Agenda Item 11-A

PROPOSED INTERNATIONAL STANDARD ON AUDITING 620
USING THE WORK OF AN AUDITOR'S EXPERT
(REVISED AND REDRAFTED)

(Effective for audits of financial statements for periods beginning on or after [date])*

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* See footnote 1.

Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the auditor's use of the work of a party possessing expertise in a field other than accounting or auditing, who is employed or engaged by the auditor to assist the auditor to obtain sufficient appropriate audit evidence.

2. The entity may employ or engage an expert to enable management to prepare the financial statements. This ISA does not deal with the auditor's consideration of the work of experts employed or engaged by the entity. When the entity employs or engages such an expert, the work of that expert is part of the preparation of the financial statements. Although this ISA does not deal with the auditor's consideration of the work of experts employed or engaged by the entity, the provisions of this ISA relating to the auditor's consideration of an auditor's expert's capabilities, competence and objectivity may be helpful in considering such matters in relation to an expert employed or engaged by the entity. Factors such as the extent to which management can exercise control over, or influence the work of an expert employed or engaged by the entity, and whether such an expert has professional obligations with respect to objectivity, may be particularly relevant in determining the nature, timing and extent of the auditor's procedures in relation to that expert's work.

Responsibilities of the Auditor

3. The auditor has sole responsibility for the audit opinion expressed and, accordingly, that responsibility is not reduced by the auditor's use of the work of an auditor's expert. Provided the auditor concludes that the work of the auditor's expert is adequate for the purposes of the audit, the auditor may accept that expert's findings and conclusions in the expert's field. (Ref: Para. A1-A2)

Effective Date

4. This ISA is effective for audits of financial statements for periods beginning on or after [date].[1]

Objectives

5. The objectives of the auditor are:

   (a) To determine whether it is necessary to use the work of an auditor's expert; and

   (b) When it is necessary to use the work of an auditor's expert, to determine whether that work is adequate for the purposes of the audit.

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[1] This date will not be earlier than December 15, 2008.

Definitions

6. For purposes of the ISAs, the following terms have the meanings attributed below:

   (a) Auditor's expert – A party, possessing expertise in a field other than accounting or auditing, employed or engaged by the auditor to assist the auditor to obtain sufficient appropriate audit evidence.

   (b) Expertise – Specialized skills, knowledge and experience in a particular field.

   (c) Engagement team – *[All partners and staff performing the engagement, including those who are experts in a field other than auditing, and any other persons performing accounting or auditing tasks on the engagement regardless of their contractual relationship with the firm.]* [2]

   (d) Auditor's external expert – An auditor's expert who is engaged, not employed, by the auditor.

Requirements

Determining the Need for, and Employing or Engaging, an Auditor's Expert

7. If expertise in a field other than accounting or auditing is required to obtain sufficient appropriate audit evidence, the auditor shall determine whether it is necessary to use the work of an auditor's expert and, if so, the auditor shall use the work of an auditor's expert who has the necessary capabilities, competence and objectivity. (Ref: Para. A3-A13)

Obtaining an Understanding of the Field of Expertise of the Auditor's Expert

8. The auditor shall obtain a sufficient understanding of the field of expertise of the auditor's expert to enable the auditor to:

   (a) Determine the nature, scope and objectives of the expert's work for the purposes of the audit, and the respective responsibilities of the auditor and the expert; and

   (b) Design and perform appropriate audit procedures to evaluate the adequacy of the expert's work for the purposes of the audit. (Ref: Para. A14-A15)

Nature, Timing and Extent of Audit Procedures

9. The nature, timing and extent of the auditor's procedures regarding the work of the auditor's expert will vary depending on the circumstances. In determining the nature, timing and extent of audit procedures, the auditor shall consider matters such as:

   (a) The nature of the matter to which the expert's work relates;

   (b) The risks of material misstatement in the matter to which the expert's work relates;

   (c) The importance of the expert's work to the auditor's conclusions; and

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[2] This definition is subject to further consideration by the IAASB and the International Ethics Standards Board for Accountants.

(d) Whether the expert is subject to the auditor's firm's quality control policies and procedures. (Ref: Para. A16)

Agreement with the Auditor's Expert

10. The auditor shall agree the following matters with the auditor's expert:

    (a) The nature, scope and objectives of the expert's work;

    (b) The respective responsibilities of the auditor and the expert; and

    (c) The nature, timing and extent of communication between the auditor and the expert, including the form of any report to be provided by the expert. (Ref: Para. A17)

Evaluating the Adequacy of the Auditor's Expert's Work

11. The auditor shall evaluate the adequacy of the auditor's expert's work for the purposes of the audit, including:

    (a) The relevance and reasonableness of the expert's findings, and their consistency with other audit evidence; and

    (b) As necessary in the circumstances, the auditor's expert's assumptions, methods, and tests of source data.

12 If the work of the auditor's expert is not adequate for the purposes of the audit, or the auditor's expert's findings are not consistent with other audit evidence, the auditor shall take appropriate action to resolve the inadequacy or inconsistency. If the auditor is unable to resolve the matter the auditor shall deal with it in the auditor's report in accordance with [proposed] ISA 705 (Revised and Redrafted), "Modifications to the Opinion in the Independent Auditor's Report." (Ref: Para. A20-A28)

Reference to the Auditor's Expert in the Auditor's Report

13. The auditor shall not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion unless required by law or regulation to refer to the work of an auditor's external expert. If such reference is required by law or regulation, the report shall indicate that the reference does not alter the auditor's opinion as stated in the report, or diminish the auditor's sole responsibility for the report.

14. If the auditor refers to the work of an auditor's expert in an auditor's report containing a modified opinion, that report shall indicate that such reference does not diminish the auditor's sole responsibility for the report. (Ref: Para. A29-A30)

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Application and Other Explanatory Material

Introduction (Ref: Para. 1-3)

A1. ISA 315 (Redrafted), "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment" requires the auditor to obtain an

understanding of various aspects of the entity. These include the classes of transactions, account balances, and disclosures to be expected in the entity's financial statements, and the entity's information system, including the financial reporting process used to prepare the financial statements. It may be necessary for management to have or use expertise in a field other than accounting in order to make certain assertions relating to a class of transactions, account balance, or disclosure, or to effect some aspects of the process used to prepare the entity's financial statements. Examples of when management may require such expertise include:

- Determining the value of complex financial instruments, land and buildings, plant and machinery, jewelry, works of art and antiques.
- Determining liabilities associated with insurance contracts or employee benefit plans.
- Determining quantities and values of oil and gas reserves.
- Determining environmental liabilities, and site clean-up costs.
- Interpreting contracts, laws and regulations.
- Designing and implementing complex aspects of information systems.
- Analyzing complex or unusual tax compliance issues.

A2. The risks of material misstatement may increase when expertise in a field other than accounting is required for management to prepare the financial statements, e.g., because this may indicate some complexity, or because management may not possess knowledge of the field of expertise. If management does not possess the required expertise in the relevant field, management may employ or engage an expert to address those risks. The design and operating effectiveness of internal control related to the application of relevant expertise, including controls that relate to the work of an expert employed or engaged by management, if any, may also affect the risks of material misstatement.

Determining the Need for, and Employing or Engaging an Auditor's Expert (Ref: Para. 7)

A3. The IFAC "Code of Ethics for Professional Accountants" requires a professional accountant in public practice to agree to provide only those services that the professional accountant is competent to perform. In addition, [proposed] ISA 220 (Redrafted), "Quality Control for Audit Engagements"[3] requires the engagement partner to be satisfied that the engagement team collectively has the appropriate capabilities and competence to perform the audit engagement in accordance with professional standards and regulatory and legal requirements. Further, ISA 300 (Redrafted), "Planning an Audit of Financial Statements," requires the auditor to ascertain the nature, timing and extent of resources necessary to perform the engagement. Considering at the start of the audit whether the involvement of an auditor's expert may be necessary, and if so when and to what extent, assists the auditor in meeting these requirements. As the audit progresses, or as circumstances change, the auditor may

[3] DRAFTING NOTE: NEED TO CHECK WORDING AGAINST FINAL 220

need to revise earlier decisions about whether to employ or engage an auditor's expert.

A4. An auditor's knowledge, professional skills and practical experience enable the auditor to be competent in a range of subject matters, including business matters in general. However, an auditor does not ordinarily have the expertise of a person trained and experienced in another profession or specialized occupation.

A5. Nonetheless, an auditor who is not an expert in a relevant field may be able to obtain a sufficient understanding of that field to perform the audit without employing or engaging an auditor's expert. This understanding may be obtained through, e.g.:

- Experience in auditing entities that require the particular field of expertise in the preparation of their financial statements.
- Education, experience or professional development in the particular field of expertise.

A6. Alternatively, the auditor may determine that it is necessary to use an auditor's expert to assist in obtaining sufficient appropriate audit evidence. Considerations when deciding whether an auditor's expert is needed may include:

- Whether management has used an expert in preparing the financial statements and, if so:
  - Whether the expert is an employee of the entity, or is engaged by the entity, e.g., the expert may be a member of a firm of experts
  - Whether the expert's work is subject to technical performance standards or other professional or industry requirements.
- The complexity of the matter.
- The materiality of the matter, and the risks of misstatement.
- The expected nature, timing and extent of procedures to respond to identified risks.
- The availability of alternative sources of evidence.

A7. An auditor's expert may be needed to assist the auditor in one or more of the following:

- Obtaining an understanding of the entity and its environment, including its internal control.
- Identifying and assessing the risks of material misstatement.
- Determining and implementing overall responses to assessed risks at the financial statement level.
- Designing and performing further audit procedures to respond to assessed risks at the assertion level.
- Evaluating the sufficiency and appropriateness of audit evidence obtained in forming an opinion on the financial statements.

The Capabilities, Competence and Objectivity of the Auditor's Expert

A8. The more capable, competent and objective an auditor's expert is, the more reliable the work

of that expert is likely to be. An auditor's expert who is a member of the engagement team is subject to quality control policies and procedures implemented in accordance with [proposed] ISA 220 (Redrafted), and [proposed] ISQC 1 (Redrafted), "Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements." The auditor may be entitled to rely on the operation of these policies and procedures concerning such matters as:

- Capabilities and competence, through recruitment and formal training programs.
- Objectivity, through accumulating and communicating relevant independence information.
- Adherence to regulatory and legal requirements, through monitoring processes.

Nonetheless, as required by [proposed] ISA 220 (Redrafted), the auditor remains responsible for establishing that the engagement team collectively has the appropriate capabilities, competence and time to perform the audit engagement, and for the direction, supervision and performance of the audit[4].

A9. Information regarding the capabilities, competence and objectivity of an auditor's external expert may come from a variety of sources, such as:

- Personal knowledge of and experience with the expert's work.
- Discussions with other auditors or others who are familiar with the expert's work.
- Knowledge of the expert's qualifications, membership of a professional body or industry association, license to practice, or other forms of external recognition.
- Published papers or books written by the auditor's expert.

A10. When considering the capabilities, competence and objectivity of the auditor's expert, it may be relevant to consider whether the expert's work is subject to technical performance standards or other professional or industry requirements, e.g., ethical standards and other membership requirements of a professional body or industry association, accreditation standards of a licensing body, or requirements imposed by law or regulation.

A11. In addition to capabilities and competence in a field, other matters that may be relevant include:

- The relevance of the auditor's expert's capabilities and competence to the matter for which the expert's work will be used, including any areas of specialty within the expert's field. For example, a particular actuary may be a specialist in property and casualty insurance, but have comparatively little expertise regarding pension calculations.
- The auditor's expert's capabilities and competence with respect to relevant accounting and auditing requirements, including experience in assisting with the preparation or audit of financial statements.

[4] DRAFTING NOTE: NEED TO CHECK WORDING AGAINST FINAL 220

Objectivity, and Independence

A12. Objectivity relates to the effects that bias, conflict of interest or the influence of others may have on the professional or business judgment of the auditor's expert. A broad range of circumstances may threaten objectivity, e.g., self-interest threats, advocacy threats, familiarity threats, and intimidation threats. Safeguards that may eliminate or reduce such threats can be created either by external structures (e.g., the auditor's expert's profession, legislation or regulation), or by the auditor's expert's work environment (e.g., quality control policies and procedures).

A13. When considering the auditor's expert's objectivity, it may be relevant to consider any independence requirements that apply to the expert. In the absence of such requirements, it may be helpful for the auditor to obtaining a written representation from an auditor's external expert that details any known interests or relationships with the entity, such as:

- Financial interests.
- Business relationships.
- Employment – past, present or future.
- Family and personal relationships.

Similarly, obtaining a representation from the entity that details any known interests or relationships with the auditor's external expert may be of assistance.

Obtaining an Understanding of the Field of Expertise of the Auditor's Expert (Ref: Para. 8)

A14. The auditor may obtain an understanding of the auditor's expert's field of expertise through, e.g.:

- Experience in auditing entities that require the particular field of expertise in the preparation of their financial statements.
- Education, experience or professional development in the particular field of expertise.
- Discussion with the auditor's expert or with other experts.
- Discussion with other auditors who have performed similar engagements.
- Reading specialist literature dealing with the auditor's expert's field.
- Attending relevant seminars.

A15. Aspects of the auditor's expert's field relevant to the auditor's understanding may include:

- Whether the expert's field has areas of specialty within it that are relevant to the audit (see paragraph A11).
- Whether any professional or other standards, and regulatory or legal requirements apply.
- What methodologies and assumptions are used, and whether they are generally accepted within the auditor's expert's field and appropriate for financial reporting purposes.
- The nature of internal and external data or information the auditor's expert uses.

Nature, timing and extent of the auditor's procedures (Ref: Para. 9)

A16. The nature, timing and extent of audit procedures regarding the work of an auditor's expert will vary depending on the circumstances. For example, the following factors may suggest the need for more extensive procedures or procedures of a different nature in applying the requirements of this ISA:

- The work of the auditor's expert relates to a significant matter that involves subjective and complex judgments.
- The auditor has not previously used the work of the expert, and has no prior experience of the expert's capabilities, competence and objectivity.
- The expert is not subject to the firm's quality control policies and procedures.

Agreement with the Auditor's Expert (Ref: Para. 10)

A17. The nature, scope and objectives of the auditor's expert's work will vary considerably with the circumstances, as will the nature, timing and extent of communication between the auditor and the auditor's expert. Effective two-way communication helps to ensure that the nature, timing and extent of planned procedures to be performed by the expert are properly integrated with other work on the audit, and the auditor's expert's objectives are modified as needed. For example, when the work of the auditor's expert is important to the auditor's conclusions relating to a significant risk, the auditor may require both a formal written report at the conclusion of the auditor's expert's work, and oral reports as the work progresses.

A18. In the case of an auditor's external expert, agreement on the nature, scope and objectives of work to be performed by the expert may be included in an engagement letter or other written form of agreement between the firm and the expert. The Appendix contains a list of matters that the auditor may include in such an agreement. The auditor may also agree to inform the auditor's external expert of the auditor's conclusions concerning the work of the expert.

A19. When the auditor's expert is a member of the engagement team, the quality control policies and procedures to which the expert is subject in accordance with [proposed] ISA 220 (Redrafted) with respect to such matters as direction and supervision, and review of documentation, may include particular policies and procedures in relation to the scope and objectives of the expert's work, and communication with the expert.

Evaluating the Adequacy of the Auditor's Expert's Work (Ref: Para. 11-12)

A20. The auditor's consideration of the auditor's expert's capabilities, competence and objectivity, the auditor's familiarity with the auditor's expert's field of expertise, and the nature of the work performed by the auditor's expert may affect the nature, timing and extent of audit procedures to evaluate the adequacy of the auditor's expert's work for the purposes of the audit.

The Findings of the Auditor's Expert

A21. Factors that may be relevant when considering relevance and reasonableness of the findings of the auditor's expert, whether in a report or other form, may include whether they are:

- Presented in a manner that is consistent with any standards of the auditor's expert's profession or industry.
- Clearly expressed, including reference to the objectives agreed to with the auditor, the scope of the work performed and standards applied.
- Neutral in tone (for example, avoiding unduly laudatory or critical comments).
- Based on appropriate period and take into account subsequent events, where relevant.
- Subject to any reservation, limitation or restriction on use, and if so, whether this has implications for the auditor.

A22. In addition to considering the auditor's expert's findings, specific procedures to evaluate the adequacy of the expert's work for the purposes of the audit may include:

- Inquiries of the auditor's expert, management or others with a particular knowledge of the matter.
- Corroborative procedures, such as:
  - Observing the auditor's expert's work.
  - Examining documentary evidence the auditor's expert provides.
  - Examining published data, such as statistical reports from reputable, authoritative sources.
  - Confirming with third parties, such as regulators, the results of their examinations.
  - Performing detailed analytical procedures.
  - Reperforming calculations.
- Reviewing the auditor's expert's working papers.
- Discussion with another expert with relevant expertise.

The Auditor's Expert's Assumptions and Methods

A23. In many cases, e.g., when the auditor's expert's work relates to an accounting estimate developed by management, the auditor's procedures are likely to be directed to considering whether the expert has properly reviewed the assumptions and methods, including models, used by management. In other cases, e.g., when the auditor's expert develops an auditor's point estimate or auditor's range for comparison with management's point estimate, it may be necessary for the auditor to evaluate the appropriateness of assumptions and methods used by the expert.

A24. [Proposed] ISA 540 (Revised and Redrafted), "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures" discusses the assumptions and methods used by management in making accounting estimates. Although that discussion is written in the context of the auditor obtaining sufficient appropriate audit evidence regarding management's assumptions and methods, it may also assist the auditor when it is necessary to

evaluate the auditor's expert's assumptions and methods.

Assumptions

A25. The nature of any assumptions used by the auditor's expert will vary with the nature and complexity of the work and the methods used by the expert. For example, when the auditor's expert uses a discounted cash flow method in relation to the value of securities, assumptions include the amount and timing of cash flows, and the discount rate(s) applied.

Methods

A26. When it is necessary to evaluate the auditor's expert's methods, relevant factors may include:

- Whether the methods are generally accepted within the auditor's expert's field.
- Whether the methods are consistent with the requirements of the applicable financial reporting framework.
- Whether the methods are consistent with those of management, and if not, what are the reason and effects of the differences.
- Whether the auditor's expert considered all available evidence, and how any internal inconsistencies were resolved.
- Whether, and if so how, errors or deviations encountered by the auditor's expert in conducting tests were extrapolated over the entire population in reaching a conclusion.

Source Data Used by the Auditor's Expert

A27. In many cases when an auditor's external expert's work involves the use of source data, it will be necessary for the auditor to test that data through procedures such as verifying the origin of the data, mathematically recomputing the inputs, and reviewing the data for completeness and internal consistency, including when applicable whether the data is consistent with management's intent and ability to carry out specific courses of action. In other cases however, e.g., when source data used by an auditor's external expert is highly technical in relation to the expert's field, the expert may test the source data. If the auditor's external expert has tested the source data, it may be appropriate for the auditor to evaluate that data's completeness, relevance and accuracy by inquiry of the expert, or supervision or review of the expert's tests.

Inadequate Work, and Inconsistent Findings

A28. If the work of the auditor's expert is not adequate for the purposes of the audit, or the auditor's expert's findings are not consistent with other audit evidence, the auditor may resolve the matter through additional audit procedures, e.g., discussions with the entity and the auditor's expert, or through requesting the auditor's expert to take further action as appropriate in the circumstances.

Reference to the Auditor's Expert in the Auditor's Report (Ref: Para. 13-14)

A29. In some cases, law or regulation may require a reference to the work of an auditor's external expert, e.g., for the purposes of transparency in the public sector. In such cases, it is important that the reference not be misconstrued to be a modification of the auditor's opinion

or a division of responsibility.

A30. It may be appropriate in some circumstances to refer to the auditor's expert in an auditor's report containing a modified opinion, to explain the nature of the modification. In such circumstances, the auditor may need the permission of the auditor's expert before making such a reference.

Appendix

(Ref: Para. A18)

Considerations for Agreement Between the Auditor and an Auditor's External Expert

This appendix lists matters that may be considered by the auditor for inclusion in any agreement with the auditor's external expert. The following list is illustrative and is not exhaustive. Whether to include particular matters in the agreement depends on the circumstances of the engagement.

Audit considerations

- The nature, scope and objective of the auditor's engagement.
- The nature, scope and objectives of the auditor's external expert's involvement.
- Materiality and risk considerations concerning the matter to which the auditor's external expert's work relates.
- Relevant auditing and accounting concepts and standards, and relevant regulatory or legal requirements.
- The auditor's intended use of the auditor's external expert's findings, including any reference to that work or disclosure of it to others, e.g. an audit committee, and the auditor's external expert's consent to that use.
- The nature and extent of the auditor's review of the auditor's external expert's work and findings.

The auditor's external expert's responsibilities

- Independence requirements, including any financial or other relationships with the entity, and the need for objectivity.
- The confidentiality requirements of management and the auditor.
- The auditor's external expert's responsibility to perform work with due skill and care.
- The auditor's external expert's competence and capacity to perform the work.
- The expectation that the auditor's external expert will use all knowledge the expert has that is relevant to the audit or, if not, will inform the auditor.
- Any restriction on the auditor's external expert's association with the auditor's report.

Nature, timing and extent of the auditor's external expert's work

- Any professional or other standards the auditor's external expert will follow.
- The methods and assumptions the auditor's external expert will use, and their authority.
- The nature of source data to be used by the auditor's external expert, who is responsible for it, whether its completeness, relevance and accuracy will be tested, and if so, by whom.

- The effective date of, or when applicable the testing period for, the subject matter of the auditor's external expert's work, and requirements regarding subsequent events.

Communications and reporting

- Methods and frequency of communications, including how the auditor's external expert's findings will be reported (written report, oral report, ongoing input to the engagement team, etc.).
- When the auditor's external expert will complete the work and report findings to the auditor.
- The auditor's external expert's responsibility to communicate promptly any potential delay in completing the work, and any potential reservation or limitation on the expert's findings.
- The auditor's external expert's responsibility to communicate promptly instances in which the entity restricts the expert's access to records, files, personnel or experts engaged by the entity.
- The auditor's external expert's responsibility to communicate to the auditor all information the expert believes may be relevant to the audit.

Other matters

- The auditor's external expert's access to the entity's files.
- Budgets and fees.
- The auditor's external expert's insurance coverage.
- Dispute resolution processes.
- Ownership and control of working papers during and after the engagement, including any file retention requirements.

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