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Our ref: ICAEW Rep 57/13

Keith Billing  
Project Director  
Financial Reporting Council

Submitted by email: [k.billing@frc.org.uk](mailto:k.billing@frc.org.uk)

Dear Keith

**FRC further consultation on prohibiting the use of internal auditors to provide direct assistance**

ICAEW is pleased to respond to your request for comments on the further consultation on prohibiting the use of internal auditors to provide direct assistance published by the FRC on 11 February 2013, a copy of which is available from this [link](#).

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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## ICAEW REPRESENTATION

**FRC further consultation on prohibiting the use of internal auditors to provide direct assistance**

**Memorandum of comment submitted in April 2013 by ICAEW, in response to the FRC consultation on use of internal audit published in February 2013**

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## INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the further consultation on prohibiting the use of internal auditors to provide direct assistance published by the FRC on 11 February 2013, a copy of which is available from this [link](#).

## WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 140,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
4. The Audit and Assurance Faculty is a leading authority on external audit and other assurance activities and is recognised internationally as a source of expertise on audit issues. It is responsible for technical audit and assurance submissions on behalf of ICAEW as a whole. The faculty membership consists of nearly 8,000 members drawn from practising firms and organisations of all sizes from both the private and public sectors. Members receive a range of services including the monthly Audit & Beyond newsletter.

## MAJOR POINTS

### Concerns about the impact of the proposals

5. ICAEW is concerned that these proposals are being introduced at this stage of the process following consultations that produced no call for such a prohibition and extensive work by the IAASB and IESBA to resolve matters in a satisfactory way.
6. In our response to the FRC's May 2012 consultation ([Rep 95/12](#)) we supported adopting the proposed changes as per where the IAASB and IESBA had ended up on the issues following a very extensive process. On direct assistance we supported including, as proposed, the IAASB new material on direct assistance that had not been formally issued at that time. We concluded that the final material from the IAASB and IESBA on this issue had dealt successfully with the challenge created by direct assistance. We note that the final revised documents from the two boards have now been issued (on 19 March): IESBA [change to the definition of "engagement team"](#) in the Code of Ethics for Professional Accountants and [ISA 610 \(revised 2013\)](#), *Using the Work of Internal Auditors*.
7. ICAEW supports adoption of these documents as drafted. The previous consultations did not produce a call to do otherwise and we do not support the FRC adopting different standards to those that apply internationally. It is highly unlikely that this move by the FRC will have any impact regarding international practice on direct assistance including in the US.
8. As we make clear in our answers to consultation questions 1 and 2 below, the FRC is proposing to go ahead with the prohibition without any proper assessment of the likely cost impact of the proposal. We are concerned that the prohibition will result in increased cost for UK and Ireland business without any clear benefits because we are not convinced by the arguments in paragraph 3.3 of the FRC paper that direct assistance might be detrimental to audit quality (see paragraph 13 below). The main cost impact flows from the extension of the prohibition to all audits conducted in accordance with ISAs (UK and Ireland) including in a

group audit to any overseas component auditor whose work is relied upon by the group auditor. We therefore propose that the FRC does some research before making any final decision.

### **Suggested addition if the FRC does proceed with the prohibition**

9. As stated in paragraph 16 of our response below, we consider that it might be useful for there to be application material to the proposed paragraph 4-1.

## **RESPONSES TO THE FRC'S SPECIFIC QUESTIONS**

### **Q1: To what extent is direct assistance a feature of current audits?**

10. We agree with the comment in the FRC paper that there seem to be relatively few UK and Ireland audits for which direct assistance is used to a significant extent in terms of volume of work. However, we are unable to answer this question definitely in the absence of proper research on the matter and the FRC ought to collect more data before making final decisions. We do not consider it good practice for the FRC to take this type of decision in the absence of hard evidence that there is a problem that needs to be addressed.
11. We have received some feedback from UK internal auditors that direct assistance is not commonly used but despite this apparent lack of direct assistance being used in the UK and Ireland, we understand that there are still likely to be a number of audits in which UK and Ireland auditors are involved where direct assistance is a feature. This is because it is well-established in certain countries such as the US. Examples include group audits for entities with US subsidiaries and UK entities with US parents with group-wide control environments (see further comments on this in the answers to other questions below).

### **Q2: Would the prohibition of direct assistance have a significant proportional impact on the costs of those audits where it is currently a feature? If yes, please give an estimate of the proportional cost.**

12. We consider that there might be a noticeable impact on costs on those audits that would be affected by the prohibition, for example where there are significant US components in a group situation and the group auditor is unable to rely on the work of the component auditor because it involved use of internal audit in a direct assistance capacity. Another example is a UK entity with a US parent with a group-wide control environment. In this situation, for example, a group-wide data processing centre where IT controls are operated, the UK auditor may be using the work of the group auditor as part of their work on controls under ISA (UK and Ireland) 315. That would be problematic if (say) the US auditor had used direct assistance; and potentially costly if the alternative was the UK team flying to the US to do the testing. We are not able to provide any solid evidence or figures in support of this view of the impact but we suggest that the FRC should acquire some hard data before making final decisions.

### **Q3: Other than cost, are there other significant possible impacts that may result from the prohibition of direct assistance? If yes, please describe them and how difficult, or easy, it would be to overcome them. The FRC is particularly interested to have views on the possible impact, if any, on audit quality.**

13. As stated in the answer to Q2 above, there might well be practical challenges to overcome in situations where direct assistance is a feature, for example in travelling abroad to do additional work. The main impact is likely to be on cost and the time needed to complete the audit. We are not convinced by the arguments in paragraph 3.3 of the FRC paper that direct assistance might be detrimental to audit quality for independence and quality control reasons. As stated in paragraph 10 above, we consider that the FRC should obtain hard evidence before concluding on whether there is an issue with independence or audit quality. Key audit judgements are unlikely to be affected by this change and in our view the additional IAASB material in the now issued in the 2013 version of revised ISA 610 deals with the position adequately.

14. Our feedback from UK internal auditors is that the impact of the ban might be beneficial as they consider that internal audit staff should concentrate on work that is of more direct importance to the business.

**Q4: Does the proposed effective date of the revised standards that would bring the prohibition into effect (audits of financial periods ending on or after 15 March 2014) allow sufficient time to overcome any practical difficulties that may arise from the prohibition, such as a need for external auditors to assign their own staff with appropriate knowledge and competencies to the work? If not, please explain why and identify what would be an appropriate effective date.**

15. We do not believe that putting the effective date back beyond that suggested by the FRC will make much difference and timing is unlikely to be an issue. Direct assistance is likely to remain embedded in US practice and also prevalent in some other jurisdictions and therefore the practical challenges (as above) for UK and Ireland auditors will remain whenever it is brought in.

## OTHER DETAILED COMMENTS

16. We consider that it might be useful for there to be application material to the proposed paragraph 4-1. Paragraph 4-1 makes clear that the prohibition extends to work of component auditors on which the group auditor is relying. It would be helpful if application material and/or the footnote indicates that this does not stop the group auditor relying on work of component auditors in areas where there has been no direct assistance. For example, if direct assistance was over service charges in a real estate subsidiary, but the group auditor had referred out only work on the property valuation (this being the only risk of any significance to the group financial statements), the group auditor can still use the work of the component auditor on that valuation.
17. This matter affects both the applicable auditing and ethical standards. The ICAEW Code of Ethics is amended periodically to take into account changes made by IESBA. The change to the definition of 'engagement team' will be considered in due course along with other recent changes made by IESBA and those in the pipeline. Of course this will be of little relevance if the FRC does go ahead with the proposed prohibition with this being reflected in FRC standards.
18. The internal auditors we have consulted express disappointment that there is no reference to the Standards of the Institute of Internal Auditors (IIA) in both FRC and IAASB standards covering internal audit working with external audit. ICAEW supports the use of the IIA standards by internal auditors.

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