



International Federation of Accountants

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Agenda Item

Q

Committee: IAASB Consultative Advisory Group

Meeting Location: Dubai

Meeting Date: March 9 – 10, 2009

Project Proposal – Revision of ISA 610 (Redrafted), “Using the Work of Internal Auditors”

A. Objectives of Agenda Item

1. To review key matters identified in the Project Proposal to be discussed by the IAASB at its March 2009 meeting.

B. Background and Relevant Developments

Background

2. The extant ISA 610¹ was last revised in March 1994. Conforming amendments were made to the standard when the IAASB issued the audit risk standards (ISAs 315,² 330,³ and 500⁴) in October 2003.
3. As part of the IAASB’s Clarity project, the extant ISA 610 was redrafted for conformity with the Clarity drafting conventions. The IAASB issued ISA 610 (Redrafted)⁵ in October 2008.

Relevant Developments

4. During the redrafting of the extant ISA 610 a number of respondents drew the IAASB’s attention to the need to revise the ISA to better reflect the current internal auditing environment. The Institute of Internal Auditors (IIA), for example, saw a need to clarify further the roles and responsibilities of internal auditors in the context of the external audit. The Basel Committee was also of the view that consideration should be given to the increased reliance that external auditors place on the work of internal auditors and to situations when the internal audit function is outsourced. Other respondents noted that the provision of direct assistance by internal auditors to the external auditor is a current and important issue that is not presently addressed.

¹ ISA 610, “Considering the Work of Internal Audit.”

² ISA 315, “Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement.”

³ ISA 330, “The Auditor’s Procedures in Response to Assessed Risks.”

⁴ ISA 500, “Audit Evidence.”

⁵ ISA 610 (Redrafted), “Using the Work of Internal Auditors.”

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5. The IAASB took these comments into account in developing its future strategy, and therefore included a proposal to revise ISA 610 (Redrafted) in its work program for 2009-2011.⁶ Many respondents to the strategy consultations and the IAASB Consultative Advisory Group were supportive of this proposal. So too were representatives of national auditing standard setters (NSS) at the March 2008 IAASB-NSS meeting. This project will therefore research the issues that have been highlighted by the stakeholders, and identify and close any gaps that may currently exist in the ISA literature with regard to the external auditor's consideration and use of the internal auditors' work.

See paragraphs 4-10 of Agenda Item 4-A of the March 2009 IAASB meeting material for further information about calls from stakeholders, developments in the internal audit function and developments in national auditing standards.

C. Project Objectives and How They Serve the Public Interest

Project Objective

6. The objective of this project is to revise ISA 610 (Redrafted) to reflect developments in the internal auditing environment and changes in practice regarding the interactions between the external and internal auditors. Key aspects to be addressed by the project include determining the matters to be taken into account when considering whether, and to what extent external auditors should, i) use the work of the internal auditors and ii) engage the direct assistance of internal auditors, and the manner in which external auditors should interact with internal auditors during the audit.

How the Project Objectives Serve the Public Interest

7. This objective is intended to serve the public interest by producing an ISA on the external auditor's use of, and interaction with, the internal auditors whilst at the same time ensuring that external auditors only use the work of internal auditors or engage their assistance⁷ when appropriate to do so and undue reliance is not placed. Such an ISA will increase the effectiveness of the external audit through such ways as enhanced risk identification and fraud prevention and detection.

D. Outline of the Project

Project Scope

8. The scope of this project is the development of enhanced requirements and guidance on the external auditor's use of internal auditors in regard to the external audit and the work of internal auditors, building to the extent practicable on the text of extant ISA 610 (Redrafted). Consideration will be given to developments in the internal auditing environment that may have implications for the external audit.

⁶ IAASB 2009-2011 Strategy and Work Program.

⁷ Subject to the expansion of the scope of the ISA in this regard.

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Major Problems and Key Issues that Will Be Addressed

9. Key matters expected to be dealt with include:

INTERACTIONS BETWEEN THE EXTERNAL AND INTERNAL AUDITORS

Using the Work of the Internal Auditor

10. Consideration will be given to whether and how the internal auditors' knowledge of the organization and expertise in risk and control can be used by the external auditors to achieve greater efficiency and effectiveness in the conduct of the audit. The project will also consider the appropriateness of requiring external auditors to use, to the extent possible, the work of the internal auditors, subject to the external auditor being satisfied with the objectivity and competence of the internal auditors. In this respect, the project will consider the relevance of the approach of the PCAOB's AS 5,⁸ which encourages the external auditor to use the work of the internal auditor, and emphasizes consideration of the requirements and guidance in the PCAOB's AU section 322.
11. Related to this matter, consideration will be given to the need to address the question of how internal audit fits within the concept of internal control insofar as the internal control requirements in ISAs 315 (Redrafted) and 330 (Redrafted) are concerned. In particular, matters which may be considered include the following:
- Whether internal auditors are part of the internal control environment;
 - Whether the work done by internal auditors (e.g. substantive testing) represents a control; and
 - To what extent the external auditors may take into account such matters in their control assessments.

Cooperation between the External and Internal Auditors

12. Consideration will be given to whether it would be appropriate to broaden the scope of the ISA beyond the consideration of *whether* the external auditor should use the work of internal auditors to include considerations relating to *how* internal and external auditors should cooperate during the conduct of the audit.⁹ Some aspects which may be considered in the project include:
- Nature of cooperation between the external auditor and internal auditor.

⁸ PCAOB's Auditing Standard No. 5, "An Audit of Internal Control Over Financial Reporting That is Integrated with an Audit of Financial Statements." This Standard establishes requirements and provides guidance relating to an audit of management's assessment of the effectiveness of internal control over financial reporting that is integrated with an audit of the financial statements as opposed to an audit of financial statements.

⁹ Proposals in this regard would be subject to the remit of the ISAs which does not extend to internal auditors.

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- Information sharing between the external auditor and internal auditor during the various stages of the external audit.
- Arrangements with regard to the external auditor's access to the work of the internal auditor.

Using Internal Auditors to Provide Direct Assistance to the External Auditor

13. Consideration will be given to the work that internal auditors nowadays perform, and the extent and manner, to which the external auditors should rely on the work of internal auditors in practice if at all. In connection to this, ISA 610 (Redrafted) currently does not address circumstances when internal auditors are used to provide direct assistance to the external auditor to carry out audit procedures. Accordingly, consideration will be given to whether the scope of the ISA should be expanded to include such situations. If the provision of direct assistance by internal auditor to the external auditor is considered to be appropriate, consideration will be given to matters that should be taken into account prior to, and standards that should apply to such use, as well as any practical implications.
14. If the scope of the ISA is expanded to address situations where the internal auditor provides direct assistance to the external auditor by carrying out audit procedures, it will be necessary to consider ethical issues that may arise. Under the IFAC *Code of Ethics for Professional Accountants*, members of the audit team cannot be employees of the client. In this regard, the IESBA will be consulted as appropriate.

Standards and Guidance of the Institute of Internal Auditors

15. While accepting that not all internal audit functions will necessarily be conducted in accordance with IIA's standard and guidance, the project will consider whether any inconsistencies exist between ISA 610 (Redrafted) and the IIA's standards and guidance in relation to references to internal audit activities, and how, if deemed necessary, such inconsistencies should be resolved. For example, the IIA's standards and guidance make reference to an appropriately approved Internal Audit Charter and accordingly, consideration will be given to whether ISA 610 (Redrafted) should address the need for the external auditor to review the internal audit charter if it exists in order to obtain an understanding of the status and scope of the internal audit function in the entity.

See paragraphs 14-21 of Agenda Item 4-A of the March 2009 IAASB meeting material for further discussion of other matters that respondents have noted during the redrafting of the extant ISA.

Impact Assessment Considerations

16. The primary benefit of this project stems from the improvements that may be made to the interactions between the external auditor and the internal auditor subject to the external auditors not putting undue reliance on internal auditors. Further, if it is considered appropriate for the scope of the ISA to be expanded to address external auditors' use of

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internal auditors to provide direct assistance, there may be efficiencies to be gained, subject to appropriate controls over the basis for the external auditor's use of such work.

17. As this project has the potential to impact other relevant IAASB standards and guidance, there may be implications for the cost of the audit as it relates to the auditor and the entity. However, as the internal audit function tends to exist only in the larger entities, any cost increases would not be expected to be significant relative to the overall cost of the external audit. It is anticipated that the revised standard will have minimal impact on smaller practitioners if at all.
18. IFAC is currently developing an impact assessment framework for its standard setting bodies. The question of whether this project or another to use as a test case for this purpose will be discussed at the March 2009 IAASB meeting.

E. Implications for Any Specific Persons or Groups

19. The project has particular implications for the following:
 - (a) The IESBA, to the extent that consultations will be necessary on matters that may arise during the revision of the ISA which have linkages to the *Code of Ethics for Professional Accountants*.
 - (b) The IIA, to the extent that consideration will be given to the need to address inconsistencies between the ISA and the IIA's standards and guidance. Inputs from the IIA will be sought in regard to the relevant matters that may arise during the revision of the ISA.
 - (c) Internal auditors, to the extent that the ISA may facilitate greater interaction and cooperation between external and internal auditors where appropriate.
 - (d) International regulatory organizations such as the Basel Committee on Banking Supervision, the Committee of European Banking Supervisors and the International Organization of Securities Commissions.
 - (e) National standards setters who have adopted ISAs, or use them as a basis for their own standards.

F. Development Process, Public Consultation, Project Timetable and Project Output

20. It is anticipated that the project will follow the normal developmental process of the IAASB for revising an ISA. Approval of proposed revised ISA 610 is tentatively scheduled for December 2001. It is anticipated that the revised ISA 610 would be effective for audits of financial statements beginning on or after December 15, 2012. This would be consistent with the IAASB's commitment to have no new standards effective for 2 years after the implementation of the clarified ISAs.

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See paragraphs 26-31 of Agenda Item 4-A of the March 2009 IAASB meeting material for further discussion.

G. Resources Required, and Relevant Sources of Information

21. A project Task Force will be created, consisting of 4-5 individuals, including Diana Hillier, IAASB Member as Chair of the Task Force. Due to the project's linkage with the *Code of Ethics for Professional Accountants*, the IESBA will be invited to nominate a member to the Task Force.
22. Consideration will also be given to the need for relevant expertise, in particular internal audit expertise. The IIA has nominated a representative to participate in the Task Force.
23. IAASB technical staff will provide support to the project Task Force.

See Section VIII of Agenda Item 4-A of the March 2009 IAASB meeting material for relevant sources of information.

Material Presented – IAASB CAG REFERENCE PAPERS ONLY

Agenda Item 4-A of the March 2009 IAASB
Meeting – Project Proposal – Revision of ISA
610

<http://www.ifac.org/IAASB/Meeting-FileDL.php?FID=4611>