

**Using the Work of Internal Auditors—  
Draft International Standard on Auditing 610 (Revised)****[Clean]**

(Effective for audits of financial statements for periods ending on or after December 15, 2013)

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International Standard on Auditing (ISA) 610 (Revised), <i>Using the Work of Internal Auditors</i>
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should be read in conjunction with ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*.

## Introduction

### Scope of this ISA

1. This International Standard on Auditing (ISA) deals with the external auditor's responsibilities if using the work of internal auditors. This includes (a) using the work of the internal audit function in obtaining audit evidence and (b) using internal auditors to provide direct assistance under the direction, supervision and review of the external auditor.
2. This ISA does not apply if the entity does not have an internal audit function with responsibilities and activities that are relevant to the audit. Even if the internal audit function has performed work that may be relevant to the audit, nothing in this ISA requires the external auditor to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor; it remains a decision of the external auditor in establishing the overall audit strategy.
3. Furthermore, the requirements in this ISA relating to direct assistance do not apply if the external auditor does not plan to use internal auditors to provide direct assistance.
4. In some jurisdictions, the external auditor may be prohibited, or restricted to some extent, by law or regulation from using the work of internal auditors. The ISAs do not override laws or regulations that govern an audit of financial statements.<sup>1</sup> Such prohibitions or restrictions will therefore not prevent the external auditor from complying with the ISAs.

### Relationship between ISA 315 (Revised) and ISA 610 (Revised)

5. Many entities establish internal audit functions as part of their internal control and governance structures. The objectives and scope of an internal audit function, the nature of its responsibilities and its organizational status, including the function's authority and accountability, vary widely and depend on the size and structure of the entity and the requirements of management and, where applicable, those charged with governance.
6. ISA 315 (Revised)<sup>2</sup> addresses how the knowledge and experience of the internal audit function can inform the external auditor's understanding of the entity and its environment and identification and assessment of risks of material misstatement. ISA 315 (Revised)<sup>3</sup> also explains 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.
7. Depending on whether the internal audit function's organizational status and relevant policies and procedures supports the objectivity of the internal auditors, the level of

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<sup>1</sup> ISA 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing*, paragraph A55

<sup>2</sup> ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*

<sup>3</sup> ISA 315 (Revised), paragraph A108

competency of the internal audit function and whether the function applies a systematic and disciplined approach, the external auditor may also be able to use the work of the internal audit function in a constructive and complementary manner. This ISA addresses the external auditor's responsibilities when, based on the external auditor's preliminary understanding of the internal audit function obtained as a result of procedures performed under ISA 315 (Revised), the external auditor expects to use the work of the internal audit function as part of the audit evidence obtained.<sup>4</sup> Such use of that work modifies the nature or timing, or reduces the extent, of audit procedures to be performed directly by the external auditor.

8. In addition, this ISA also addresses the external auditor's responsibilities if considering using internal auditors to provide direct assistance.
9. There may be individuals in an entity that perform procedures similar to those performed by an internal audit function. However, unless performed by an objective and competent function that applies a systematic and disciplined approach, including quality control, such procedures would be considered internal controls and obtaining evidence regarding the effectiveness of such controls would be part of the auditor's responses to assessed risks in accordance with ISA 330.

### **The External Auditor's Responsibility for the Audit**

10. The external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal audit function or internal auditors to provide direct assistance on the engagement. Although they may perform audit procedures similar to those performed by the external auditor, 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.<sup>5</sup> This ISA, therefore, defines the conditions that are necessary for the external auditor to be able to use the work of internal auditors. It also defines the necessary work effort to obtain sufficient appropriate evidence that the work of the internal audit function, or internal auditors providing direct assistance, is adequate for the purposes of the audit. The requirements are designed to provide a framework for the external auditor's judgments regarding the use of the work of internal auditors to prevent over or undue use of such work.

### **Effective Date**

11. This ISA is effective for audits of financial statements for periods ending on or after December 15, 2013.

### **Objectives**

12. The objectives of the external auditor, where the entity has an internal audit function and the external auditor expects to use the work of the function to modify the nature or

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<sup>4</sup> See paragraphs 15–24 of this ISA.

<sup>5</sup> ISA 200, paragraph 14

timing, or reduce the extent, of audit procedures to be performed directly by the external auditor, or to use internal auditors to provide direct assistance, are:

- (a) To determine whether the work of the internal audit function or direct assistance from internal auditors can be used, and if so, in which areas and to what extent; and having made that determination:
- (b) If using the work of the internal audit function, to determine whether that work is adequate for purposes of the audit; and
- (c) If using internal auditors to provide direct assistance, to appropriately direct, supervise and review their work.

## **Definitions**

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

- 13. Direct assistance – The use of internal auditors to perform audit procedures, under the direction, supervision and review of the external auditor.
- 14. Internal audit function – A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes. (Ref: Para. A1–A5)

## **Requirements**

### **Determining Whether, in Which Areas and to What Extent the Work of the Internal Audit Function Can Be Used**

#### *Evaluating the Internal Audit Function*

- 15. The external auditor shall determine whether the work of the internal audit function can be used for purposes of the audit by evaluating the following:
  - (a) The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors; (Ref: Para. A6–A10)
  - (b) The level of competence of the internal audit function; and (Ref: Para. A6–A10)
  - (c) Whether the internal audit function applies a systematic and disciplined approach, including quality control. (Ref: Para. A11–A12)
- 16. The external auditor shall not use the work of the internal audit function if the external auditor determines that:
  - (a) The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;
  - (b) The function lacks sufficient competence; or
  - (c) The function does not apply a systematic and disciplined approach, including quality control. (Ref: Para. A13–A15)

*Determining the Nature and Extent of Work of the Internal Audit Function that Can Be Used*

17. As a basis for determining the areas and the extent to which the work of the internal audit function can be used, the external auditor shall consider the nature and scope of the work that has been performed, or is planned to be performed, by the internal audit function and its relevance to the external auditor's overall audit strategy and audit plan. (Ref: Para. A16–A17)
18. The external auditor shall make all the significant judgments in the audit engagement and, to prevent undue use of the work of the internal audit function, the external auditor shall plan to use less of the work of the internal audit function and perform more of the work directly: (Para Ref: A16–A17)
  - (a) The higher the assessed risk of material misstatement at the assertion level with special consideration given to risks identified as significant; (Para Ref: A18–A20)
  - (b) The more judgment is involved in:
    - (i) Planning and performing relevant audit procedures; and
    - (ii) Evaluating the audit evidence gathered; (Ref: Para. A21–A22)
  - (c) The greater the threats to the objectivity of internal auditors; and
  - (d) The lower the level of competence of the internal audit function.
19. The external auditor shall also evaluate whether using the overall body of work of the internal audit function as planned would result in the external auditor being sufficiently involved, given the external auditor's sole responsibility for the audit opinion expressed. (Ref: Para. A16–A22)

**Using the Work of the Internal Audit Function**

20. If the external auditor plans to use the work of the internal audit function, the external auditor shall discuss the planned use of their work with the internal audit function as a basis for coordinating their respective activities. (Ref: Para. A23–A26)
21. The external auditor shall read the reports of the function relating to the work of the internal audit function that the external auditor plans to use to obtain an understanding of the nature and extent of audit procedures it performed and the related findings.
22. The external auditor shall perform audit procedures on the overall body of work of the internal audit function that the external auditor plans to use in order to determine its adequacy for purposes of the audit. (Ref: Para. A27–A31)
23. The nature and extent of the external auditor's audit procedures shall include some reperformance and shall be responsive to the external auditor's evaluation of the objectivity of the internal auditors and the competence of the internal audit function, the assessed risk of material misstatement and the amount of judgment involved<sup>6</sup> and shall provide a basis for evaluating whether: (Ref: Para. A27–A31)

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<sup>6</sup> See paragraph 18 of this ISA.

- (a) The work of the function is properly planned, performed, supervised, reviewed and documented;
  - (b) Sufficient appropriate evidence is obtained to enable the internal audit function to draw reasonable conclusions; and
  - (c) Conclusions reached are appropriate in the circumstances and the reports prepared by the internal audit function are consistent with the results of the work performed, demonstrating the overall quality of the function's work and the objectivity with which it has been performed.
24. The external auditor shall also evaluate whether the external auditor's conclusions regarding the internal audit function in paragraph 15 of this ISA and the determination of the nature and extent of use of the work of the internal audit function for purposes of the audit in paragraphs 18–19 of this ISA remain appropriate. (Ref: Para. A27–A31)

**Determining Whether, in Which Areas and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance**

*Determining Whether Internal Auditors Can Be Used to Provide Direct Assistance for Purposes of the Audit*

25. The external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. However, if the external auditor is permitted, and plans, to use internal auditors to provide direct assistance on the audit, the external auditor shall evaluate the threats to objectivity and the level of competence of the internal auditors who will be providing such assistance. (Ref: Para. A32–A36)
26. The external auditor shall not use an internal auditor to provide direct assistance if:
- (a) There are significant threats to the objectivity of the internal auditor; or
  - (b) The internal auditor lacks the necessary competence to perform the proposed work. (Ref: Para. A32–A36)

*Determining the Nature and Extent of Work that Can Be Assigned to Internal Auditors Providing Direct Assistance*

27. In determining the nature and extent of work that may be assigned to internal auditors and the nature, timing and extent of direction, supervision and review that is appropriate in the circumstances, the external auditor shall consider:
- (a) The external auditor's evaluation of the threats to the objectivity and level of competence of the internal auditors who will be providing such assistance;
  - (b) The assessed risk of material misstatement; and
  - (c) The amount of judgment involved in:
    - (i) Planning and performing relevant audit procedures; and
    - (ii) Evaluating the audit evidence gathered. (Ref: Para. A37–A39)

28. The external auditor shall not use internal auditors to provide direct assistance to perform procedures that:
- (a) Involves making significant judgments in the audit;
  - (b) Relate to higher assessed risks of material misstatement and require judgment in performing the relevant audit procedures or evaluating the audit evidence gathered;
  - (c) 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; or
  - (d) Relate to decisions the external auditor makes in accordance with this ISA regarding the internal audit function and the use of its work or direct assistance. (Ref: Para. A37–A39)

### **Using Internal Auditors to Provide Direct Assistance**

29. Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:
- (a) Obtain 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
  - (b) Obtain 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. (Ref: Para. A40–A41)
30. The external auditor shall direct, supervise and review the work performed by internal auditors on the engagement in accordance with ISA 220.<sup>7</sup> The nature, timing and extent of direction, supervision, and review shall recognize that the internal auditors are not independent of the entity and be responsive to the outcome of the evaluation of the factors in paragraph 27 of this ISA. The review procedures shall include the external auditor checking back to the underlying audit evidence for some of the work performed by the internal auditors. (Ref: Para. A40–A41)
31. In directing, supervising and reviewing the work performed by internal auditors, the external auditor shall remain alert for indications that the external auditor's evaluation in paragraph 25 is no longer appropriate.

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<sup>7</sup> ISA 220, *Quality Control for an Audit of Financial Statements*



## **Documentation**

32. If the external auditor uses the work of the internal audit function, the external auditor shall include in the audit documentation:
  - (a) The evaluation of the threats to the objectivity of the internal audit function and the level of competence of the internal audit function, and whether it applies a systematic and disciplined approach, including quality control;
  - (b) The nature and extent of the work used and the basis for that decision; and
  - (c) The audit procedures performed by the external auditor to evaluate the adequacy of the work used.
33. If the external auditor uses internal auditors to provide direct assistance on the audit, the external auditor shall include in the audit documentation:
  - (a) The evaluation of whether the internal audit function's organizational status and relevant policies and procedures supports the objectivity of the internal auditors, and the level of competence of the internal auditors used to provide direct assistance;
  - (b) The basis for that decision regarding the nature and extent of the work performed by the internal auditors;
  - (c) The nature and extent of the external auditor's review of the audit work in accordance with ISA 230;
  - (d) The written agreements obtained from an appropriate representative of the entity and the internal auditors under paragraph 29 of this ISA; and
  - (e) The working papers prepared by the internal auditors who provided direct assistance on the audit engagement.

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## **Application and Other Explanatory Material**

### **Definition of Internal Audit Function** (Ref: Para. 14)

- A1. The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control such as the following:

#### Activities relating to governance

- The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.

Activities relating to risk management

- The internal audit function may assist the entity by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and internal control (including effectiveness of the financial reporting process).
- The internal audit function may perform procedures to assist the entity in the detection of fraud.

Activities relating to internal control

- Evaluation of internal control. The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control. For example, the internal audit function might plan and perform tests or other procedures to provide assurance to management and those charged with governance regarding the design, implementation and operating effectiveness of internal controls, including those that are relevant to the audit.
  - Examination of financial and operating information. The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.
  - Review of operating activities. The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non-financial activities of an entity.
  - Review of compliance with laws and regulations. The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.
- A2. Activities similar to those performed by an internal audit function may be conducted by functions with other titles within an entity. Some or all of the activities of an internal audit function may also be outsourced to a third-party service provider. Neither the title of the function, nor whether it is performed by the entity or a third-party service provider, are sole determinants of whether or not the external auditor can use the work of the internal audit function. Rather, it is the nature of the activities, and the objectivity and competence, and systematic and disciplined approach of the function that are relevant. References in this ISA to the work of the internal audit function include relevant activities of other functions or third party providers that have these characteristics.
- A3. In addition, those in the entity with operational and managerial duties and responsibilities outside of the internal audit function would ordinarily face threats to their objectivity that would preclude them from being treated as part of an internal audit function for the purpose of this ISA, although they may perform control activities that can be tested in

accordance with ISA 330.<sup>8</sup> For this reason, monitoring controls performed by an owner-manager would not be considered equivalent to an internal audit function.

- A4. While the objectives of an entity's internal audit function and the external auditor differ, the function may perform audit procedures similar to those performed by the external auditor in an audit of financial statements. If so, the external auditor may make use of the function for purposes of the audit in one or more of the following ways:
- To obtain information that is relevant to the external auditor's assessments of the risks of material misstatement due to error or fraud. In this regard, ISA 315 (Revised)<sup>9</sup> requires the external auditor to obtain an understanding of the nature of the internal audit function's responsibilities, its status within the organization, and the activities performed, or to be performed, and make inquiries of appropriate individuals within the internal audit function (if the entity has such a function); or
  - Unless prohibited, or restricted to some extent, by law or regulation, the external auditor, after appropriate evaluation, may decide to use work that has been performed by the internal audit function during the period in partial substitution for audit evidence to be obtained directly by the external auditor.<sup>10</sup>

In addition, unless prohibited, or restricted to some extent, by law or regulation, the external auditor may use internal auditors to perform audit procedures under the direction, supervision and review of the external auditor (referred to as direct assistance in this ISA).<sup>11</sup>

- A5. This ISA describes the conditions which have to be met in order for the external auditor to be able to use results of those audit procedures as part of the audit evidence obtained for the external audit.

### **Determining Whether, in Which Areas and to What Extent the Work of the Internal Audit Function Can Be Used**

#### *Evaluating the Internal Audit Function*

##### Objectivity and Competence (Ref: Para. 15(a)–(b))

- A6. The external auditor exercises professional judgment in determining whether the work of the internal audit function can be used for purposes of the audit, and the nature and extent to which the work of the internal audit function can be used in the circumstances.
- A7. The threats to the objectivity of internal auditors and the level of competence of the internal audit function are particularly important in determining whether to use, and if so, the nature and extent of the use of the work of the internal audit function that is appropriate in the circumstances.

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<sup>8</sup> See paragraph 9 of this ISA.

<sup>9</sup> ISA 315 (Revised), paragraph 6(a)

<sup>10</sup> See paragraphs 15–24 of this ISA.

<sup>11</sup> See paragraphs 25–31 of this ISA.

- A8. Objectivity refers to the ability to perform those tasks without allowing bias, conflict of interest or undue influence of others to compromise professional judgments. Factors that may affect the external auditor's evaluation include the following:
- Whether the organizational status of the internal audit function, including the function's authority and accountability, supports the ability of the function to be free from bias, conflict of interest or undue influence of others to override professional judgments. For example, whether the internal audit function reports to those charged with governance or an officer with appropriate authority, or if the internal audit function reports to management, whether the internal audit function has direct access to those charged with governance.
  - Whether the internal audit function is free of any conflicting responsibilities for example, having managerial or operational duties or responsibilities that are outside of the internal audit function.
  - Whether those charged with governance oversee employment decisions related to the internal audit function for example, determining the appropriate remuneration policy.
  - Whether there are any constraints or restrictions placed on the internal audit function by management or those charged with governance for example, in communicating internal audit findings to the external auditor.
  - Whether the internal auditors are members of relevant professional bodies and their memberships obligate their compliance with relevant professional standards relating to objectivity, or whether their internal policies achieve the same objectives.
- A9. Competence of the internal audit function refers to the attainment and maintenance of knowledge and skills of the function as a whole at the level required to enable assigned tasks to be performed diligently and in accordance with applicable professional standards. Factors that may affect the external auditor's determination include the following:
- Whether the internal audit function is adequately and appropriately resourced relative to the size of the entity and the nature of its operations.
  - Whether there are established policies for hiring, training and assigning internal auditors to internal audit engagements.
  - Whether the internal auditors have adequate technical training and proficiency in auditing. Relevant criteria which may be considered by the external auditor in making the assessment may include for example, the internal auditors' possession of a relevant professional designation and experience.
  - Whether the internal auditors possess the required knowledge relating to the entity's financial reporting and the applicable financial reporting framework and whether the internal audit function possesses the necessary skills (for example, industry-specific knowledge) to perform work related to the entity's financial statements.

- Whether the internal auditors are members of relevant professional bodies that oblige them to comply with the relevant professional standards including continuing professional development requirements.
- A10. Objectivity and competence may be viewed as a continuum. The lower the threats to the objectivity of internal auditors and the higher the level of competence of the internal audit function, the more likely the external auditor may make use of the work of the internal audit function and in more areas. However, the absence of any threats to the objectivity of internal auditors cannot compensate for the lack of sufficient competence of the internal audit function. Equally, a high level of competence of the internal audit function cannot compensate for the presence of significant threats to the objectivity of internal auditors.

Application of a Systematic and Disciplined Approach (Ref: Para. 15(c))

- A11. The application of a systematic and disciplined approach to planning, performing, supervising, reviewing and documenting its activities distinguishes the activities of the internal audit function from other monitoring control activities that may be performed within the entity.
- A12. Factors that may affect the external auditor's determination of whether the internal audit function applies a systematic and disciplined approach include the following:
- The existence, adequacy and use of documented internal audit procedures or guidance covering such areas as risk assessments, work programs, documentation and reporting, the nature and extent of which is commensurate with the size and circumstances of an entity.
  - Whether the internal audit function has appropriate quality control policies and procedures for example, such as those policies and procedures in ISQC 1<sup>12</sup> that would be applicable to an internal audit function (such as those relating to leadership, human resources and engagement performance) or quality control requirements in standards set by the relevant professional bodies for internal auditors. Such bodies may also establish other appropriate requirements such as conducting of periodic external quality assessments.

Circumstances When Work of the Internal Audit Function Cannot Be Used (Ref: Para. 16)

- A13. The external auditor's evaluation of the threats to the objectivity and the level of competence of the function, and whether it applies a systematic and disciplined approach, may indicate that the risks to the quality of the work of the function are too significant and therefore it is not appropriate to use any of the work of the function as audit evidence.
- A14. Consideration of the factors in paragraphs A8, A9 and A12 of this ISA individually and in aggregate is important because an individual factor is often not sufficient to conclude that the work of the internal audit function cannot be used for purposes of the audit. For

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<sup>12</sup> International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

example, the internal audit function's organizational status is particularly important in evaluating the threats to the objectivity of the internal auditors. If the internal audit function reports to management, this would be considered a significant threat to the function's objectivity unless other factors such as those described in paragraph A8 of this ISA, collectively provide sufficient safeguards to reduce the threat to an acceptable level.

- A15. In addition, the IESBA Code<sup>13</sup> states that a self-review threat is created when the external auditor accepts an engagement to provide internal audit services to an audit client, and the results of those services will be used in conducting the audit. This is because of the possibility that the engagement team will use the results of the internal audit service without properly evaluating those results or without exercising the same level of professional skepticism as would be exercised when the internal audit work is performed by individuals who are not members of the firm. The IESBA Code<sup>14</sup> discusses the prohibitions that apply in certain circumstances and the threats and the safeguards that can be applied to reduce the threats to an acceptable level in other circumstances.

*Determining the Nature and Extent of Work of the Internal Audit Function that Can Be Used*

Factors Affecting the Determination of the Nature and Extent of the Work of the Internal Audit Function that Can Be Used (Ref: Para. 17–19)

- A16. Once the external auditor has determined that the work of the internal audit function can be used for purposes of the audit, a first consideration is whether the planned nature and scope of the work of the internal audit function that has been performed, or is planned to be performed is relevant to the overall audit strategy and audit plan that the external auditor has established in accordance with ISA 300.
- A17. The external auditor's determination of the planned nature and extent of use of the work of the internal audit function will be influenced by the external auditor's evaluation of the threats to the objectivity of internal auditors and the level of competence of the internal audit function in paragraph 18 of this ISA. In addition, the assessed risk of material misstatement at the assertion level and the amount of judgment needed in planning, performing and evaluating such work are inputs to the external auditor's determination. Further, there are circumstances in which the external auditor cannot use the work of the internal auditor function for purpose of the audit as described in paragraph 16 of this ISA.

*Assessed risk of material misstatement*

- A18. For a particular account balance, class of transaction or disclosure, the higher an assessed risk of material misstatement at the assertion level, the more judgment is often involved in planning and performing the audit procedures and evaluating the results thereof. In such circumstances, the external auditor will need to perform more procedures directly in accordance with paragraph 18 of this ISA, and accordingly, make less use of the work of the internal audit function in obtaining sufficient appropriate audit evidence. Furthermore, as

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<sup>13</sup> The IESBA's *Code of Ethics for Professional Accountants* (IESBA Code), Section 290.199

<sup>14</sup> IESBA Code, Section 290.195- 290.200

explained in ISA 200,<sup>15</sup> the higher the assessed risks of material misstatement, the more persuasive the audit evidence required by the external auditor will need to be, and, therefore, the external auditor will need to perform more of the work directly.

- A19. As explained in ISA 315 (Revised),<sup>16</sup> significant risks require special audit consideration and therefore the external auditor's ability to use the work of the internal audit function in relation to significant risks will be limited to procedures that involve limited judgment. In addition, where the risks of material misstatement is other than low, the use of the work of the internal audit function alone is unlikely to reduce audit risk to an acceptably low level and eliminate the need for the external auditor to perform some tests of those assertions directly.
- A20. Carrying out procedures in accordance with this ISA may cause the external auditor to re-evaluate the external auditor's assessment of the risks of material misstatement. Consequently, this may affect the external auditor's determination of whether to use the work of the internal audit function and whether further application of this ISA is necessary.

#### Judgments in planning and performing audit procedures and evaluating results

- A21. The greater the judgment needed to be exercised in planning and performing the audit procedures and evaluating the audit evidence, the external auditor will need to perform more procedures directly in accordance with paragraph 18 of this ISA, because using the work of the internal audit function alone will not provide the external auditor with sufficient appropriate audit evidence.
- A22. Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement in accordance with paragraph 18. Significant judgments include the following:
- Assessing the risks of material misstatement;
  - Evaluating the sufficiency of tests performed;
  - Evaluating the appropriateness of management's use of the going-concern assumption;
  - Evaluating significant accounting estimates; and
  - Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor's report.

#### Using the Work of the Internal Audit Function

##### *Discussion and Coordination with the Internal Audit Function* (Ref: Para. 20)

- A23. In discussing the planned use of their work with the internal audit function as a basis for coordinating the respective activities, it may be useful to address the following:
- The timing of such work

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<sup>15</sup> ISA 200, paragraph A29

<sup>16</sup> ISA 315 (Revised), paragraph 4(e)

- The nature of the work performed
  - The extent of audit coverage
  - Materiality for the financial statements as a whole (and, if applicable, materiality level or levels for particular classes of transactions, account balances or disclosures), and performance materiality
  - Proposed methods of item selection and sample sizes
  - Documentation of the work performed
  - Review and reporting procedures
- A24. Coordination between the external auditor and the internal audit function is effective when for example:
- Discussions take place at appropriate intervals throughout the period;
  - The external auditor informs the internal audit function of significant matters that may affect the internal audit function;
  - The external auditor is advised of and has access to relevant internal audit reports and is informed of any significant matters that come to the attention of the internal audit function when such matters may affect the work of the external auditor so that the external auditor is able to consider the implications of such matters for the audit engagement; and
- A25. ISA 200<sup>17</sup> discusses the importance of the auditor planning and performing the audit with professional skepticism, including being alert to information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence. Accordingly, 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.<sup>18</sup> 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. In addition, 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.<sup>19</sup>
- A26. In accordance with ISA 260,<sup>20</sup> the external auditor communicates with those charged with governance an overview of the planned scope and timing of the audit. In doing so, the external auditor may discuss how the external auditor has planned to use the work of the internal audit function in a constructive and complementary manner.

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<sup>17</sup> ISA 200, paragraphs 15 and A18

<sup>18</sup> ISA 315(Revised), A108

<sup>19</sup> ISA 315(Revised), A11

<sup>20</sup> ISA 260, *Communication with Those Charged with Governance*, paragraph 15



*Procedures to Determine the Adequacy of Work of the Internal Audit Function* (Ref: Para. 22–24)

A27. Examples of work of the internal audit function that can be used by the external auditor include the following:

- Testing of the operating effectiveness of controls
- Substantive procedures involving limited judgment
- Observations of inventory counts
- Tracing transactions through the information system relevant to financial reporting
- Testing of compliance with regulatory requirements
- In some circumstances, audits or reviews of the financial information, of subsidiaries that are not significant components to the group (where this does not conflict with the requirements of ISA 600<sup>21</sup>)

A28. The procedures the external auditor may perform to evaluate the quality of the work performed and the conclusions reached by the internal audit function in addition to reperformance in accordance with paragraph 23 include the following:

- Making inquiries of appropriate individuals within the internal audit function
- Observing procedures performed by the internal audit function
- Reviewing the internal audit function's work program and working papers

A29. The nature and extent of the audit procedures that the external auditor performs on the overall body of work of the internal audit function used in order to have a sufficient basis for the use of that work will depend on the external auditor's evaluation of:

- The amount of judgment exercised by the internal audit function in planning and performing relevant audit procedures for particular classes of transactions, account balances and disclosures;
- Threats to the objectivity of internal auditors; and
- The level of competence of the internal audit function.

The greater the threats to the objectivity of internal auditors or the lower the level of competence of the internal audit function, or the more judgment involved, the more audit procedures are needed to be performed by the external auditor to support the decision to use the work of the internal audit function in obtaining sufficient appropriate audit evidence on which to base the audit opinion.

A30. Reperformance involves the external auditor's independent execution of procedures that were originally performed by the internal audit function. It 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. Reperformance provides more persuasive evidence

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<sup>21</sup> ISA 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*

regarding the adequacy of the work of the internal audit function compared to other procedures the external auditor may perform in paragraph A28. While it is not necessary for the external auditor to do reperformance in each area of work of the internal audit function that is being used, some reperformance is required on the overall body of work of the internal audit function that the external auditor plans to use in accordance with paragraph 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.

- A31. In determining the adequacy of the work performed by the internal audit function, the external auditor may consider whether any exceptions or unusual matters communicated by the function such as misstatements or control deficiencies are properly addressed by the entity and in the event they are not, whether the internal audit function followed-up on these matters.

### **Determining Whether, in Which Areas and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance**

*Determining Whether Internal Auditors Can Be Used to Provide Direct Assistance for Purposes of the Audit* (Ref: Para. 25–26)

- A32. The external auditor may obtain direct assistance from the internal auditors to carry out audit procedures which otherwise would be performed directly by the external auditors themselves. In such circumstances, the internal auditors are under the direction, supervision and review of the external auditor.
- A33. In accordance with ISA 260,<sup>22</sup> the external auditor communicates with those charged with governance an overview of the planned scope and timing of the audit. In doing so, the external auditor may discuss matters such as the planned use of direct assistance.
- A34. In accordance with paragraph 25 of this ISA, the external auditor evaluates the threats to the objectivity and the level of competence of the internal auditors who are used to provide direct assistance on the audit before assigning them to specific tasks.
- A35. As stated in paragraph A8 of this ISA, objectivity refers to the ability to perform the proposed work without allowing bias, conflict of interest or undue influence of others to compromise professional judgments. Factors that may affect the external auditor's evaluation of threats to the objectivity of an internal auditor include the following:
- Family and personal relationships
  - Association with the division in the entity to which the work relates
  - Financial interests that are exceptional in the circumstances
- A36. In evaluating the level of competence of an internal auditor, many of the factors in paragraph A9 of this ISA may also be relevant but in the context of individual internal auditors and the work to which they may be assigned.

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<sup>22</sup> ISA 260, *Communication with Those Charged with Governance*, paragraph 15

*Determining the Nature and Extent of Work that Can Be Assigned to Internal Auditors Providing Direct Assistance* (Ref: Para. 27–28)

- A37. Paragraphs A16–A22 of this ISA provide relevant guidance in determining the nature and extent of work that may be assigned to internal auditors.
- A38. In determining the nature of work that may be assigned to internal auditors, the external auditor is careful to limit such work to those areas that would be appropriate to be assigned. Examples of activities and tasks that would not be appropriate to use internal auditors to provide direct assistance include the following:
- Discussion of fraud risks. However, the external auditors may make inquiries of internal auditors about fraud risks in the organization in accordance with ISA 315 (Revised)<sup>23</sup>
  - Discussion of matters relating to the audit opinion
  - Determination of locations for inventory counts
  - Determination of unannounced audit procedures as addressed in ISA 240
- A39. Similarly, since in accordance with ISA 505<sup>24</sup> the external auditor is required to maintain control over external confirmation requests and evaluate the results of external confirmation procedures, it would not be appropriate to assign these responsibilities to internal auditors. However, internal auditors may assist in assembling information necessary for the external auditor to resolve exceptions in confirmation responses.

**Using Internal Auditors to Provide Direct Assistance** (Ref: Para. 29–30)

- A40. The direction, supervision and review by the external auditor of the audit procedures performed by the internal auditors need to be sufficient in order for the external auditor to be satisfied that the internal auditors have obtained sufficient appropriate audit evidence to support the conclusions based on that work. As individuals in the internal audit function are not independent of the entity as is required of the external auditor when expressing an opinion on financial statements, the external auditor's involvement in these circumstances will generally be of a different nature and more extensive than if members of the engagement team perform the work.
- A41. The nature, timing and extent of direction, supervision and review of the audit procedures performed by the internal auditors is also dependent on the outcome of the external auditor's evaluation of the threats to the objectivity and the level of competence of, and the nature and extent of audit procedures to be performed by, the internal auditors. In directing the internal auditors, the external auditor may for example, remind the internal auditors to bring all significant accounting and auditing issues identified during the audit to the attention of the external auditor. In reviewing the work performed by the internal auditors, the external auditor's considerations include whether the evidence obtained is

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<sup>23</sup> ISA 315 (Revised), paragraph 6(a)

<sup>24</sup> ISA 505, paragraphs 7 and 16

sufficient and appropriate in the circumstances, and that it supports the conclusions reached.