

## PROPOSED INTERNATIONAL STANDARD ON AUDITING 610 (REDRAFTED) THE AUDITOR'S CONSIDERATION OF THE INTERNAL AUDIT FUNCTION

Paragraph of extant ISA 610	Redrafted ISA 610 (as per Agenda Item 11-A). Highlighted text indicates new material.
	<b>Introduction</b>
	<b>Scope of this ISA</b>
1	1. <del>The purpose of this</del> This International Standard on Auditing (ISA) <del>is to establish standards and provide guidance to deals with the</del> external auditor's <del>in considering the work of internal auditing considerations when obtaining an understanding of and determining whether to use the work of the internal audit function and the extent to which the external auditor may use that work.</del> This ISA does not deal with instances when internal audit personnel assist the external auditor in carrying out external audit procedures. <del>The audit procedures noted in this ISA need only be applied to internal auditing activities which are relevant to the audit of the financial statements.</del>
	<i>Relationship Between the Internal Audit Function and the External Auditor</i>
6	2. The role of the internal audit function is determined by management <sup>1</sup> , <del>and its M</del> management's objectives differ from those of the external auditor <del>who is appointed to report independently on the financial statements, whose overall objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to report on the financial statements in accordance with the auditor's findings. The external auditor's primary concern is whether the financial statements are free of material misstatement.</del> <u>The objectives of the internal audit function vary according to management's requirements.</u> (Ref: A1-A2)
4, 7	3. <del>Nevertheless some of the means of achieving their respective</del> The internal audit function may achieve its objectives <del>are often</del> in a manner similar to that of the external auditor. <del>and thus</del> <u>Accordingly</u> , certain aspects of <del>the internal auditing internal audit function's activities</del> may be useful <u>to the external auditor</u> in determining the nature, timing and extent of <del>external</del> audit procedures <u>to be performed</u> .
4, 8	4. <del>Internal auditing is part of the entity. Irrespective of</del> <u>Notwithstanding the</u> degree of autonomy and objectivity of <del>internal auditing the internal audit function,</del> it cannot achieve the same degree of <del>independence objectivity</del> <u>as</u> required of the external auditor when expressing an opinion on the financial statements. The external auditor has sole responsibility for the audit opinion expressed, <del>and that.</del>

<sup>1</sup> In some circumstances, the role of the internal audit function may be determined by those charged with governance.

	<del>That</del> responsibility is not reduced by <del>any use made of internal auditing</del> the external auditor's use of the internal audit function. <del>All judgments relating to the audit of the financial statements are those of the external auditor.</del>
	<b>Effective Date</b>
	5. This ISA is effective for audits of financial statements for periods beginning on or after [date <sup>2</sup> ].
	<b>Objective</b>
2	<p>6. The objective of the external auditor is to determine whether the activities of the internal audit function are relevant to planning and performing the audit and, if relevant, the effect, if any, on the procedures performed by the external auditor.</p> <p>(Or, alternatively as presented at the September 2006 IAASB meeting)</p> <p>The objective of the external auditor is to determine the relevance of the activities of the internal audit function and their effect, if any, on the external auditor's procedures.</p>
	<b>Requirements</b>
	<b>Understanding and <del>Preliminary</del> Assessment of the Internal Audit Function</b>
9	<p>7. The external auditor <del>should</del> <u>shall</u> obtain <del>a sufficient</del> <u>an</u> understanding of <del>the internal audit activities to identify and assess the risks of material misstatement of the financial statements and to design and perform further audit procedures</del> internal audit function in conjunction with obtaining an understanding of internal control (as required by ISA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment"). The understanding obtained by the external auditor shall include <u>an understanding of the organizational status of the internal audit function and the scope of the internal audit function's activities.</u> (Ref: A3-A5)</p>
11	<p>8. The external auditor <del>should</del> <u>shall</u> perform an assessment of the internal audit function when <del>internal auditing is relevant to the external auditor's risk assessment.</del> <u>the external auditor is considering whether to use the work of the internal auditor. In those instances, the external auditor shall assess:</u></p> <p><u>(a) The technical competence and objectivity of the internal audit function and its members;</u></p> <p><u>(b) Whether the internal audit function is carried out with due professional care; and</u></p> <p><u>(c) The effect of any constraints or restrictions placed on the internal audit function by management.</u> (Ref: A5)</p>

<sup>2</sup> This date will not be earlier than December 15, 2008.

	<b>Planned Use of the Internal Audit Function's Work</b>
<u>12</u>	<p>9 <del>The external auditor's assessment of the internal audit function will influence the external auditor's judgment about the use which may be made of internal auditing in making risk assessments and thereby modifying the nature, timing, and extent of further external audit procedures.</del> In making judgments about the extent of the effect of the work of the internal audit function on the external auditor's procedures, the external auditor shall consider:</p>
	(a) The materiality of <u>the related</u> financial statement amounts;
	(b) The risk, consisting of inherent and control risk, of material misstatement of the assertions related to those financial statement amounts;
	(c) The degree of subjectivity involved in the evaluation of the audit evidence gathered in support of the relevant assertions. (Ref: A6-A8)
	<b>Evaluating the Work of the Internal Audit Function</b>
16	<p>10. When the external auditor intends to use <del>specific the</del> work of <del>internal auditing the internal audit function</del>, the external auditor <del>should</del> shall <u>perform procedures sufficient to evaluate and perform audit procedures on that work to confirm its the</u> adequacy <u>of that work</u> for the external auditor's purposes. <u>In making this evaluation, the external auditor shall test a portion of the internal audit function's work and compare the results of the external auditor's tests with the results of that work.</u> (Ref: A9-A10)</p>
17	<p>11. <del>The evaluation of</del> <u>When evaluating</u> specific work <del>of internal auditing performed by the internal audit function</del>, <del>involves consideration the external auditor shall consider</del> the adequacy of the scope of work and related programs and whether the assessment of the internal audit function remains appropriate. <del>This evaluation may include consideration of whether</del> The external auditor shall consider whether:</p> <p>(a) The work is performed by persons having adequate technical training and proficiency as internal auditors;</p> <p>(b) The work of assistants is properly supervised, reviewed and documented;</p> <p>(c) Sufficient appropriate audit evidence is obtained to be able to draw reasonable conclusions;</p> <p>(d) Conclusions reached are appropriate in the circumstances and any reports prepared are consistent with the results of the work performed; and</p> <p>(e) Any exceptions or unusual matters disclosed by the internal audit function are properly resolved. (Ref: A10-A12)</p>

	<b>Application and Other Explanatory Material</b>
	<b>Scope and Objectives of the Internal Audit Function</b>
3	A1. An internal audit function may be responsible for providing analyses, evaluations, assurances, recommendations, and other information to the entity's management and to those charged with governance. To effectively fulfill its responsibility, the internal audit function needs to maintain objectivity with respect to the activities it undertakes.
5	A2. The scope and objectives of <del>internal auditing</del> internal audit functions vary widely and depend on the size and structure of the entity and the requirements of its management. <del>Ordinarily, The</del> internal auditing function's activities <u>may</u> include one or more of the following:
5	<ul style="list-style-type: none"> <li>Monitoring of internal control. <del>The establishment of adequate internal control is a responsibility of management which demands proper attention on a continuous basis. Internal auditing is ordinarily</del> The internal audit function <u>may be</u> assigned specific responsibility by management for reviewing controls, monitoring their operation and recommending improvements thereto.</li> </ul>
5	<ul style="list-style-type: none"> <li>Examination of financial and operating information. <del>This may include The</del> <u>internal audit function may be assigned to</u> review <del>of</del> the means used to identify, measure, classify and report <del>such financial and operating</del> information, and specific inquiry into individual items including detailed testing of transactions, balances and procedures.</li> </ul>
5	<ul style="list-style-type: none"> <li>Review of the economy, efficiency and effectiveness of operating activities including non-financial <del>controls</del> activities of an entity.</li> </ul>
5	<ul style="list-style-type: none"> <li>Review of compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.</li> </ul>
	<b>Understanding and Assessment of the Internal Audit Function</b>
10	A3. <del>Effective internal auditing will often allow a modification in</del> <u>An effective internal audit function may affect</u> the nature, <del>and</del> timing, and <del>a reduction in the</del> extent of audit procedures performed by the external auditor, but cannot eliminate them entirely.
1, 10	A4. <del>In some cases, however, having considered the activities of internal auditing, the external auditor may decide that internal auditing will have no effect on the external audit procedures. In obtaining an understanding of the internal</del> <u>audit function, the external auditor may conclude that the internal audit function's activities are not relevant to the financial statement audit.</u> In such circumstances, <u>the external auditor need not consider the internal audit function further.</u> In other

	circumstances, the external auditor may conclude that it would not be effective to include the effect of the internal audit function in the external auditor's risk assessment, and the scope of the external auditor's understanding and assessment of the work of the internal audit function would be determined accordingly.
13	A5. <del>When obtaining an understanding and performing an assessment of the internal audit function, the important criteria are the following</del> Factors that may affect the external auditor's understanding and assessment of the internal audit function include:
13(a)	<p><i>Organizational status of the internal audit function:</i> <del>Specife</del>The status of <del>internal auditing the internal audit function within</del> the entity and the effect <del>this such</del> status has on the internal audit <del>function's or's</del> ability to be objective <del>include</del>:</p> <ul style="list-style-type: none"> <li>• Whether the internal audit function reports to an officer of appropriate authority to ensure broad audit coverage and adequate consideration of, and action on, the findings and recommendations of the internal audit function.</li> <li>• Whether the internal audit function has direct access and reports regularly to the board of directors, those charged with governance, or the owner-manager.</li> <li>• Whether those charged with governance oversee or the owner-manager oversees employment decisions related to the internal audit function.</li> </ul>
13(a)	<del>In the ideal situation Ideally, internal auditing the internal audit function will</del> reports to the highest level of management, <del>or to those charged with governance,</del> and is free of any other operating responsibility. In particular, the <del>internal auditors internal audit function will</del> needs to be free to communicate fully with the external auditor.
13(b)	<p><i>Scope of the internal audit function:</i></p> <ul style="list-style-type: none"> <li>• The nature and extent of internal auditing assignments performed.</li> <li>• <del>The internal auditor would also need to consider w</del>Whether, and to what extent management acts on <del>internal audit the</del> recommendations of the internal audit function and how <del>this such action</del> is evidenced.</li> </ul>
13(c)	<p><i>Technical competence:</i></p> <ul style="list-style-type: none"> <li>• Whether <del>internal auditing is performed by the</del> persons performing the internal audit function have adequate technical training and proficiency as internal auditors.</li> <li>• <del>Whether there are established The external auditor may, for example, review the</del> policies for hiring and training the internal auditing staff <del>and their experience and professional qualifications.</del></li> </ul>
13(d)	<p><i>Due professional care:</i></p> <ul style="list-style-type: none"> <li>• Whether internal auditing activities are <del>is</del> properly planned, supervised,</li> </ul>

	<p>reviewed and documented.</p> <ul style="list-style-type: none"> <li>The existence <del>of adequate and adequacy of</del> audit manuals, work programs and working papers <del>would be considered</del>.</li> </ul>
	<u>The auditor's assessment of the objectivity of the internal audit function may be affected by all of the above considerations.</u>
	<b>Planned Use of the Internal Audit Function's Work</b>
	A6 As the materiality of the financial statement amounts increases and either the risk of material misstatement or the degree of subjectivity increases, the need for the auditor to perform his or her own tests of the assertions increases.
14	<p>A7. When planning to use the work of <del>internal auditing the internal audit function</del>, the external auditor <del>will need to consider might review the</del> internal auditing's <del>function's</del> tentative plan for the period and discuss <del>that plan it at as early a stage as possible with the internal audit function</del>. <del>Where the work of internal auditing is to be a factor in determining the nature, timing and extent of the external auditor's procedures, it is desirable</del> <u>It also may be useful</u> to agree in advance <u>the following matters</u>:</p> <ul style="list-style-type: none"> <li><u>the timing of such work;</u></li> <li><u>the extent of audit coverage;</u></li> <li><u>materiality levels; and</u></li> <li><u>proposed methods of sample selection;</u></li> <li><u>documentation of work performed; and</u></li> <li><u>review and reporting procedures.</u></li> </ul>
15.	<p>A8. Liaison with internal auditing is <del>more-most</del> effective when meetings are held at appropriate intervals during the period. <u>It may be useful for the</u> <del>The</del> external auditor <del>would need</del> to be advised of and have access to relevant <u>reports of the internal auditing function reports</u> and <u>to be kept</u> informed of any significant matters <del>that comes to the attention of the internal audit functioner's attention which when these matters</del> may affect the work of the external auditor. Similarly, <u>it may be useful for</u> the external auditor <del>to would ordinarily</del> inform the internal auditor of any significant matters which may affect <u>the</u> internal auditing <del>ing function</del>.</p>
	<b>Evaluating the Work of the Internal Audit Function</b>
18	<p>A9 The nature, timing, and extent of the <del>audit</del> procedures <u>to be performed on the specific work of internal auditing when evaluating the work of an internal audit function will depend on the external auditor's judgment as to the risk of material misstatement of the area concerned are matters of professional judgment depending on the extent of the effect of the internal audit function's work on the</u></p>

	<u>external auditor's procedures, the assessment of internal auditing and the evaluation of the specific work by internal auditing.</u>
18	<p>A10. <u>Such audit procedures</u> The procedures performed by the external auditor on the specific work of the internal audit function may include one or a combination of the following:</p> <ul style="list-style-type: none"> <li>• Re-<del>examination</del> <u>performance</u> of <u>work performed items examined</u> by the internal audit function;</li> <li>• Examination of other similar items; <u>and or</u></li> <li>• Observation of <del>internal auditing</del> procedures <u>performed by the internal audit function.</u></li> </ul>

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