

IESBA Agenda Paper 2-C

REVISION OF SECTION 290

INDEPENDENCE – AUDIT AND REVIEW ENGAGEMENTS

Paragraphs 290.1-290.194 of the updated Section 290 will be unchanged and paragraphs 290.195-290.-200 will be deleted and replaced with the following paragraphs.

Internal Audit Services

General Provisions

290.195 The scope and objectives of internal audit activities vary widely and depend on the size and structure of the entity and the requirements of management and those charged with governance. Internal audit activities may include:

- (a) Monitoring of internal control – reviewing controls, monitoring their operation and recommending improvements thereto;
- (b) Examination of financial and operating information – reviewing the means used to identify, measure, classify and report financial and operating information, and specific inquiry into individual items including detailed testing of transactions, balances and procedures;
- (c) Review of the economy, efficiency and effectiveness of operating activities including non-financial activities of an entity; and
- (d) Review of compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

290.196 Internal audit services involve assisting the audit client in the performance of its internal audit activities. The provision of internal audit services to an audit client creates a self-review threat to independence if the firm uses the internal audit work in the course of a subsequent external audit. ~~Assisting an audit client in the performance of Performing~~ a significant part of the client's internal audit activities increases the possibility that firm personnel providing internal audit services will assume a management responsibility. If the firm's personnel assume a management responsibility when providing internal audit services to an audit client, the threat created would be so significant that no safeguards could reduce the threat to an acceptable level. Accordingly, a firm's ~~should ensure that its~~ personnel ~~do should~~ not assume a management responsibility when providing internal audit services to an audit client.

290.197 Examples of internal audit services that involve assuming management responsibilities include:

- (a) Setting internal audit policies or the strategic direction of internal audit activities;
- (b) Directing and taking responsibility for the actions of the entity's internal audit employees;

- (c) Deciding which recommendations resulting from internal audit activities should be implemented;
- (d) Reporting the results of the internal audit activities to those charged with governance on behalf of management;
- (e) Performing procedures that form part of the internal control, such as reviewing and approving changes to employee data access privileges;
- (f) Taking responsibility for designing, implementing and maintaining internal control; and
- (g) Performing outsourced internal audit services, comprising all or a substantial portion of the internal audit function, where the firm is responsible for determining the scope of the internal audit work and may have responsibility for one or more of the matters noted in (a) – (f).

290.198 To ~~avoid ensure that, in performing internal audit services, the firm does not assume~~ assuming a management responsibility, the firm should only provide internal audit services to an audit client if all of the following conditions are met:

- (a) The client designates an appropriate and competent resource, preferably within senior management, to be responsible at all times for internal audit activities and to acknowledge responsibility for designing, implementing, and maintaining internal control;
- (b) The client's management or those charged with governance reviews, assesses and approves the scope, risk and frequency of the internal audit services;
- (c) The client's management evaluates the adequacy of the internal audit services and the findings resulting from their performance;
- (d) The client's management evaluates and determines which recommendations resulting from internal audit services to implement and manages the implementation process; and
- (e) The client's management reports to those charged with governance the significant findings and recommendations resulting from the internal audit services.

290.199 When a firm uses the work of an internal audit function, international standards on auditing require the performance of procedures to evaluate the adequacy of that work. When a firm accepts an engagement to provide internal audit services to an audit client, and the results of those services will be used in conducting the external audit, a self-review threat is created because of the possibility that the audit team will use the results of the internal audit service without appropriately evaluating those results or exercising the same level of professional skepticism as would be exercised when the internal audit work is performed by individuals who are not members of the firm. The significance of the threat will depend on factors such as:

- The materiality of the related financial statement amounts;

- The risk of misstatement of the assertions related to those financial statement amounts; and
- The degree of reliance that will be placed on the internal audit service.

The significance of the threat should be evaluated and, if the threat is not clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include using professionals who are not members of the audit team to perform the internal audit service.

Audit Clients that are Public Interest Entities

290.200 In the case of an audit client that is a public interest entity, a firm should not provide internal audit services that relate to:

- (a) the Significant internal accounting controls over financial reporting;
- (b) Financial systems that generate information that is significant to the client's accounting records or to the financial statements on which the firm will express an opinion; or
- (c) Amounts or disclosures that are, separately or in the aggregate, material to the financial statements on which the firm will express an opinion.

~~290.201 A firm is not, however, precluded from providing to an audit client that is a public interest entity a non-recurring internal audit service to evaluate a specific matter that relates to the internal accounting controls, financial systems or financial statements provided the conditions in paragraph 290.189 are met, the facts and circumstances related to the service are discussed with those charged with governance, the service would otherwise be permitted under Section 290, and safeguards are applied as necessary to reduce any threat that is not clearly insignificant to an acceptable level.~~

Paragraphs 290.192-290.212 of the updated Section 290 will be unchanged and paragraphs 290.213-290.219 will be deleted and replaced with the following paragraphs:

Fees

Fees – Relative Size

290.213 When the total fees from an audit client represent a large proportion of the total fees of the firm expressing the audit opinion, the dependence on that client and concern about losing the client may create a self-interest threat. The significance of the threat will depend on factors such as:

- The operating structure of the firm;
- Whether the firm is well established or new; and
- The significance of the client qualitatively and/or quantitatively to the firm.

The significance of the threat should be evaluated and, if the threat is not clearly insignificant, safeguards should be considered and applied when necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Reducing the dependency on the audit client;
- External quality control reviews; or
- Consulting a third party, such as a professional regulatory body or ~~another~~ professional accountant, on key audit judgments.

290.214 A self-interest threat may also be created when the fees generated from an audit client represent a large proportion of the revenue from an individual partner's clients or a large proportion of the revenue of an individual office of the firm. The significance of the threat will depend upon factors such as:

- The significance of the client qualitatively and/or quantitatively to the partner or office; and
- The extent to which the remuneration of the partner, or the partners in the office, is dependent upon the fees generated from the client.

The significance of the threat should be evaluated and, if the threat is not clearly insignificant, safeguards should be considered and applied when necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Reducing the dependency on the audit client;
- Having an additional professional accountant review the work or otherwise advise as necessary; or
- Regular independent internal or external quality reviews of the engagement.

Audit Clients that are Public Interest Entities

290.215 In the case of an audit client that is a public interest entity when, for two consecutive years, the total fees from the client and its related entities (subject to the considerations in paragraph 290.24) represent more than 15% of the total fees received by the firm expressing the opinion on the financial statements of the client, the self-interest threat would be too significant unless the firm discloses to those charged with governance of the audit client the fact that the total of such fees represents more than 15% of the total fees received by the firm, ~~and~~ discusses which of the safeguards below ~~it will be applied~~apply to reduce the threat to an acceptable level, and applies the selected safeguard:

- After the audit opinion on the second year's financial statements has been issued, and before the issuance of the audit opinion on the third year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements of the client, or a professional regulatory body performs a review that is equivalent to an engagement quality control review ("a post-issuance review"); or

- Prior to the issuance of the audit opinion on the second year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements of the client, performs an engagement quality control review or a professional regulatory body performs a review that is equivalent to an engagement quality control review ("a pre-issuance review")

When the total fees significantly exceed 15%, the firm should determine whether the significance of the threat is such that a post-issuance review would not reduce the threat to an acceptable level and, therefore, a pre-issuance review is required. In such circumstances a pre-issuance review should be performed.

Thereafter, when the fees continue to exceed 15%, each year, the disclosure to and discussion with those charged with governance should occur and one of the above safeguards should be applied. If the fees significantly exceed 15%, the firm should determine whether the significance of the threat is such that a post-issuance review would not reduce the threat to an acceptable level and, therefore, a pre-issuance review is required. In such circumstances a pre-issuance review should be performed.