

**Using the Work of Internal Auditors—
IAASB Task Force Recommendations in Response to IAASB’s Consideration
of Significant Comments on Exposure**

Background

1. In June 2011, the Task Force received comments from the IAASB, the International Ethics Standards Board for Accountants (IESBA) and the International Federation of Accountants (IFAC) Small and Medium Practices Committee on significant issues raised by respondents on the Exposure Draft (ED) and on the amendments the Task Force was proposing to make to revised ISAs 315 and 610¹ in response:
 - (a) The IAASB expressed broad support for the approach the Task Force has taken to respond to comments received on exposure. The IAASB noted that a wide range of views, some deeply-divided and strongly held, in relation to a number of significant proposals in the ED were expressed by respondents. The challenge at hand is therefore to achieve the right balance in formulating responses to these comments.
 - (b) A number of IAASB members felt that taken together, the proposed revisions to the ED resulted in the ISA being more rules-based and, overall, conveyed a negative tone regarding the external auditors’ use of the work of internal auditors. Some members expressed concern that this could deter external auditors from considering the work of internal auditors, which in their view, would not be in the best interest of audit quality. These IAASB members were of the view that a more balanced approach that promoted the “constructive and complementary” relationship referred to in ISA 260² is preferred. Others, however, felt that the Task Force has headed in the right direction in its attempt to respond to comments and that the resulting revised ISA 610 is clearer on the expectations of the external auditor.
 - (c) In the area of direct assistance, some IAASB members felt that, if direct assistance is to be allowed, the revised framework for the external auditor’s judgments regarding whether, in which areas and to what extent internal auditors can be used to provide direct assistance is overly restrictive. In many cases, applying the framework would result in external auditors only being able to obtain the direct assistance of internal auditors on the audit in relation to insignificant items of low risk. Whilst accepting that additional safeguards are appropriate in relation to direct assistance, the IAASB did not believe it was necessary to restrict the use of direct assistance to such an extent.
 - (d) The IESBA considered respondents’ comments on the matter of direct assistance at its June 15–17, 2011 meeting. Given the importance of the IESBA’s views to the IAASB’s own decisions on this matter, the IAASB received an update on the key outcomes of the IESBA’s discussion. In particular, the IESBA agreed to set up a task force to give further consideration to the matters raised by respondents and to put

¹ Proposed ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* and proposed ISA 610 (Revised), *Using the Work of Internal Auditors*

² ISA 260 (Revised), *Communication with those Charged with Governance*, paragraph A14

forward recommendations for the IESBA's consideration at a future meeting.³ Depending on the IESBA ISA 610 Task Force's recommendation, it is likely that the IESBA may require additional time to discuss this issue before it reaches a conclusion.

2. Based on the comments received, the Task Force recommends revisions to the June 2011 drafts of revised ISAs 315 and 610. Marked drafts of these ISAs are presented in **Agenda Item 9-B** and **Agenda Item 9-C** respectively. This Issues Paper makes reference to these.

Significant Issues and Task Force Recommendations

Structure of this Paper

3. The remainder of paper sets out the Task Force's recommendations on the remaining significant matters raised by the IAASB in June 2011 in relation to comments received on the ED and is structured as follows:
 - (a) **Section A: Balanced Tone on the Use the Work of Internal Auditors.** Discusses the Task Force's recommendations to improve the overall tone of proposed revised ISA 610 and to achieve a better-balanced standard.
 - (b) **Section B: Using Internal Auditors to Provide Direct Assistance.** Discusses the Task Force's recommendations relating to the placement of materials on direct assistance and revising requirements in proposed ISA 610 (Revised) relating to the external auditor's consideration of assessed risk of material misstatement.
 - (c) **Section C: Other Matters.** Discusses proposals to address other comments regarding the use of the work of the internal audit function and the use of internal auditors to provide direct assistance.

Section A: Balanced Tone on the Use the Work of Internal Auditors

4. A wide range of suggestions were offered by respondents to further strengthen the framework for the external auditor's judgments relating to evaluation of the internal audit function for determining the nature and extent of the function's work that can be used for purpose of the audit. A number of respondents, in particular regulators and oversight bodies, felt strongly that the requirements in certain areas of the ED needed strengthening and that inclusion of stronger messages to alert external auditor to over and undue use of internal audit work is desirable.
5. Some IAASB members felt that in the Task Force's attempt to accommodate these comments, the resulting revised ISA 610 conveyed an overly negative tone regarding use of the work of internal auditors by external auditors. These members believed that a more balanced approach is preferred—one that highlights not just the pitfalls of over and undue use of the work of internal auditors for purposes of the audit, but also the possibility for the external auditor to

³ At its October 2011 meeting, the IESBA will consider its ISA 610 Task Force's proposals including whether there is a need to revise the IESBA *Code of Ethics for Professional Accountants* and if so, what amendments are required.

make use of the work of the internal audit function in a constructive and complementary manner, where appropriate, to foster coordination and cooperation.

Task Force Recommendations

6. The Task Force agrees that revised ISA 610 should contain a balance of messages regarding the external auditor’s use of the work of internal audit function for purposes of the audit. To better achieve this, the Task Force proposes the following:
 - (a) Including a cross-reference in the introductory paragraphs in ISA 315⁴ that explains how the external auditor’s relationship with the internal audit function provides insights that help to inform the external auditor’s understanding of the entity and its environment and risk assessments, and how effective communication between the internal and external auditors also creates an environment in which the external auditor can be informed of significant matters that may affect the external auditor’s work. **[See paragraph 6 in Agenda Item 9-C.]**
 - (b) Explaining more clearly in the introductory paragraphs that the external auditor may also be able to use the work of the internal audit function in a constructive and complementary manner, but such decisions depend on whether the internal audit function’s organizational status and relevant policies and procedures supports the objectivity of the internal auditors, the level of competency of the internal audit function and whether the function applies a systematic and disciplined approach **[See paragraph 7 in Agenda Item 9-C.]**; and
 - (c) Drawing on the guidance in ISA 315⁵ regarding the external auditor’s responsibility to plan and perform the audit with professional skepticism, introduce guidance to emphasize that communication with the internal audit function throughout the engagement may provide opportunities for internal auditors to bring matters that may affect the work of the external auditor to the external auditor’s attention. The external auditor is then able to take such information into account in the external auditor’s identification and assessment of risks of material misstatement. The guidance further points out that if such information may be indicative of a heightened risk of a material misstatement of the financial statements or, regarding any actual, suspected or alleged fraud, the external auditor can take this into account in the external auditor’s identification of risk of material misstatement due to fraud in accordance with ISA 240.⁶ **[See paragraph A25 in Agenda Item 9-C.]**

Matter for IAASB Consideration

1. The IAASB is asked whether the revisions to proposed revised ISA 610 improve the overall tone of the ISA and achieve a better-balanced standard.

⁴ ISA 315 (Revised), paragraph A108

⁵ ISA 315 (Revised), paragraph A108

⁶ ISA 315 (Revised), paragraph A11

Section B: Using Internal Auditors to Provide Direct Assistance

Placement of Materials Relating to Direct Assistance

7. In June 2011, the IAASB considered two options for placement of requirements and guidance relating to direct assistance: either (i) within revised ISA 610 or (ii) in a separate ISA. Mixed views were expressed. Some members noted that dealing with the matter of direct assistance in a separate standard may be viewed positively in jurisdictions where such practices are prohibited. This is because it presents these jurisdictions with the option of electing not to adopt the ISA dealing with direct assistance. The IAASB instructed the Task Force to give this matter further consideration.

Task Force Recommendations

8. The majority of Task Force members felt that materials relating to the matter of direct assistance should be contained within ISA 610 as opposed to in a separate ISA for the following reasons:
- (a) There are significant overlaps in the external auditor's considerations and responsibilities under the two circumstances: using the work of the internal audit function and using internal auditors to provide direct assistance. Dealing with each circumstance in a separate ISA would result in some duplication in the suite of ISAs.
 - (b) Also related to (a), splitting the two circumstances may result in the materials regarding the external auditor's use of the work of internal auditors being less coherent in the suite of ISAs. The introductory section of proposed revised ISA 610 provides an integrated discussion of the relationship between the external auditor's responsibilities (relating to the internal audit function) when obtaining an understanding the entity and its environment under ISA 315 and those relating to the use of the work of internal auditors under ISA 610. Also contained in the introduction are key messages that emphasize the external auditor's sole responsibility for the audit opinion expressed. In the event the two circumstances (using the work of the internal audit function and using internal auditors to provide direct assistance) are dealt with in separate ISAs, consideration would need to be given to how best to address these contextual materials so as to ensure minimal duplication in the suite of ISAs.

Notably, a respondent⁷ raised that clear recognition in revised ISA 610 of all the potential uses of the internal audit function and/or internal auditors as addressed in the ISAs is important. This is to recognize the fact that the various types of use may be aimed at achieving different purposes and therefore carry different considerations required of the external auditor.

- (c) Importantly, a separate ISA on direct assistance would accord such practices a higher profile in the suite of ISA. The Task Force questioned whether this is indeed the message that the IAASB wants to convey.

⁷ IOSCO

- (d) Although addressing direct assistance in a separate ISA might more easily allow jurisdictions that do not permit such practices not to adopt that ISA, this might not be effective solution. Group auditors in such jurisdictions would nonetheless need to be aware that direct assistance may exist in other jurisdictions as it is relevant to the instructions they may need to give to component auditors for purposes of the audit.

Matter for IAASB Consideration

2. The IAASB is asked for its views regarding the placement of materials relating to direct assistance. In particular, the IAASB is asked whether its preference is to deal with direct assistance within proposed revised ISA 610 or in a separate ISA.

External Auditor's Consideration of Assessed Risk of Material Misstatement

9. In June 2011, some IAASB members expressed the view that the revised framework for the external auditor's judgments on whether, in which areas and to what extent internal auditors can be used to provide direct assistance is overly restrictive because in many cases, it would result in the limiting of such use on audit engagements solely to insignificant items of low risk. Specifically, the IAASB queried the Task Force's proposals regarding the external auditor's consideration of the assessed risk of material misstatement as follows:

- (a) The IAASB felt that a blanket prohibition of the use of internal auditors to perform procedures that are designed to respond to a significant risk of material misstatement was overly restrictive. It preferred that the external auditor be required to consider the assessed risk of material misstatement when determining the nature and extent of work that may be assigned to internal auditors providing direct assistance and the nature, timing and extent of direction, supervision and review that is appropriate in the circumstances, as well as whether judgment is involved in performing the procedures and evaluating the audit evidence gathered.

The Task Force is in agreement and proposes to clarify the relevant requirement in draft revised ISA 610 accordingly. **[See paragraph 27(b) in Agenda Item 9-C.]**

- (b) The IAASB was also concerned that the proposed prohibition on obtaining direct assistance in relation to *areas* on which the internal audit function has reported to management and those charged with governance was unduly restrictive. The IAASB discussed the example of the internal audit function having performed work and reported on inventory obsolescence. The concern raised was that, under the proposed framework, the external auditor would be prohibited from engaging the assistance of internal auditors to perform any procedures relating to inventory. Consequently, the external auditor would not be able to obtain direct assistance in inventory counts. The IAASB felt that this should continue to be permitted in the circumstances.

The Task Force proposes to clarify that the boundary is drawn where the procedures relate to *work* on which the internal audit function has already reported or will report to management or those charged with governance with which the internal auditors have been involved. **[See paragraph 28(c) in Agenda Item 9-C.]**

Matter for IAASB Consideration

3. The IAASB is asked whether it agrees with the proposals described in paragraph 9 regarding the external auditor’s consideration of the assessed risk of material misstatement when making decisions regarding the use of internal auditors to provide direct assistance.

Section C: Other Matters

Using the Work of the Internal Audit Function

10. In June 2011, the IAASB also commented on other matters relating to the external auditor’s use of the work of the internal audit function which the Task Force has considered and proposes the following:

- (a) *Application of a Systematic and Disciplined Approach.* A few IAASB members commented that one of the prerequisites for using the work of an internal audit function for purposes of the audit—application of a systematic and disciplined approach by the function, including quality control—appears to introduce the requirement for a certain level of formality to the structures of internal audit functions within entities. They believe that the use of such a phrase may inadvertently be misunderstood as precluding external auditors from using the work of internal audit functions in smaller sized entities. This is because internal audit functions in such entities are typically organized in a less formal fashion. The IAASB directed the Task Force to include guidance in revised ISA 610 to clarify that “systematic and disciplined approach” is a scalable concept that should be applied with appropriate consideration for the size and nature of the entity being audited.

The Task Force proposes guidance to explain that in determining whether the internal audit function applies a systematic and disciplined approach, the external auditor would consider whether the nature and extent of such matters as the existence, adequacy and use of formal documented internal audit procedures or guidance covering such areas as risk assessments, work programs, documentation and reporting, are commensurate with the size and circumstances of an entity. [See paragraph A12 in Agenda Item 9-C.]

- (b) *Overall Body of Work of the Internal Audit Function.* A number of IAASB members questioned the meaning of the term “body of work of the internal audit function.” Whilst supportive of the Task Force’s intent in introducing the concept, it was felt that its use in the context of revised ISA 610 needed to be clarified.

The Task Force proposes to revise the term to “*overall* body of work of the internal audit function.” The phrase is now first introduced in the “stand back” consideration of whether the extent of planned use of internal audit work is excessive, which should help to explain that this refers to the work of the internal audit function that is planned to be used by the external auditor for purposes of the audit. [See paragraphs 19 and 22 in Agenda Item 9-C.]

- (c) *Meaning of “Reperformance.”* An IAASB member raised that it is unclear whether the procedure—reperformance by the external auditor of some of the work of the internal audit function—is intended to include the external auditor’s independent execution of procedures to examine *both* items already examined by the internal audit function and other similar items not actually examined by the internal audit function. This seemed different to how the term is explained in ISA 500.⁸

The Task Force proposes guidance to explain that reperformance of some of the work originally performed by the internal audit function by the external auditor may be accomplished by examining items already examined by the internal audit function, or other similar items not actually examined by the internal audit function **[See paragraph A30 in Agenda Item 9-C.]**

- (d) *Presentation of Requirements Relating to Using Work of the Internal Audit Function.* The IAASB commented that the requirements in the sections on determining the nature and extent of work that can be used, and using the work, seemed rather complicated and directed the Task Force to consider simplifying them.

The Task Force has attempted to do this through combining and re-ordering of some paragraphs. **[See paragraphs 17-19 and 20-24 in Agenda Item 9-C.]**

Matters for IAASB Consideration

4. The IAASB is asked whether it agrees with the proposals described in paragraph 10 as follows:
- Including guidance to clarify that “systematic and disciplined approach” is a scalable concept to be applied with appropriate consideration for the size and nature of the entity being audited;
 - Introducing the term “overall body of work of the internal audit function” and including guidance to explain that it refers to the work of the internal audit function that is planned to be used by the external auditor for purposes of the audit; and
 - Clarifying that reperformance by the external auditor of some of the work of the internal audit function includes examining items already examined by the internal audit function, or other similar items not actually examined by the internal audit function.
 - Simplifying requirements relating to using work of the internal audit function.

Using Internal Auditors to Provide Direct Assistance

11. In June 2011, the IAASB also commented on further matters relating to the external auditor’s use of internal auditors to provide direct assistance which the Task Force has considered and recommends the following:
- (a) *Definition of Internal Auditor.* An IAASB member raised that defining internal auditor as “individuals that perform the activities of the internal audit function” and simultaneously

⁸ ISA 500, *Audit Evidence*, paragraph A20

using the same term to describe individuals of the internal audit function that provide direct assistance on the audit may create confusion.

The Task Force is of the view that narrowly defining internal auditors as “individuals that perform the activities of the internal audit function” is problematical given the scope of proposed revised ISA 610 is now expanded to also deal with the matter of direct assistance.⁹ The Task Force proposes to eliminate the definition of internal auditors, as it was more a statement of fact (“individuals that perform the activities of the internal audit function”) than a definition given a definition of internal audit function is now included in proposed revised ISA 610 in response to comments received on the ED. It is proposed that the ISA simply refer to “using the work of the internal audit function” and “using internal auditors provide direct assistance” in the revised ISA. **[See paragraph 13 in Agenda Item 9-C.]**

(b) *Obtaining Written Agreements from the Entity and Internal Auditors.* In June 2011, the Task Force proposes to require the external auditor to obtain the following agreements prior to using internal auditors to provide direct assistance for purposes of the audit:

- Written agreement from an appropriate representative of the entity that the internal auditors will be allowed to follow the external auditor’s instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor; and
- Written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.

Whilst the IAASB supported the Task Force’s proposals, the comment was raised that external auditor should be required to obtain such agreements in *written form*. The Task Force was in agreement and proposes revisions to ISA 610 accordingly. **[See paragraph 29 in Agenda Item 9-C.]**

Matters for IAASB Consideration

5. The IAASB is asked whether it agrees with the proposals described in paragraph 11 as follows:

- Excluding the definition of internal auditors and simply refer to “using the work of the internal audit function” and “using internal auditors provide direct assistance” in proposed revised ISA 610; and
- Requiring the external auditor to obtain the necessary agreements for using internal auditors to provide direct assistance for purposes of the audit in written form.

⁹ This is subject to the IAASB’s views on Question 2 in this Issues Paper.