

PROPOSED INTERNATIONAL STANDARD ON AUDITING 610 (REDRAFTED)

USING THE ~~AUDITOR'S CONSIDERATION~~ WORK OF ~~THE~~ INTERNAL AUDIT FUNCTION AUDITORS

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Introduction

Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the external auditor's ~~considerations when obtaining an understanding of and determining whether to use~~ responsibilities when using the work of ~~the internal audit function, and the extent to which the external auditor may use that work~~ internal auditors for purposes of the audit of the financial statements. This ISA does not deal with instances when internal ~~audit personnel assist~~ 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 ~~is~~ are determined by management ~~or, and where applicable,~~ those charged with governance¹. ~~The~~ These ~~objectives of management and those charged with governance~~ 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. ~~The~~ While the objectives of the internal audit function ~~vary according to the requirements of management or those charged with governance~~ 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 internal audit function may achieve its objectives in a manner similar to that of the external auditor. Accordingly, certain aspects of the internal audit function's activities may be useful to the external auditor in determining the nature, timing and extent of audit procedures to be performed.~~⁴ ~~Notwithstanding its degree of autonomy and objectivity, the internal audit function is not independent of management or the entity. The~~ external auditor has sole responsibility for the ~~audit~~ external auditor's opinion ~~expressed and, accordingly, 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

- ~~5.4.~~ 4. This ISA is effective for audits of financial statements for periods beginning on or after ~~{date²}~~ December 15, 2009.

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

² ~~This date will not be earlier than December 15, 2008.~~

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:
- (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) ~~6. — The objective of the external auditor is to obtain an understanding of the internal audit function and determine whether~~ Internal auditors – Those individuals who perform the activities of the internal audit function are relevant to planning and performing the audit and, if relevant, the effect, on the procedures performed by the external auditor. **[ISSUE B]**

Requirements

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

~~Obtaining an Understanding~~ Preliminary Evaluation of the Internal Audit Function

7. ~~The~~ If the external auditor determines that the activities of the internal audit function are relevant to the audit², the external auditor shall ~~obtain an understanding~~ perform a preliminary evaluation of the internal audit function ~~in conjunction with~~ by 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 auditor shall include an understanding of the organizational status of the internal audit function and the scope of the internal audit function’s responsibilities. (Ref: Para. A3-A5)–; (Ref: Para. A3-A4)~~ **[ISSUE C(ii)]**

~~Planning to Use the Work of the Internal Audit Function~~

8. ~~When the external auditor intends to use the work of the internal audit function, the external auditor shall evaluate:~~
- (a) The objectivity ~~and technical competence of members~~ of the internal audit function;
 - (b) ~~The technical competence of the internal auditors; and~~
 - (c) Whether the ~~internal audit function is~~ work of internal auditors is likely to be carried out with due professional care; ~~and–.~~

² As required by ISA 315, paragraph 22.

Using the Work of Internal Auditors

- ~~(e) The effect of any constraints or restrictions placed on~~8. If the preliminary evaluation of the internal audit function by management or those charged with governance. (Ref: Para. A6)9. ~~—In making judgments about the effect of the internal audit function's work on the external auditor's procedures 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:
- The ~~materiality of the related financial statement amounts;~~ detailed scope and nature of work performed by the internal auditors. (Ref: Para. A5);
 - The ~~risk~~assessed risks of material misstatement ~~of the assertions related to those financial statement amounts~~at the assertion level for particular classes of transactions, account balances, and disclosures; and
 - The degree of subjectivity involved in the evaluation of the audit evidence gathered in support of the relevant assertions. ~~(Ref: Para. A7-A9)~~ **[ISSUE C(ii)]**

Using the Work of the Internal Audit Function

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 the external auditor uses~~evaluating specific work ~~of the performed by~~ internal ~~audit function~~auditors, in accordance with paragraph 9, the external auditor shall ~~perform procedures to evaluate the adequacy of that work. (Ref: Para. A10-A11)~~11. ~~—When evaluating specific work performed by the internal audit function, the external auditor shall consider the adequacy of the scope of work and whether the evaluation of the internal audit function remains appropriate. The external auditor shall evaluate whether:~~
- The work ~~is~~was performed by ~~persons~~internal auditors having adequate training and proficiency ~~appropriate skills and expertise;~~
 - The work ~~is~~was properly supervised, reviewed and documented;
 - Sufficient appropriate audit evidence ~~is~~has been obtained to ~~be able~~enable the internal auditors to draw reasonable conclusions;
 - 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
 - Any exceptions or unusual matters disclosed by the internal ~~audit function~~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 ~~scope and~~ 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. ~~Internal~~The activities of the internal audit function ~~activities~~ 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)**]

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

- A3. ~~An effective internal audit function may affect the nature, timing, and extent of audit procedures performed by the external auditor, but cannot eliminate them entirely.~~
- A4. ~~As a result of obtaining an understanding of the internal audit function, the external auditor may conclude that the internal audit function's activities are not relevant to the financial statement audit. In such circumstances, the external auditor need not consider the internal audit function further. In other circumstances, the external auditor may conclude that it would not be effective to include the effect of the work of the internal audit function in the external auditor's risk assessment, and the scope of the external auditor's understanding of the work of the internal audit function, would be determined accordingly.~~
- A5. ~~Factors that may affect the external auditor's understanding of the internal audit function include:~~ Factors that may affect the external auditor's preliminary evaluation of the internal audit function include:

Objectivity:

- ~~Organizational status of the internal audit function:~~ The status of the internal audit function within the entity and the effect such status has on the ~~internal audit function's~~ ability of internal auditors to be objective.
- 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,~~ for example, the highest level of management.
- Whether the internal ~~audit function has~~ auditors are free of any other operating responsibilities.
- Whether the internal auditors have direct access and ~~reports report~~ regularly to ~~the board of directors,~~ those charged with governance, ~~or the owner-manager.~~
- Whether those charged with governance or the owners oversee ~~or the owner-manager oversees~~ 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.
- ~~Ideally, the internal audit function reports to the highest level of management, or to those charged with governance, and is free of any other operating responsibility. In addition, the internal audit function needs to be free to communicate fully~~ Whether the internal auditors are free to communicate openly with the external auditor.

~~Scope of the internal audit function:~~

- ~~The nature and extent of internal audit assignments performed.~~
- Whether, and to what extent, management acts on the recommendations of the internal audit function, and how such action is evidenced.

Planning to Use the Work of the Internal Audit Function (Ref: Para. 8-9)

~~A6. Factors, in addition to those identified in paragraph A5, that may affect the external auditor's evaluation of the internal audit function include:~~

Technical competence:

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

Due professional care:

- Whether activities of the internal audit ~~activities~~ function are properly planned, supervised, reviewed and documented.
- The existence and adequacy of audit manuals or other similar documents, work programs and ~~working papers~~ internal audit documentation.

~~A7. As the risk of material misstatement of the financial statement item increases, the need for the auditor to perform his or her own tests of the relevant assertions increases.~~

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)

~~A8.5.~~ When ~~planning~~ determining how to use the work of ~~the~~ internal ~~audit function~~ auditors, the external auditor ~~may review~~ reviews the internal audit function's tentative plan for the period and ~~discuss~~ discusses that plan with the internal ~~audit function~~ auditors. It may also ~~may~~ 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.

~~A9. Liaison with the internal audit function is likely to be most effective when meetings are held at appropriate intervals throughout the period. It may be useful for the external auditor to be advised of and have access to relevant reports of the internal audit function and to be informed of any significant matters that come to the attention of the internal audit function when these matters may affect the work of the external auditor. Similarly, it may be useful for the external auditor to inform the internal audit function of any significant matters that may affect the internal audit function.~~

~~Using the Work of the Internal Audit Function~~ (Ref: Para. 10)

~~A10. The nature, timing, and extent of the procedures to be performed when evaluating the work of an internal audit function are matters of professional judgment depending on the extent of the effect of the internal audit function's work on the external auditor's.~~

~~A11. The external auditor's testing of the internal audit function's work may include one or a combination of the following:~~

- ~~• Re-performance of work performed by the internal audit function;~~
- ~~• Examination of other similar items; or~~
- ~~• Observation of procedures performed by the internal audit function.~~

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 function¹, 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 auditors² ~~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.

¹ 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.”

² The term “internal auditors” is defined in ISA 610 as “those individuals performing the activities of the internal audit function.”

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