

**PROPOSED INTERNATIONAL STANDARD ON AUDITING 610 (REDRAFTED)
USING THE WORK OF INTERNAL AUDITORS**

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Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the external auditor's responsibilities when using the work of internal auditors for purposes of the audit of the financial statements. This ISA does not deal with instances when internal auditors provide direct assistance to the external auditor in carrying out external audit procedures. The audit procedures noted in this ISA need only be applied when the external auditor has determined that the work of internal auditors is relevant to the audit of the financial statements.

Relationship Between the Internal Audit Function and the External Auditor

2. The role and objectives of the internal audit function are determined by management, and where applicable, those charged with governance¹. These objectives differ from those of the external auditor 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. While the objectives of the internal audit function and the external auditor are different, the way in which the internal audit function and the external auditor achieve their respective objectives may be similar. (Ref: Para. A1-A2)
3. The external auditor has sole responsibility for the external auditor's opinion on the financial statements; that responsibility is not reduced by the external auditor's use of the work of internal auditors. Although the internal audit function is not independent of management, those charged with governance, or the entity, the internal audit function may, nevertheless, achieve a degree of autonomy and objectivity such that aspects of the work of internal auditors may be used by the external auditor as audit evidence. Where this is the case, use of the work of internal auditors may allow for modification of the nature, timing, and extent, of audit procedures performed by the external auditor, but cannot eliminate them entirely.

Effective Date

4. This ISA is effective for audits of financial statements for periods beginning on or after December 15, 2009.

Objective

5. The objectives of the external auditor, where the entity has an internal audit function whose activities the external auditor has determined are relevant to the audit, are:
 - (a) To determine whether to use the work of internal auditors; and
 - (b) If using the work of internal auditors, to determine whether that work is adequate for the purposes of the audit. [ISSUE A]

Definitions

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

¹ In some circumstances, the role of the internal audit function may be determined by law or regulation.

- (a) Internal audit function – A management monitoring activity established as a service to the entity, and conducted, for example, by an internal audit department or a compliance department. [ISSUE B]
- (b) Internal auditors – Those individuals who perform the activities of the internal audit function. [ISSUE B]

Requirements

[ED 610 paragraph 7 – see proposed amendment to ISA 315 – [ISSUE C(i)]]

Preliminary Evaluation of the Internal Audit Function

7. If the external auditor determines that the activities of the internal audit function are relevant to the audit², the external auditor shall perform a preliminary evaluation of the internal audit function by obtaining an understanding of: (Ref: Para. A3-A4) [ISSUE C(ii)]
 - (a) The objectivity of the internal audit function;
 - (b) The technical competence of the internal auditors; and
 - (c) Whether the work of internal auditors is likely to be carried out with due professional care.

Using the Work of Internal Auditors

8. If the preliminary evaluation of the internal audit function suggests that the work of the internal auditors is likely to be adequate for purposes of the audit, the external auditor shall determine the effect of the work of internal auditors on the nature, timing and extent of the procedures to be performed by the external auditor. In making this determination, the external auditor shall consider:
 - (a) The detailed scope and nature of work performed by the internal auditors. (Ref: Para. A5);
 - (b) The assessed risks of material misstatement at the assertion level for particular classes of transactions, account balances, and disclosures; and
 - (c) The degree of subjectivity involved in the evaluation of the audit evidence gathered in support of the relevant assertions [ISSUE C(iii)]
9. When the external auditor intends to use specific work of internal auditors, the external auditor shall evaluate and test the adequacy of that work for the external auditor's purposes. [ISSUE C(iv)]
10. When evaluating specific work performed by internal auditors, in accordance with paragraph 9, the external auditor shall evaluate whether:
 - (a) The work was performed by internal auditors having adequate technical training and proficiency;
 - (b) The work was properly supervised, reviewed and documented;

² As required by ISA 315, paragraphs 22.

- (c) Sufficient appropriate audit evidence has been obtained to enable the internal auditors to draw reasonable conclusions;
 - (d) Conclusions reached are appropriate in the circumstances and any reports prepared by the internal auditors are consistent with the results of the work performed; and
 - (e) Any exceptions or unusual matters disclosed by the internal auditors are properly resolved.
11. The external auditor's testing of the work of internal auditors, in accordance with paragraph 9, shall include one or a combination of the following:
- Re-performance of work performed by the internal auditors;
 - Examination of other similar items; or
 - Observation of procedures performed by the internal auditors.

Documentation

12. The external auditor shall document the basis for the external auditor's conclusions regarding the evaluation and testing of the specific work of internal auditors that has been used.

Application and Other Explanatory Material

Scope and Objectives of the Internal Audit Function (Ref: Para. 2)

- A1. An internal audit function may be responsible for providing analyses, evaluations, assurances, recommendations, and other information to the entity's management and those charged with governance.
- A2. The objectives of internal audit functions vary widely and depend on the size and structure of the entity and the requirements of management and those charged with governance. The activities of the internal audit function may include one or more of the following:
- Monitoring of internal control. The internal audit function may be assigned specific responsibility for reviewing controls, monitoring their operation and recommending improvements thereto.
 - Examination of financial and operating information. The internal audit function may be assigned to review the means used to identify, measure, classify and report financial and operating information, and to make specific inquiry into individual items including detailed testing of transactions, balances and procedures.
 - Review of operating activities. The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities including non-financial activities of an entity.
 - Review of compliance with laws and regulations. The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

- Risk management. The internal audit function may assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems.
- Governance. The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.

[PARAGRAPH A4 OF ED 610 – see conforming amendment to ISA 315 – **ISSUE C(i)**]

Preliminary Evaluation of the Internal Audit Function (Ref: Para. 7)

A3. Factors that may affect the external auditor's preliminary evaluation of the internal audit function include:

Objectivity:

- The status of the internal audit function within the entity and the effect such status has on the ability of internal auditors to be objective.
- Whether the internal audit function reports to an officer of appropriate authority, for example, the highest level of management.
- Whether the internal auditors are free of any other operating responsibilities.
- Whether the internal auditors have direct access and report regularly to those charged with governance.
- Whether those charged with governance or the owners oversee employment decisions related to the internal audit function.
- Whether there are any constraints or restrictions placed on the internal audit function by management or those charged with governance.
- Whether the internal auditors are free to communicate openly with the external auditor.
- Whether, and to what extent, management acts on the recommendations of the internal audit function, and how such action is evidenced.

Technical competence:

- Whether the internal auditors are members of relevant professional bodies.
- Whether the internal auditors have adequate technical training and proficiency as internal auditors.
- Whether there are established policies for hiring and training internal auditors.

Due professional care:

- Whether activities of the internal audit function are properly planned, supervised, reviewed and documented.

- The existence and adequacy of audit manuals or other similar documents, work programs and internal audit documentation.

A4 Whether there is effective communication between the external auditor and the internal auditors may also affect the external auditor's preliminary evaluation of the internal audit function. Communication between the external auditor and the internal auditors may be most effective when:

- Meetings are held at appropriate intervals throughout the period.
- The external auditor is advised of and has access to relevant internal audit reports and is informed of any significant matters that come to the attention of the internal auditors when these matters may affect the work of the external auditor.
- The external auditor informs the internal auditors of any significant matters that may affect the internal audit function.

Using the Work of Internal Auditors (Ref: Para. 8)

A5. When determining how to use the work of internal auditors, the external auditor reviews the internal audit function's tentative plan for the period and discusses that plan with the internal auditors. It may also be useful to agree in advance the following matters with the internal auditors:

- The timing of such work;
- The extent of audit coverage;
- Materiality levels;
- Proposed methods of sample selection;
- Documentation of the work performed; and
- Review and reporting procedures.

Proposed Amendment to ISA 315, “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and its Environment”

Requirements

[315]22 The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting, including those related to those control activities relevant to the audit, and how the entity initiates corrective actions to its controls. If the entity has an internal audit function³, the auditor shall obtain an understanding of the nature of its responsibilities and the activities performed, and determine whether those activities are relevant to the audit. (Ref: Para. A94-96)

[315]23 The auditor shall obtain an understanding of the sources of the information used in the entity’s monitoring activities, and the basis upon which management considers the information to be sufficiently reliable for that purpose. (Ref: Para. A97)

Application Material

Components of Internal Control – Monitoring of Controls (Ref: Para. 22)

[315]A94 Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It involves assess the effectiveness of controls on a timely basis and taking necessary corrective actions. Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.

[315]A95 In many entities, internal auditors⁴ ~~or personnel performing similar functions~~ contribute to the monitoring of an entity’s activities. ~~ISA 610, “Considering the Work of Internal Audit” establishes requirements and provides guidance on the auditor’s consideration of the work of internal auditing.~~ Management’s monitoring activities may also include using information from communications from external parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.

[315]A95x In obtaining an understanding of activities of the internal audit function, the external auditor considers the nature and extent of internal audit assignments performed.

[315]A95y As a result of obtaining an understanding of the internal audit function, the external auditor may conclude that the activities of the internal audit function are not relevant to the financial statement audit. In such circumstances, the external auditor need not consider further the internal audit function. Even if some of the activities of the internal audit function are relevant to the audit, the external auditor may conclude that it would not be effective or efficient to use the work of internal auditors. If the external auditor decides that it is likely to be effective or efficient to use the work of internal auditors work ISA 610 “Using the Work of Internal Auditors” applies.

³ The term “internal audit function” is defined in ISA 610 as, “an appraisal of internal control established within an entity as a service to the entity, including among other things, examining, evaluating and monitoring the adequacy and effectiveness of internal control, for example, internal audit departments or compliance departments.”

⁴ The term “internal auditors” is defined in ISA 610 as “those individuals performing the activities of the internal audit function.”

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