of the fact previously noted by the IAASB that, particularly in larger, more complex audits, there is an increasing need to use the work of accounting and auditing experts, and auditors may look to this ISA for assistance in such cases.

D3. The task force therefore proposes that a footnote be added noting that although the ISA does not directly deal with this matter, parts of the ISA may nonetheless be of assistance when an

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accounting or auditing expert is used (see footnote 1 to the draft).