

Proposed International Standards on Auditing

ISA 315 (Revised), Identifying and
Assessing the Risks of Material
Misstatement through Understanding
the Entity and Its Environment

ISA 610 (Revised), Using the Work of
Internal Auditors



International Federation
of Accountants

REQUEST FOR COMMENTS

The International Auditing and Assurance Standards Board (IAASB) approved this exposure draft for publication in July 2010. This proposed exposure draft may be modified in light of comments received before being issued in final form.

Respondents are asked to submit their comments **electronically** through the IAASB website (www.iaasb.org), using the “Submit a Comment” link on the Exposure Drafts and Consultation Papers page. Please note that first-time users must register to use this new feature. All comments will be considered a matter of public record and will ultimately be posted on the IAASB website.

Comments can also be faxed to the attention of the IAASB Technical Director at +1 (212) 856-9420, or mailed to:

Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

Comments should be submitted by **November [XX], 2010**.

Copies of this exposure draft may be downloaded free of charge from the IAASB website at www.iaasb.org.

The IAASB develops auditing and assurance standards and guidance for use by all professional accountants under a shared standard-setting process involving the Public Interest Oversight Board, which oversees the activities of the IAASB, and the IAASB Consultative Advisory Group, which provides public interest input into the development of the standards and guidance.

The objective of the IAASB is to serve the public interest by setting high-quality auditing and assurance standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession.

The structures and processes that support the operations of the IAASB are facilitated by IFAC. The mission of IFAC is to serve the public interest, strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession’s expertise is most relevant.

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EXPLANATORY MEMORANDUM

(Including analysis of impacts of the IAASB's proposals)

1. Subject

This memorandum provides background to, and explanations for, the proposed revisions to International Standard on Auditing (ISA) 610, *Using the Work of Internal Auditors*. The proposed revised ISA 610 was approved by the International Auditing and Assurance Standards Board (IAASB) in June 2010 for exposure. The comment period ends 120 days after the release of the exposure draft.

2. Statement of the Nature and Magnitude of the Problem and the Need for Action

The extant ISA 610 was last revised in March 1994.¹ As part of the IAASB's Clarity project, the ISA was redrafted for conformity with the Clarity drafting conventions. The IAASB issued the redrafted ISA 610 in October 2008.

Since extant ISA 610 was issued, there have been developments in the internal audit environment. For example, in many entities, there have been changes in the organizational status of the internal audit function, the activities performed by internal auditors and the manner of interaction between internal auditors and external auditors. During the clarity redrafting of extant ISA 610, a number of respondents referred to these developments and indicated to the IAASB the need to revise the ISA to better reflect the current internal auditing environment. This view was also shared by National Auditing Standard Setters (NSS)² and the IAASB Consultative Advisory Group (CAG).³ During this period, best practices at the national level have also developed that are not currently addressed in extant ISA 610.

The IAASB is of the view that in order to ensure the ISA continues to be fit-for-purpose and to minimize inconsistencies in global audit practices, the appropriateness of adopting and codifying these best practices in a revised ISA 610 should be considered.

¹ Conforming amendments were made to the standard when the IAASB issued the audit risk standards (ISA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment," ISA 330, "The Auditor's Responses to Assessed Risks," and ISA 500, "Audit Evidence") in October 2003.

² Views were obtained at the March 2008 IAASB-NSS meeting.

³ A listing of the member organizations of the IAASB CAG can be accessed at:
<http://www.ifac.org/IAASB/CAG.php>.

3. Statement of the Objective of the IAASB in Addressing the Problem

The IAASB's objective in revising ISA 610 is to enhance the performance of external auditors by providing new and revised requirements and guidance designed both to better enable the external auditor to leverage the knowledge and findings of an entity's internal audit function in making risk assessments in the external audit, and to provide a robust framework for the evaluation and use of the work of internal auditors in obtaining audit evidence. The IAASB believes that proposed revision will enhance quality of audits internationally.

As a basis for the proposed revisions, the IAASB set out to gain a robust understanding of recent developments in the internal auditing environment and changes in practice regarding the interactions between the external and internal auditors. That understanding has helped the IAASB identify any gaps that may currently exist in the ISA literature regarding how the work of the internal audit function can be used effectively in the audit engagement. In doing so, however, the IAASB became aware of perceptions that the ISAs do not currently reflect how the knowledge and findings of the internal audit function should be leveraged by the external auditor to further audit effectiveness. The IAASB also acknowledges that there are perceptions of undue reliance by external auditors on the work of internal auditors and some believe that a more robust framework for the external auditor's judgments regarding when, where and how to use work of the internal auditor is required.

The IAASB articulates its key proposals for revision of the ISA in this explanatory memorandum and provides explanations in support of these conclusions. It is the objective of the IAASB that the proposed revisions will ensure the continued relevance and usefulness of ISA 610. An analysis of the impacts anticipated by the IAASB to arise as a result of the proposed revisions is also provided.

4. Statement of the Primary Options that Were Considered in Achieving the Objective

Primary Options Considered in Achieving the Objective

The IAASB concluded that a comprehensive revision of extant ISA 610 was needed in order to ensure its continued relevance and usefulness and, importantly, to respond to the challenges regarding the rigor of the ISA. As pointed out earlier, this view is shared by other stakeholders who drew the IAASB's attention to the reasons for needing to revise extant ISA 610 particularly to respond to concerns about undue reliance by external auditors on the work of internal auditors in some circumstances, and that external auditors might not be taking internal audit knowledge and findings into account when performing their risk assessments.

Key Issues Addressed in Achieving the Objective and Primary Options Considered

Using the Work of the Internal Audit Function

The IAASB proposes enhancements to the requirements in ISA 610 to establish a more robust judgment-based framework for the external auditor's judgments in deciding whether, when and how to use the work of the internal audit function. The IAASB's conclusion is formed on the basis that

such revisions will result in a strengthened framework for the external auditor's decision-making with respect to using the work of internal auditors on the audit engagement.

Determining Whether the Work of the Internal Audit Function Can Be Used

The IAASB proposes that the external auditor's initial assessment of whether the work of the internal audit function can be used for purposes of the audit be based on an evaluation of the internal audit function's degree of objectivity (as supported by its organizational status, and relevant policies and procedures), level of competence and application of a systematic and disciplined approach, including quality control.⁴ The related requirements and guidance on factors to consider in making this evaluation have been updated to reflect developments in internal audit practice.

The IAASB believes that the focus on whether the internal audit function applies a systematic and disciplined approach is important. It is this characteristic that differentiates the work of the internal audit function from other internal controls. The IAASB is of the view that the underlying premise in ISA 610 is the external auditor's objective to obtain sufficient evidence about the internal audit function as a whole, rather than "test" each individual piece of work performed by the function as is required by ISA 330 in relation to other controls.⁵

In addition to the new requirements and guidance, the IAASB believes that it is appropriate to establish clearer boundaries for the circumstances when the use of any of the work of the internal audit function by the external auditor would not be appropriate. Specifically, where either the degree of objectivity or level of competence of the internal audit function is assessed as low, the work of the internal audit function should not be used for purposes of the audit. Applying this principle, a high degree of objectivity cannot offset a low level of competence, and similarly, a high level of competence cannot offset a low degree of objectivity.⁶

The IAASB's believes that, together, these proposed requirements will:

- (a) Provide a framework for determining the nature and extent of the work of the internal audit function that can justifiably be used in the external audit; and
- (b) Set out clear boundaries to guard against use of the work of the internal audit function in circumstances in which it would be inappropriate.

Determining the Planned Use of the Work of the Internal Audit Function

In determining the planned use of the work of the internal audit function, the IAASB believes that the external auditor should take into account:

- (a) The external auditor's evaluation of the internal audit function's degree of objectivity and level of competence,
- (b) The nature and scope of the work performed and therefore its relevance to the audit engagement, and

⁴ Proposed revised ISA 610, paragraph [].

⁵ Proposed revised ISA 610, paragraph [].

⁶ Proposed revised ISA 610, paragraph [].

- (c) The amount of judgment involved in planning and performing the audit procedures, and evaluating the audit evidence obtained by the internal audit function.⁷

Particularly, the IAASB believes that the amount of judgment involved in planning and performing audit procedures, and in evaluating the results, is an important determinant of the likelihood of whether the external audit can use the work of the internal audit function and in which areas.

The IAASB acknowledges that some might expect the external auditor's decisions regarding the use of the work of the internal audit function to be related to the assessed risk of material misstatement at the assertion level for particular classes of transactions, account balances and disclosures. The IAASB agrees that there is a relationship between the amount of judgment involved and the level of risk. The higher the risk of material misstatement, the greater the amount of judgment that would ordinarily be involved in planning and performing procedures, and evaluating the results of audit procedures.⁸ However, the IAASB is of the view that even in relation to significant risks, there may be some audit work involving less judgment that can contribute to the audit evidence obtained. For that reason, the IAASB believes the focus on judgment in the requirement is appropriate. However, proposed new guidance explains that the external auditor is less likely to be able to make substantial use of the work of the internal audit function the higher the assessed risk, particularly in relation to significant risks.⁹

The IAASB believes that the proposed new requirements and guidance strengthen the framework for the evaluations necessary to determine whether and to what extent the external auditor can use the work of the internal audit function. In this respect, they will help to ensure appropriate use of, and deter undue reliance on, such work by the external auditor. However, as a further safeguard, the IAASB also proposes to introduce a new requirement clarifying that, because the external auditor has sole responsibility for the audit opinion, the external auditor needs to make all significant judgments in the audit engagement and perform sufficient procedures directly to be able to draw reasonable conclusions on which to base their audit opinions.¹⁰

Inquiry of the Internal Audit Function

ISA 240¹¹ indicates that inquiries made by the external auditor of the internal audit function to comply with the requirements of ISA 315 and ISA 610 may help to meet the external auditor's obligation under ISA 240 to inquire with the function regarding fraud in the entity.¹² Despite this, extant ISA 315 and ISA 610 do not presently contain a requirement for the auditor to make inquiries of the internal audit function. To address this gap in the ISA literature, the IAASB proposes a requirement for the external auditor to make inquiries of the internal audit function about information they are aware of that is relevant to identifying and assessing the risks of

⁷ Proposed revised ISA 610, paragraph [].

⁸ Proposed revised ISA 610, paragraph [].

⁹ Proposed revised ISA 610, paragraph [].

¹⁰ Proposed revised ISA 610, paragraph [].

¹¹ ISA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," paragraph A18.

¹² ISA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," paragraphs 19 and A18. The objective of the inquiries is to determine whether the internal audit function has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.

material misstatement due to error. This will enable the external auditor to more fully leverage the internal auditor's understanding of the entity and its environment.¹³

The IAASB believes this is appropriate because it provides a practicable basis for the external auditor to learn from and use the internal auditor's knowledge of the organization and expertise in risk and control. The IAASB believes that this will not only achieve greater efficiency and effectiveness on the audit engagement, but also improve audit quality by seeking out relevant information that might not otherwise come to the auditor's attention.

In connection with this, the IAASB debated whether the external auditor should be required to read reports of the internal audit function.¹⁴ The IAASB considered but did not favor a requirement for the external auditor to read all reports of the internal audit function. The IAASB concluded that such a requirement would impose an onerous amount of audit effort, which given the possible nature and extent of reports issued by the internal audit function would not outweigh the corresponding benefits.

Notwithstanding this, the IAASB concluded that it is appropriate for the external auditor to read the reports of the internal audit function relating to work that the external auditor is planning to use because this would assist the external auditor in obtaining a complete understanding of the nature and extent of audit procedures performed and the related findings.¹⁵ Further, although not mandating that the external auditor read all other internal audit reports, the IAASB has introduced guidance explaining the possible usefulness of reading related reports if internal auditors bring matters to the external auditor's attention.¹⁶

Direct Assistance

In many jurisdictions, internal auditors provide direct assistance to the external auditor through performance of audit procedures on the audit engagement under the direction, supervision and review of the external auditor. Extant ISA 610 states explicitly that it does not deal with such instances.¹⁷ There is ambiguity about whether the fact that ISA 610 does not deal with this practice meant that the IAASB did not support its use, or whether it was simply not addressed in the scope of the ISA. The ambiguity is exacerbated by the fact that national auditing standards of a number of jurisdictions allow for direct assistance, and it is common practice in many; whilst in others, it is not allowed. The IAASB concluded that continued ambiguity about IAASB's intent is not in the public's interest.

In deciding on whether to permit or prohibit direct assistance, the IAASB acknowledged the concerns of some stakeholders about threats to the perceived independence of the external audit team when internal auditors provide direct assistance under the direction, supervision and review of the external auditor. However, the IAASB concluded that appropriate safeguards can be put in place to ensure that direct assistance is employed only in appropriate areas, and that the nature and amount of direction, supervision and review exercised by the external auditor is appropriate

¹³ Proposed revised ISA 610, paragraph [].

¹⁴ Proposed revised ISA 610, paragraph [].

¹⁵ Proposed revised ISA 610, paragraph [].

¹⁶ Proposed revised ISA 610, paragraph [].

¹⁷ ISA 610, paragraph 2.

given these circumstances. Therefore, the IAASB proposes to provide requirements and guidance in the revised ISA 610 that would ensure that direct assistance of internal auditors is employed by external auditors only in appropriate circumstances and with appropriate involvement of the external auditor. Of particular importance is guidance on the nature and extent of direction, supervision and review that external auditors should exercise over internal audit staff.¹⁸ Clarity on the external auditor's responsibilities in this regard is designed to address possible risks to audit quality arising from the fact that internal audit staff are not independent of the entity as is required of the external auditor in an audit of financial statements.

Notwithstanding this, the IAASB is cognizant that there are jurisdictions where such practices are explicitly prohibited by local law or regulation. Accordingly, the proposed ISA explicitly acknowledges this fact.¹⁹ It also explains that prohibitions or restrictions regarding the use of the work of internal auditors will not prevent the external auditor from complying with the ISA because the proposed requirements do not require or encourage the external auditor to obtain, or to consider obtaining, direct assistance of internal audit staff.²⁰

The decisions of whether and to what extent to obtain direct assistance are presented as remaining solely those of the external auditor.²¹ The IAASB believes that this is important so as to avoid undue pressures being inadvertently placed on the external auditor to use internal auditors for cost or other reasons, which could be detrimental to audit quality. Accordingly, the IAASB did not require the external auditor to defend its decision regarding whether or not to use direct assistance to those charged with governance. Nevertheless, in accordance with ISA 260,²² the external auditor would communicate with those charged with governance the planned scope and timing of the audit, including the extent to which the auditor will use the work of internal auditors, and would similarly discuss with those charged with governance their work plan, including any proposal for internal auditors to provide direct assistance to the external auditor on the audit engagement.

5. Analysis of the Overall Impact of the Proposed Revised ISA 610 and of the Impacts of the Preferred Options (Impacts are Presented in Tabular Format in the Appendix)

External Auditors

Audit Effectiveness

Overall, the IAASB believes that the proposed revised ISA 610 is likely to increase the effectiveness of audit engagements where an internal audit function exists. This conclusion is based upon an analysis of the significant revisions proposed by the IAASB to ISA 610 which is further described below.

¹⁸ Proposed revised ISA 610, paragraph [].

¹⁹ Proposed revised ISA 610, paragraph [].

²⁰ Proposed revised ISA 610, paragraph [].

²¹ Proposed revised ISA 610, paragraph [].

²² ISA 260, "Communication with Those Charged with Governance," paragraph 15.

Improvement to audit effectiveness is anticipated to result from the strengthening of the framework for determining the external auditor's use of the work of the internal audit function. Specifically, by requiring the external auditor to focus on the internal audit function's level of objectivity, degree of competence, and application of a systematic and disciplined approach when determining whether to use work of the internal audit function, and further, the amount of judgment involved in performing such work when determining its planned use, the IAASB believes that the external auditor's resulting assessment will be more robust. Arguably, this will help to ensure appropriate use of the work of the internal audit function on audit engagements.

In connection with this, the IAASB proposes further strengthening of the framework in ISA 610 by establishing clear boundaries in the form of minimum requirements of the degree of objectivity and level of competence of the internal audit function, and the need for the external auditor to make all significant judgments and to perform sufficient work directly. These boundaries are intended to guard against inappropriate use of the work of the internal audit function under the circumstances of the engagement.

The IAASB also anticipates a positive impact on audit effectiveness will be generated as a result of the requirement for the external auditor to make inquiries of the internal audit function. This is because such inquiries will enable the external auditor to leverage the internal audit function's knowledge of the entity and its expertise in risk and control, to inform the former's understanding of the entity and its environment, as a basis for the external auditor's risk assessment. Further, by encouraging effective communication between internal auditors and external auditors, the revised ISA supports an environment in which internal auditors can bring significant matters that may affect the work of the external auditor to the external auditor's attention.

Work Effort

The IAASB is of the view that the overall effect of the proposed revised ISA 610 on the external auditor's work effort will in part be dependent on whether and to what extent external auditors are using the work of internal auditors today and, in particular, whether direct assistance of internal auditors is obtained on the engagement. This and other key determinants of changes to the external auditor's work effort the IAASB anticipates to arise as a result of the proposed revisions are further described below.

Where the direct assistance of internal auditors is employed on the engagement, a reduction in the external auditor's work effort is expected because the assistance of internal auditors are engaged to perform audit procedures on the engagement which otherwise would be performed by the external auditors themselves. However, it is for this reason that, in formulating the requirements and guidance relating to direct assistance, the IAASB was careful to ensure that the revised ISA 610 adequately guards against undue use of the assistance of internal auditors on audit engagements and the consequent possible risks to audit quality. The larger the internal audit function and the more well-established it is, the greater the reduction in work effort of the external auditor that might be realized because the external auditor is likely to be able to use the work of internal auditors to a greater extent and in more areas. Small- and medium-sized entities typically do not have a separate internal audit function, in which case no impact to audit effectiveness is expected as a result of the IAASB's proposals.

The IAASB also anticipates that a small increase in the external auditor's work effort may result as the external auditor is expected to spend a greater effort in ensuring that the proposed strengthened framework is properly and adequately applied to the determination of whether and to what extent to use of the work of the internal audit function on the audit engagement.

Similarly, a marginal increase to the external auditor's work effort is anticipated as the external auditor is expected, as part of the external auditor's risk assessment procedures, to include inquiries of the internal audit function. The aggregate work effort will be greater if the external auditor determines it is appropriate to use the work of the internal audit function and consequently is required by the revised ISA to examine the internal audit function's reports relating to such work.

Other Impacts

The IAASB believes that a positive impact on audit effectiveness may be had simply through the clarification of the ambiguity surrounding whether the practice of direct assistance is allowed under the ISAs. More specifically, addressing the matter of direct assistance in ISA 610 allows the avoidance of those situations where the ISAs not dealing with instances of direct assistance is interpreted to imply that an audit conducted in accordance with ISAs cannot, therefore, use direct assistance even though circumstances of the engagement may be that doing so will result in audit efficiencies.

Also related to the matter of direct assistance, the IAASB is cognizant of the likelihood that threats to the perceived independence of the external auditor may be created due to the fact that internal auditors are not independent of the entity as is required of the external auditor in an audit of financial statements. The IAASB believes however that by guarding against undue use of the assistance of internal auditors on audit engagements through clarifying the requirements of the external auditor in these cases and provision of appropriate guidance in the revised ISA 610, safeguards are established to reduce actual threats to an acceptable level.

Internal Audit Functions/Internal Auditors

Work Effort

The IAASB believes that the overall effect of the proposed revised ISA 610 on the work effort of the internal audit functions/internal auditors will be dependent on whether and to what extent direct assistance is obtained by the external auditor from the internal auditors on the engagement. This and other key determinants of changes to the work effort of the internal audit functions/internal auditors the IAASB anticipated to arise as a result of the proposed revisions are further described below.

Where the direct assistance of internal auditors is employed on the engagement, the IAASB anticipates an increase in the work effort of the internal auditors because their assistance is obtained by the external auditor to perform audit procedures on the engagement. It believes that the magnitude of the impact will vary across engagements and will be dependent on the extent to which the external auditor obtains direct assistance from the internal auditors.

The IAASB also anticipates a small increase in the work effort of internal audit functions resulting from the proposed requirement for the external auditors to make inquiries with

appropriate individuals in the function. This is because internal audit functions will be expected to interact with the external auditor and respond to inquiries posed by the external auditor. Where the external auditor determines it is appropriate to use the work of the internal audit function and consequently is required to read the corresponding reports of the internal audit function, the IAASB envisages that the assistance of the internal audit function will also be called upon for accessing and understanding these reports.

Audit Oversight Bodies

The IAASB anticipates that audit oversight bodies may incorporate the new requirements in the proposed revised ISA 610 into their inspection processes. In connection with this, the IAASB believes that the clarifications regarding the obligations of the external auditor when using the work of internal auditors could result in gains in efficiency. This is particularly the case where requirements and guidance are not currently provided in the suite of ISAs, such as in the case of direct assistance, which allows for divergent practices.

6. Statement of Consultation to Date

Representatives from the internal auditing community and the International Ethics Standards Board for Accountants (IESBA) participated directly in the development of the proposed revisions to ISA 610.

An integral and important part of the IAASB's formal process of consultation is through the IAASB CAG. More than 30 key stakeholder organizations participate in the bi-annual meetings of the IAASB CAG. Member organizations include the International Organization of Securities Commissions, the World Bank, the European Commission and the Basel Committee on Banking Supervision. Throughout the course of development of the proposed revised ISA 610, consultations were undertaken with Representatives of the IAASB CAG to ensure the rigor of the proposals and their adequacy for application in practice. Through key IAASB consultative, liaison and promotional channels, preliminary inputs were also sought from the regulatory community and networks of audit firms.

As part of due process, the IAASB will give further consideration to whether further consultation would be appropriate to obtain necessary input before finalization of the revised ISA 610.

7. Project Timetable

The following timetable identifies the major milestones for the project and the expected timeline for achieving those milestones:

Comment Deadline	November 2010
Review of Comments on Exposure Draft	March 2011 – June 2011
Approval of Final Revised Standard	June 2011

Release of Final Revised Standard ²³	September 2011
Provisional Effective Date of the Final Revised Standard	[Refer to discussion in Issues Paper presented in Agenda Item 4-A]

8. Guide for Respondents

This section describes the guidelines for respondents in developing comments on the Exposure Draft. It includes requests for specific comments on matters such as public interest concerns, developing nations, and translation issues. It also addresses any special considerations in the audit of smaller entities or public sector entities.

a. General

The IAASB welcomes comments on all matters addressed in the exposure draft. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in this exposure draft (especially those calling for change in current practice), it will be helpful for the IAASB to be made aware of this view.

b. Request for Specific Comments

The IAASB would welcome views on the following:

1. Do respondents believe that it is desirable for the scope of ISA 610 to be expanded to address the matter of direct assistance? If yes, whether respondents believe that when obtaining the direct assistance of internal auditors, the external auditor should:
 - Evaluate the internal auditors' level of competence and degree of objectivity; and
 - Direct, supervise and review the audit procedures performed by the internal auditors in a way that recognizes they are not independent of the entity?
2. Do respondents believe that the factors proposed to be evaluated by the external auditor in determining (a) whether the work of the internal audit function can be used for purposes of the audit engagement and (b) the planned use of the work of the internal audit function are appropriate?
3. Do respondents believe that it is appropriate to introduce a requirement for the external auditor to make inquiries of appropriate individuals within the internal audit function? If so, whether it agrees that such a requirement is appropriately placed in ISA 315?

²³ Approval by the Public Interest Oversight Board is required to be obtained before the final revised ISA may be released.

4. Do respondents believe that it is appropriate to introduce a requirement for the external auditor to read reports produced by the internal audit function relating to the work of the internal audit function used by the external auditor?

c. Request for Other Specific Comments

5. Public Interest Concerns—Respondents are asked to address whether there are any public interest concerns that have not been addressed.
6. Special Considerations in the Audit of Smaller Entities—Respondents are asked to comment whether, in their opinion, guidance addressing special considerations in the audit of smaller entities should be provided in the proposed ISA. If so, respondents are asked to explain why, and to suggest the nature of any such considerations.
7. Special Considerations in the Audit of Public Sector Entities—Respondents are asked to comment whether, in their opinion, special considerations in the audit of public sector entities have been dealt with appropriately in the proposed ISA.
8. Developing Nations—Recognizing that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed ISA in a developing nation environment.
9. Translations—Recognizing that many respondents intend to translate the final ISA for adoption in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing the proposed ISA.
10. Effective Date—Respondents are asked to comment whether, in their opinion, the provisional effective date is appropriate for supporting effective adoption and implementation of the revised ISAs at the national level.

d. Request for Comments on Analysis of Impacts

The IAASB is piloting the use of impact analyses. The impact analysis contained in this Explanatory Memorandum shows the IAASB's consideration of the potential impacts of both the overall revised standard and the preferred option for each key issue addressed during the development of a proposed revised standard.

Narrative descriptions of this analysis are included in this explanatory memorandum and presented in tabular format in the appendix. The impact analysis in the appendix identify who will be affected by the proposed revised standard and preferred options, how and to what extent they will be affected. It provides for respondents to analyze the primary impacts and other impacts. It is important to note that the impact analysis is intended to communicate the impact of the incremental difference between the extant and proposed revised ISA 610, not between current and future practice.

The IAASB's revision of ISA 610 has been selected as a pilot test. To assist the IAASB in further refining the process, it would appreciate comments on the following:

11. Was the analysis of impact presented in Section 5 of the Explanatory Memorandum helpful to respondents in considering and commenting on the impact of the IAASB's proposals?
12. Do respondents agree with the impact analysis as presented? Are there any other stakeholders or other impacts on stakeholders that should be addressed?
13. Are there any changes to the narrative or tabular presentation of the impact analysis that would be helpful to respondents?
14. Would respondents find such a tool useful at the national level?

Appendix

Analysis of Impacts of the Revision of ISA 610 *Using the Work of Internal Auditors*

Subject: Revision of ISA 610, “Using the Work of Internal Auditors”

Audit Effectiveness	Direction and Magnitude of Impact (Note 1)	Variability by Size/Nature of Entity Subject to Audit (Note 2)	Duration of Impact (Note 3)
<p>Overall increase in audit effectiveness because of the following:</p> <ul style="list-style-type: none"> The external auditor will be guided by a strengthened framework, focused on the necessary attributes of a well-functioning internal audit function (objectivity, competence and application of a systematic and disciplined approach), for determining whether the work of the internal audit function can be used for purposes of the audit, and further, the amount of judgment involved in performing such work when determining its planned use. Clear boundaries in the form of minimum requirements of the degree of objectivity and level of competence of the internal audit function are also established to guard against inappropriate use of work of the internal audit function under the circumstances of the audit engagement; The external auditor will be required to make inquiries of the internal audit function to leverage the function’s knowledge of the entity and its expertise in risk and control. This will further inform the external auditor’s understanding of the 	<p>Increase.</p> <p>The magnitude of impact is dependent on whether and the extent to which the external auditor uses the work of the internal audit function.</p>	<p>All audits where an internal audit function exists. Small- and medium-sized entities typically do not have a separate internal audit function in which case there will be no impact.</p>	<p>Recurring</p>

Audit Effectiveness	Direction and Magnitude of Impact (Note 1)	Variability by Size/Nature of Entity Subject to Audit (Note 2)	Duration of Impact (Note 3)
<p>entity and its environment which forms the basis for the external auditor's risk assessments. Further, the revised ISA encourages effective communication between internal auditors and external auditors, which supports an environment in which internal auditors can bring significant matters that may affect the work of the external auditor to the latter's attention.; and</p> <ul style="list-style-type: none"> The external auditor will be required to read relevant reports of the internal audit function relating to the function's work that the external auditor plans to use on the audit engagement. This would assist the external auditor in obtaining an understanding of the nature and extent of audit procedures performed and the related findings of the internal audit function. 			
<p>External Auditors (Note 4)</p> <p>Overall decrease in work effort because of the following:</p> <ul style="list-style-type: none"> The external auditor may obtain the direct assistance of internal auditors on the audit engagement to perform procedures that would otherwise be performed by the external auditors themselves. It is important to note that to avoid inappropriate use of assistance from internal auditors on audit engagements, focus is placed on providing appropriate requirements and guidance to the external auditor in these cases particularly in regard to the nature and extent of direction, 	<p>Decrease.</p> <p>The magnitude of impact is dependent on whether and the extent to which the external auditor uses the work of internal auditors.</p>	<p>All audits where an internal audit function exists but particularly those where the internal audit functions are bigger in size and are well-established. Small- and medium-sized entities typically do not have a separate internal audit function in which case there will be no impact.</p>	<p>Recurring</p>

Audit Effectiveness	Direction and Magnitude of Impact (Note 1)	Variability by Size/Nature of Entity Subject to Audit (Note 2)	Duration of Impact (Note 3)
<p>supervision and review that should be exercised by the external auditor over the internal audit staff.</p> <p>However, the decrease in work effort is off-set marginally by the following:</p> <ul style="list-style-type: none"> • The external auditor may spend greater effort in ensuring the strengthened framework is properly and adequately applied in determining whether and to what extent to use of the work of the internal audit function for purposes of the audit; • The external auditor will be required to make inquiries of the internal audit function as part of the external auditor's risk assessment procedures; and • The external auditor will be required to read relevant reports of the internal audit function relating to the function's work that the external auditor plans to use on the audit engagement. 			
<p>Internal Audit Functions/ Internal Auditors</p> <p>Overall increase in work effort because of the following:</p> <ul style="list-style-type: none"> • The assistance of internal auditors may be obtained by the external auditor to perform procedures on the audit engagement which are otherwise performed by the external auditors themselves; • The internal audit function will be expected to interact with the external auditor and respond to inquiries posed by the external auditor; and 	<p>Increase.</p> <p>The magnitude of impact is dependent on whether and the extent to which the external auditor uses the work of internal auditors.</p>	<p>All audits where an internal audit function exists. Small- and medium-sized entities typically do not have a separate internal audit function in which case there will be no impact.</p>	<p>Recurring</p>

Audit Effectiveness	Direction and Magnitude of Impact (Note 1)	Variability by Size/Nature of Entity Subject to Audit (Note 2)	Duration of Impact (Note 3)
<ul style="list-style-type: none"> The internal audit function will be expected to assist the external auditor in accessing and understanding the relevant reports relating to the work of the internal audit function that the external auditor plans to use. 			
<p>External Auditors: Clarifying Ambiguity Regarding Direct Assistance</p> <p>Clarification of the ambiguity regarding whether the practice of direct assistance is allowed under the ISAs. This avoids situations where direct assistance of internal auditors is not obtained by external auditors even though appropriate in the circumstances simply because the ISAs not dealing with instances of direct assistance is interpreted to imply that an audit conducted in accordance with ISAs cannot, therefore, use direct assistance of internal auditors.</p>	<p>The magnitude of impact is dependent on whether and the extent to which the external auditor uses the work of the internal auditors.</p>	<p>All audits where an internal audit function exists and the direct assistance of internal auditors are employed on the engagement. Small- and medium-sized entities typically do not have a separate internal audit function in which case there will be no impact.</p>	<p>One-off</p>
<p>External Auditors: Perceived Independence</p> <p>Threats to the perceived independence of the external auditor may be created if the direct assistance of internal auditors are obtain for purposes of the audit because internal auditors are not independent of the entity as is required of the external auditor in an audit of financial statements.</p>	<p>By guarding against undue use of the assistance of internal auditors on audit engagements through clarifying the requirements of the external auditor in these cases and provision of appropriate guidance, safeguards are established to reduce actual threats to an acceptable level.</p>	<p>All audits where an internal audit function exists and the direct assistance of internal auditors are employed on the audit engagement. Small- and medium-sized entities typically do not have a separate internal audit function in which case there will be no impact.</p>	<p>Recurring</p>

Audit Effectiveness	Direction and Magnitude of Impact (Note 1)	Variability by Size/Nature of Entity Subject to Audit (Note 2)	Duration of Impact (Note 3)
<p>Audit Oversight Bodies: Inspection Process</p> <p>Audit oversight bodies may incorporate the new requirements in the proposed revised ISA 610 into their inspection processes. However, in some cases, efficiencies in the inspection process may be had resulting from clarifications regarding the obligations of the external auditor when using work of internal auditors.</p>	<p>The direction and magnitude of impact is dependent on whether and the extent to which the new requirements are incorporated into the inspection processes of the respective audit oversight bodies and the extent of divergence in practices at the national level resulting from the lack of clarity in the ISAs.</p>	<p>All audits where an internal audit function exists and which are subject to inspection oversight.</p>	<p>Recurring</p>

Note 1: The extent (magnitude) of the impact on audit effectiveness may be measured in qualitative terms, using a simple 7-point directional scale (The scale takes account of the direction (increase or decrease) and relative magnitude of the impact (small, moderate or large) [*Large increase, Moderate increase, Small increase, None, Small decrease, Moderate decrease, Large decrease*]. Impacts on different entities should be described separately. For example, a large increase for large public companies and a small increase for small nonpublic companies should be described as such. They should not be combined and presented as an overall moderate impact for all companies. In the case of the proposed revisions to ISA 610, the IAASB has determined that because the magnitude of each impact listed is dependent on a number of factors as described, determination of an overall magnitude for each impact is not appropriate.

Note 2: Indicate whether audit effectiveness, work effort, or other impact is affected for all entities or is limited to specific industries, particular types of entities, or entities in particular jurisdictions. In particular, the difference between the impact on small and large firms should be considered.

Note 3: For auditors, the duration of the impact is measured at the engagement level. It is normally assumed that most impacts will be recurring, with the exception of the one-off impact of implementing the change. For example, a system may have a large on-off impact when it is modified to meet a new requirement.

Note 4: The references to Auditors are assumed to include Supreme Audit Institutions.