

**Using the Work of Internal Auditors—
Issues and IAASB Task Force Proposals****Background**

1. In March 2010, the Task Force received comments from the IAASB, Representatives of the IAASB Consultative Advisory Group (CAG), the International Ethics Standards Board for Accountants (IESBA) and the IFAC Small and Medium Practices Committee on significant issues in the revision of clarified ISA 610 and first drafts of the proposed revised ISA 315 and ISA 610.
2. Based on the comments received, the Task Force recommends revisions to the draft revised ISAs presented in March 2010. Marked drafts of the proposed revised ISA 315 and ISA 610 showing the Task Force's proposed changes to the draft ISAs presented in March are presented in **Agenda Item 4-B** and **Agenda Item 4-C** respectively. This Issues Paper makes references to these drafts. Marked drafts showing all proposed changes to the original extant ISA 315 and ISA 610 have also been prepared and are presented in **Agenda Item 4-D** and **Agenda Item 4-E** respectively.
3. The remainder of this Issues Paper sets out the Task Force's deliberations and its recommendations in regard to remaining significant issues in the revision of clarified ISA 610.

Significant Issues**Direct Assistance**

4. At its March 2010 meeting, the IAASB iterated its support for an expansion of the scope of ISA 610 to address circumstances when internal auditors are asked to provide direct assistance to the external auditor in carrying out audit procedures on the engagement, when not prohibited by local law or regulation. However, the IAASB felt that insufficient guidance was provided in the draft revised ISA 610 to assist external auditors in deciding whether to obtain direct assistance and where, and the procedures that are needed to be performed in relation to that work. The Task Force was asked to further clarify whether and how the requirements in the proposed revised ISA 610 relating to the external auditor's evaluation of the internal audit function for the purpose of using the function's work apply in the case of direct assistance.
5. In this regard, the Task Force proposes the following:
 - Clarifying that for the purpose of determining the work that may be assigned to the internal auditors and the amount of direction, supervision and review that is appropriate in the circumstances, the external auditor has to apply similar considerations as those required to be considered when determining the planned use

of the work of the internal audit function.¹ See paragraphs 21, 22, A25 and A27 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.

- Providing in the form of guidance material a narrative description of the practice of direct assistance to avoid any doubts in the external auditor's determination of whether direct assistance from the internal auditor is obtained and therefore whether ISA 610 applies. See paragraph A23 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.
 - Reinforcing in the guidance materials that the external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's decision to obtain the direct assistance of internal auditors on the audit engagement. See paragraph A24 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.
6. The IAASB and Representatives of the IAASB CAG at their March meetings and the IESBA at its February meeting also expressed concern about the proposed reference to audit procedures performed by internal auditors as “presumed to provide *less reliable* evidence” although noting that the Task Force had drawn on the concepts regarding audit evidence in ISA 500.² However, further changes made to the draft revised ISA 610 have made the reference superfluous as the basis for the external auditor's judgment on the nature, timing and extent of procedures that is needed to be performed draws on the same requirements and guidance as when using the work of the internal audit function. Accordingly, all references to “less reliable evidence” have been removed. See paragraphs 7, 24 and A26 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.
7. In addition, the IAASB considered whether the external auditor should be required to reperform procedures conducted by the internal auditors. In this regard, the Task Force considered the definition of reperformance in ISA 500³ which states that this involves the auditor independently executing procedures originally performed by others. To ensure clarity, the Task Force proposes further guidance to explain that reperformance involves the external auditor examining items already examined by the internal audit function or other similar items (that is, “redoing” some of the tests). The Task Force agreed that it is possible for the external auditor to reperform some of the work of the internal audit function in obtaining evidence as a basis to determine the adequacy of that work for purposes of the audit engagement. However, the Task Force questioned whether this was necessary in the case of direct assistance since the external auditor would have directed, supervised and reviewed the performance of the procedures directly. See paragraph A21 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.

¹ Namely the considerations referred to in paragraphs 15 and 16 of the proposed revised ISA 610 presented in **Agenda Item 4-C**.

² ISA 500, “Audit Evidence”

³ ISA 500, paragraph A20 states that “reperformance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.”

8. Notwithstanding this, the Task Force did believe that often in the case of direct assistance, copies of the supporting records examined by the internal audit staff may be available during the external auditor's review, and that the nature of the external auditor's review of the work of the internal auditor could involve "walking through" the procedures performed by the internal auditors. Such procedures constitute, in the Task Force's view, detailed review rather than reperformance of the work of the internal auditor (as defined in ISA 500). However, the Task Force agreed that further guidance in this regard could usefully be provided. See paragraph A27 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.

Internal Auditors and the Engagement Team

9. The views of the IESBA were sought on the matter of direct assistance at its October 2009 and February 2010 meetings, including whether the extant IESBA Code⁴ prohibits such practices. One question in particular was asked: whether by performing audit procedures on the external audit these individuals may, under the prevailing definitions in the ISAs and the IESBA Code, be deemed to be members of the engagement team?⁵ The IESBA indicated that it did not intend for the definition of engagement team in the IESBA Code to encompass internal auditors providing assistance to the external auditor, but also noted that some of the wording in the IESBA Code could inadvertently be interpreted to suggest that an internal auditor may not work under the direction of the external auditor.
10. To explain, section 290.163 of the IESBA Code states that an example of activities that would generally be considered a management responsibility includes directing and taking responsibility for the actions of the entity's employees. The IESBA considered whether by directing, supervising and reviewing the internal auditors when obtaining their assistance on the audit engagement, the external auditor may be considered to be assuming a management responsibility which is prohibited under the IESBA Code. The IESBA concluded that it is not its intention that the external auditor's actions in directing, supervising and reviewing of the internal auditors who are providing direct assistance on the audit would be considered as performance of a management responsibility as in this case, the external auditor actions are concerned with matters relating to the audit and therefore within the remit of the external auditor's responsibilities. In connection with this, the IESBA also considered and decided that clarification of this matter in the IESBA Code or through other means is not required.
11. Separately, the IESBA also drew a parallel between the case of direct assistance and when the external auditor accepts an engagement to provide internal auditing services to an audit client, and the results of those services are used in conducting the external audit.

⁴ The IESBA's *Code of Ethics for Professional Accountants* (IESBA Code).

⁵ In the ISAs, the engagement team is defined as all partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes external experts engaged by the firm or a network firm. In the Code, the engagement team is defined as all personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.

The IESBA discussed the likelihood that in the same way, self-review threats may arise when the direct assistance of internal auditors is obtained on the procedures performed in connection with work of the internal audit function which the external auditor plans to use on the audit engagement.

12. The Task Force has considered the IESBA's comment and, in light of the self-review threat, recommends that a prohibition be introduced to disallow the external auditor from obtaining the direct assistance of internal auditors in performing procedures for determining the adequacy of the work of the internal audit function that the external auditor plans to use for purposes of the audit engagement. The Task Force believes that this is appropriate because the results of these procedures form the basis for supporting the external auditor's planned use of the work of the internal audit function. Consequently if the procedures are performed by the internal auditors, self-review threats will be generated.
13. See paragraph 23 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.

Matters for IAASB's Consideration

The IAASB is asked:

- Whether it agrees that the external auditor should apply similar considerations when determining the work that may be assigned to internal auditors and the amount of direction, supervision and review that is appropriate in the circumstances as those required to be considered when determining the planned use of the work of the internal audit function?
- Whether it agrees that the external auditor should not obtain the direct assistance of internal auditors in performing procedures for determining the adequacy of the work of the internal audit function that the external auditor plans to use?
- For its views on whether sufficient guidance is provided on the nature, timing and extent of the external auditor's direction, supervision and review of work performed by internal audit staff?

Using the Work of the Internal Audit Function

Determining Whether and to What Extent to Use the Work of the Internal Audit Function

14. At its March 2010 meeting, the IAASB expressed support for the Task Force's proposals to refine the framework for determining how the external auditor would conclude whether the work of the internal audit function can be used for the purposes of the audit and the judgments involved in determining where and how the work of the internal audit function can be used by the external auditor.
15. In this regard, some IAASB members questioned whether the assessed risk of material misstatements should also be taken into account in deciding when, where and how to use the work of the internal audit function. In particular, it felt that for areas of higher risk, the external auditor should be expected to do more work directly. Others questioned whether the

work of internal audit should be used at all in relation to significant risks. The IAASB further questioned whether it is possible for the external auditor to evaluate the *degree of objectivity* of the internal audit function since objectivity refers to a state of mind specifically that of being free from bias, conflict of interest and the undue influence of others. For some, it is a binary decision (that is, whether or not someone is objective), rather than it taking on the form of a sliding scale. The IAASB also noted that the proposed use of term “key audit judgments” appears to not be aligned to terms presently used in ISA literature. It instructed the Task Force to revisit the proposed phrase for consistency with the terminology in extant suite of ISAs.

16. In this regard, the Task Force proposes the following:
 - Explaining that the degree of the objectivity of the internal audit function refers to the extent to which the internal audit function’s organizational status and relevant policies and procedures support the objectivity of the internal auditors. See paragraphs 13(a) and A7 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.
 - Replacing “key audit judgments” with “significant judgments” which is the term employed in ISA 220,⁶ the IESBA Code and the International Accounting Education Standards Board’s (IAESB) IES 8.⁷ See paragraph 16 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.
 - As suggested by a Representative of the IAASB CAG, clarifying that the competence of internal auditors is also affected by whether they possess the required knowledge relating to the entity’s financial reporting and the applicable financial reporting framework. See paragraph A7 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.
17. The Task Force continues to believe that it is the nature of the procedures that are performed that is relevant to the external auditor’s decision on when work of the internal audit function can be used—that is, the amount of judgment involved. Applying this concept, it should be possible to use work of the internal audit function, for example, in relation to significant risks when such work does not involve substantial judgment. However, the Task Force agrees that there is a relationship between the assessed level of risk and the judgment involved because it is highly unlikely (if even possible) that procedures involving less judgment would constitute a significant part of the audit evidence needed in relation to significant risks.
18. Accordingly, the Task Force felt that it would be appropriate to emphasize the link between the amount of judgment and the level of risk by focusing on the fact that the higher an assessed risk of material misstatement at the assertion level (in particular for significant risks), the more judgment is often involved in planning and performing the audit procedures and evaluating the results thereof. In addition, it should also be specified that in these cases the external auditor is less likely to be able to make substantial use of the work of the internal

⁶ ISA 220, “Quality Control for an Audit of Financial Statements”

⁷ In March 2010, the IAESB issued for public comment a consultation paper on the revision of International Education Standard (IES) 8, “Competence Requirements for Audit Professionals.” Comments are due by June 15, 2010.

audit function in obtaining sufficient appropriate audit evidence. See paragraph A13 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.

Matters for IAASB's Consideration

The IAASB is asked:

- Whether it agrees with the proposed clarification of the term “degree of objectivity of the internal audit function”?
- Whether it agrees with replacing the term “key audit judgments” with “significant judgments”?
- Whether it agrees that knowledge of the entity’s financial reporting and the financial reporting framework is an important factor that determines the competence of internal auditors?
- Whether it agrees with the proposed clarification of the relationship between the assessed risk of material misstatement at the assertion level and the extent to which the external auditor can use the relevant work of the internal audit function on the audit engagement?

Using the Work of the Internal Audit Function

19. At the March 2010 IAASB Consultative Advisory Group (CAG) meeting, it was discussed whether there should be a minimum requirement for the external auditor to reperform some of the work of the internal audit function in each instance of use, or at least in relation to, for example, significant risks. As noted earlier, the need to reperform internal audit work was also raised in relation to direct assistance. The Task Force considered whether the question raised by Representatives of the IAASB CAG may have partly arisen from confusion between procedures performed by the external auditor as part of the external auditor’s review of the work of the internal audit function (that is, a detailed review), and actual reperformance of the work of the internal audit function.
20. In this regard, the Task Force proposes the following:
 - Including in the form of guidance material a description of reperformance that mirrors the definition in ISA 500. See paragraph A21 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.
 - Clarifying that reperformance is one type of procedure amongst a few others that may be performed by the external auditor to appraise the quality of the work performed and conclusions reached by the internal audit function. Notwithstanding this, further emphasizing that in most circumstances, some reperformance of such work is appropriate and in this regard, the external auditor is more likely to focus reperformance in those areas where more judgment was exercised by the internal audit function in planning, performing and evaluating the results of the audit procedures. See paragraphs A20 and A21 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.

Matters for IAASB's Consideration

The IAASB is asked:

- Whether it agrees with including in the form of guidance material a description of reperformance that mirrors the definition in ISA 500?
- Whether it agrees with emphasizing the circumstances under which reperformance of the work of the internal audit function would be appropriate and the areas where this type of procedure is more likely to be performed by the external auditor?

Reading the Relevant Reports of the Internal Audit Function

21. At its March 2010 meeting, the IAASB discussed the importance of leveraging the internal audit function's knowledge of the entity and its expertise in risk and control, to inform the external auditor's understanding of the entity and its environment which forms the basis for the external auditor's risk assessment. There was support for the introduction of a requirement in the ISAs for the external auditor to make inquiries of the internal audit function about its findings and work performed that are likely to be relevant to the external auditor's overall audit strategy and audit plan. In connection with this, the IAASB also discussed whether the external auditor should be required to read some of the reports of the internal audit function, particularly if they are relevant to the entity's financial reporting and the audit.
22. At its September 2009 meeting, the IAASB had discussed whether the external auditor's reading of reports of the internal audit function should be a required procedure, but agreed that a requirement could result in an onerous amount of additional audit effort given the possible nature and extent of internal audit reports. Where this is the case, the costs of doing so will outweigh the benefits obtained. It was also pointed out that even by specifying a more targeted requirement to require the external auditor to only read the *relevant* reports, the external auditor would only be able to make such determination after reading all the reports. Notwithstanding this, the IAASB asked the Task Force to consider whether the external auditor should be reading the related report if using work of the internal audit function addressed in that report.
23. The Task Force has considered and agrees with the view expressed by the IAASB. It believes that reading such reports assists the external auditor in obtaining a complete understanding of the nature and extent of audit procedures performed by the function and its related findings regarding the work of the function that the external auditor plans to use. It is also the Task Force's understanding that this procedure is already commonly performed in practice today. See paragraphs 18 and A17 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.
24. In addition, although not requiring the external auditor to read other internal audit reports, the Task Force proposes to clarify the related guidance in the proposed revised ISA 315 to explain the circumstances when it may be useful to read certain internal audit reports as

part of the external auditor's risk assessment procedures. See paragraph A6b in the proposed revised ISA 315 presented in **Agenda Item 4-B**.

Matters for IAASB's Consideration

The IAASB is asked whether it agrees with the inclusion of a requirement for the external auditor to read reports produced by the internal audit function relating to the work of the function that the external auditor plans to use for purposes of the audit engagement?

Other Matters

25. At its March meeting, the Board also commented on further matters which the Task Force considered and recommends the following proposed revisions to extant ISA 315 and ISA 610:

Proposed revised ISA 315

- (a) Clarifying that since the external auditor's obtaining of an understanding of the entity and its environment is a continuous, dynamic process of gathering, updating and analyzing information throughout the audit, depending on the circumstances, the inquiries made by the external auditor of the internal audit function may occur throughout the audit engagement. See paragraph A6 in the proposed revised ISA 315 presented in **Agenda Item 4-B**.
- (b) Clarifying the linkage between the inquiries made by the external auditor of the internal audit function and the external auditor's reading of the relevant reports of the function. Specifically that the external auditor's reading of such reports typically results from the external auditor becoming aware from inquiries of the internal audit function that there are findings of the function that are relevant to the entity's financial reporting and the audit. See paragraph A6b in the proposed revised ISA 315 presented in **Agenda Item 4-B**.
- (c) Specifying that in making inquiries and examining relevant reports of the internal audit function, the auditor may consider the manner in which management has responded to the findings of the internal audit function regarding identified weaknesses in internal control and the function's recommendations thereof. See paragraph A71a in the proposed revised ISA 315 presented in **Agenda Item 4-B**.
- (d) Addressing in the form of guidance material circumstances where internal auditors bring significant matters to the external auditor's attention that may affect the work of the external auditor. See paragraph A103b in the proposed revised ISA 315 presented in **Agenda Item 4-B**.

Proposed revised ISA 610

- (e) Clarifying in the scope paragraph of the ISA the circumstances in which the application of ISA 610 is not necessary. See paragraph 2 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.

- (f) Clarifying that in determining whether and to what extent to use the work of the internal audit function *and* direct assistance of the internal auditors, the external auditor gives consideration to the fact that neither the internal audit function nor the internal auditors are independent of the entity as is required of the external auditor in an audit of financial statements in accordance with ISA 200. See paragraph 5 in the proposed revised ISA 610 presented in **Agenda Item 4-C**.

Provisional Effective Date

26. Following the completion of its Clarity project, the IAASB has agreed, subject to any unforeseen circumstances, not to issue any additional auditing standards that would become effective in the next two years. Clarity ISAs are effective for audits of financial statements for periods beginning on or after December 15, 2009. Accordingly, the revised ISA 315 and ISA 610 may become effective no earlier than for periods beginning on or after December 15, 2011. With this in mind, there are two further considerations relevant to the determination of a provisional effective date for the revised ISA 315 and ISA 610.

Adoption and Implementation

27. The first consideration relates to the period required for effective adoption and implementation of the revised ISAs at the national level. If the revised ISAs are effective for 2012 audits (that is, for periods beginning on or after December 15, 2011), relative to the anticipated release of the final revised ISAs in September 2011, a lead time of 15 months is provided.⁸ However, most NSS would likely be offside assuming 3-6 months lead time is required to adopt the revised ISAs at the national level followed by another 6-9 months required for implementation. Further, this would leave at the shortest only 3-6 months for implementation in cases where the external auditor engages with the internal auditors for planning the work of the internal auditors which typically takes place during early stages of the audit.
28. If the revised ISAs are effective for 2013 audits (that is, for periods beginning on or after December 15, 2012), relative to the anticipated release of the final revised ISAs in September 2011, a lead time of 27 months is provided. Whilst recognizing that a much extended period for adoption and implementation at the national level is provided with this option, early adoption of the revised ISAs will be permitted.

Form of the Effective Date

29. The second consideration relates to the form of the effective date. In this regard, the Task Force proposes that the following options be considered:
- (a) Periods *beginning* on or after December 15, 20xx; or
 - (b) Periods *ending* on or after December 15, 20xx.

⁸ In its previous discussions, the IAASB has signaled that approximately 18 months from the release of a new or revised standard is a reasonable period to allow for effective adoption and implementation at the national level.

30. The suite of the clarified ISAs adopts an effective date of similar format to the first option shown above. However, the second option (an effective date based on reporting entities' ending periods) will avoid inadvertent application of the revised ISAs to audits of financial statements for periods less than one year in the first year the revised ISAs become operative.⁹

Matters for IAASB's Consideration

The IAASB is asked for its views on: (a) the period that would be appropriate for effective adoption and implementation of the revised ISAs at the national level, and (b) the form that should be taken by the effective date of the revised ISA 315 and ISA 610.

Impact Analysis Considerations

31. IFAC is currently developing an impact analysis framework for its Public Interest Activity Committees (PIACs). Each PIAC, including the IAASB, will be piloting the use of the proposed impact analysis framework operationalized mainly through a revised and restructured explanatory memorandum which is supplemented by impact analyses presented in tabular form in the appendix. In the case of the IAASB, its project to revise ISA 610 has been selected as a test case for this purpose.
32. At its March 2010 meeting, the IAASB agreed on the significant proposals to be addressed in the revision of ISA 610 that should be highlighted for the purpose of analyzing anticipated impacts arising from these proposals. The proposals selected are as follows:
- (a) The proposed expansion of the scope of ISA 610 to address the matter of internal auditors providing direct assistance to external auditors on audit engagements.
 - (b) The proposed judgment-based approach to the external auditor's determination of whether and to what extent to use the work of the internal audit function.
 - (c) The proposed requirement in ISA 315 for the external auditor to make inquiries of the internal audit function about its findings and work performed that are likely to be of relevance to the external audit as a basis for leveraging the knowledge and experience of the internal audit function to inform the external auditor's risk assessments.
33. As a result of the IAASB's comments in March 2010, the Task Force is of the view that the third proposal listed above should be expanded to include the requirement for the external auditor to read the relevant reports of the internal audit function regarding the work of the function that the external auditor plans to use on the audit engagement.

⁹ As indicated in the draft explanatory memorandum presented in **Agenda Item 4-H**, the Task Force anticipates that the approval of the final revised standards will be in June 2011. The proposed effective dates would therefore allow 18 months for adoption from the date of final approval of the revised standards. If this is delayed to September 2011, the effective date of the revised ISAs will be required to be adjusted accordingly by at least 6 months.

34. A draft of the explanatory memorandum for the exposure draft of the proposed revised ISA 315 and ISA 610 is presented in **Agenda Item 4-H**. This preliminary draft is based on the new structure proposed by the Impact Analysis Task Force.
35. Subject to the IAASB's approval of the proposed revised ISA 315 and ISA 610 for issue as an exposure draft, the Task Force proposes that respondents' views be specifically sought on the following matters:
- (a) 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?
 - (b) Do respondents believe that the factors proposed to be evaluated by the external auditor in determining: (i) whether the work of the internal audit function can be used for purposes of the audit engagement and (ii) the planned use of the work of the internal audit function are appropriate?
 - (c) 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?
 - (d) 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 to be used by the external auditor?
36. Respondents' views will also be sought on whether the provisional effective date is appropriate for supporting effective adoption and implementation of the revised ISAs at the national level.

Matters for IAASB's Consideration

The IAASB is asked:

- Whether it agrees that an analysis of impacts should be performed for the proposed requirement for the external auditor to read the relevant reports of the internal audit function relating to the work of the function that the external auditor plans to use?
- For its views on the draft of the explanatory memorandum for the exposure draft of the proposed revised ISA 315 and ISA 610.
- Whether it agrees with the questions on the proposed revised ISA 315 and ISA 610 for which respondents' views should be specifically sought?

Consideration by IAASB of Significant Matters Identified by Task Force

37. In the Task Force's view, the significant matters the Task Force has identified as a result of its deliberations since the beginning of this project, and the Task Force's considerations thereon, have all been reflected in the issues papers presented to the IAASB at its meetings. In the Task Force's view, there are no significant matters discussed within the Task Force on this project that have not been brought to the IAASB's attention.

Consideration by IAASB of Need for Further Consultation

38. At its September 2009 meeting, the IAASB considered and decided that further consultation in the form of a consultation paper or other forms of consultation (for example, focus groups or roundtables) in advance of development of an exposure draft on the revised ISA 610 is not required. The Task Force does not believe any new developments for which further consultation to inform its views have arisen that would suggest a need to revisit the IAASB's decision in this regard.