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November 1, 2018

Mr. Arnold Schilder, Chairman  
International Auditing and Assurance Standards Board

Dear Arnold,

The Institute of Internal Auditors (IIA) is pleased to share feedback on the International Auditing and Assurance Standards Board's *Proposed International Standards on Auditing 315 (Revised)*.

The IIA has supported sound governance and effective risk management in public- and private-sector organizations for more than 75 years. With more than 190,000 members worldwide, The IIA is part of a global voice that encourages strong internal controls and an enterprisewide approach to risk management.

The IIA encourages a strong and symbiotic association with external audit, as part of organizational efforts to ensure the accuracy of financial reporting and to support external audit's efforts to identify and assess the risk of material misstatement.

Although the following response does not follow the question-and-answer format identified in Section 4 Request for Comment, its content does apply to questions 4 and 6 generally and most particularly to 5(a), 5(b) and 9(d).

No discussion of ISA 315 can ignore its close association to ISA 610. The latter includes direction for evaluating the extent to which external audit should rely on the work of internal audit. This includes taking account of internal audit's **objectivity<sup>1</sup>, competency, approach and quality control**.

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<sup>1</sup> The internal audit function's ability to act independently in order to provide objective assurance is what is being tested. The IIA prefers "independence," and subsequent references will use "independence" in this context.

Simply put, external auditors can and should rely on the work of internal audit when the internal audit function is independent, appropriately resourced, and follows The IIA's *International Standards for the Professional Practice of Internal Auditing*. Therefore, the sole test of the reliability of internal audit's work should focus on conformance to the *Standards*, including assessing the function's status within the organization.

The fundamental purpose of the *Standards* is to provide practitioners with guidance and direction for successfully performing professional internal auditing. The *Standards*, part of the *International Professional Practices Framework* (IPPF), includes attribute standards that address both individual and organizational **independence** and **objectivity** (Standards 1100, 1110, 1112, 1120, 1130), **proficiency** and **due professional care** (Standards 1200, 1210, 1220), and **quality assurance** (Standards 1300, 1310, 1311, 1312, 1320, 1321, 1322).

Additionally, The IIA's performance standards further direct practitioners on managing the internal audit activity, as well as planning and executing engagements. Implementation guidance provides additional direction on applying the *Standards*. This comprehensive, tested, and proven set of professional canons provides what practitioners need to conduct high-quality internal audit and should be the only measure of internal audit independence, objectivity, competency, and quality. The IIA urges IAASB to reconsider its direction to external auditors regarding reliance on the work of internal audit by specifically focusing on three areas:

- Conformance to IIA *Standards* is fundamental to internal audit competency and quality and, therefore, should be the only barometer of whether internal audit can be relied on. Otherwise, the test is at best subjective and at worst runs the risk of a perception of self-interest.
- Recognizing audit committee oversight relating to internal and external audit operations is integral to understanding internal audit's status in the organization.
- Reviewing the possibility that ISA 315 (revised) and ISA 610 (revised), as currently constituted, could create a perception of self-interest bias by the external auditor in the public's view.

These three points are further examined below.

### **Conformance to IIA *Standards***

The work of external audit — providing assurance on the accuracy of financial reporting — is a complex operation. Adding to the challenge, external auditors face increasing pressure from boards, regulators and activist investors to identify material weaknesses in internal controls.

A generally accepted definition of material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis.

Identifying such weaknesses requires a thorough and sophisticated understanding of internal control within the organization. Internal audit's place as an independent and ongoing assurance provider on internal controls across the organization makes it the default expert. In its limited and periodic review

role, external audit cannot be expected to have as comprehensive an understanding of internal control.

Conformance to IIA *Standards*, as well as other components of the IPPF, endorses that the function is independent, is operating to a strict code of ethics and defined professional standards, undergoes periodic internal and external quality assessments, and its staff is trained to specified standards of educational and continued professional development.<sup>2</sup>

In addition, using the work of internal audit should not be a reactive or ad hoc process. There is scope for internal and external audit to communicate plans in such a way as to coordinate activity with a view to supporting and assisting each other as appropriate. When properly planned, this cooperation and the benefits it promotes do not affect the independence of either party.

Research by the Center for Audit Quality and The IIA in 2014 concluded that collaboration among the audit committee, internal audit and external audit help organizations succeed.

*“Successful organizations will recognize the importance of building and sustaining effective relationships among the audit committee, those responsible for the internal audit function, and the external auditor. There are efficiencies and enhancements that can be realized in risk assessment, risk management, and in the performance of the external audit, while respecting each stakeholder’s roles and responsibilities in accordance with professional standards.”<sup>3</sup>*

## **The Role of the Audit Committee**

As mentioned previously, ISA 315 and ISA 610 identify an evaluation of internal audit’s independence, competence, approach, and quality control as the basis for determining whether its work can be trusted. However, this direction fails to account for the significant role the audit committee plays in determining the efficacy of both internal audit and external audit.

Audit committee oversight of both internal audit and external audit affects how assurance is provided to the organization. Audit committee support is vital to internal audit independence, scope, and resources.

Therefore, any evaluation of the internal audit function must include an examination of whether the audit committee is fulfilling its oversight responsibilities. It is this oversight that ensures the independence of both internal audit and external audit, by:

- Ensuring adequate resourcing.
- Coordinating and aligning the internal audit plan and external audit engagements.
- Appointing and evaluating the need for periodic rotation of the external auditors.
- Hiring, firing and compensation matters relating to the chief audit executive (CAE).
- Performing due diligence to ensure the competence of internal auditors and external auditors.
- Considering reports received from internal auditors and external auditors.

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<sup>2</sup> IIA Position Paper, *Why Conformance Matters: Meeting Internal Audit Standards Key to Providing True Assurance*®

<sup>3</sup> INTERSECTING ROLES: Fostering Effective Working Relationships Among External Audit, Internal Audit, and the Audit Committee®

## Self-interest Concerns

Finally, the IAASB should consider two potential hazards associated with the current approach to determining the reliability of internal audit's work: variability across the profession in how evaluations are made (due to the current absence of objective, defined criteria), and subjectivity in an individual external auditor's evaluation. These could contribute to the threat, or appearance, of self-interest bias because a determination that the work of internal audit is unreliable increases the amount of work and related fees required by external audit.

This risk of self-interest bias is compounded by direction in ISA 315 and ISA 610 that precludes the use of some of internal audit's work out of hand.

“... the external auditor's ability to use the work of the internal audit function in relation to significant risks will be restricted to procedures that involve limited judgement. 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 directly.”<sup>4</sup>

This default position regarding significant areas of risk itself creates unintended risk by dismissing internal audit's work outright and renders any evaluation of the function's objectivity, competency, approach, and quality moot.

If anything, this is the area where internal audit's work should be most valued. As mentioned earlier, internal audit's place as an independent assurance provider on internal controls across the organization makes it the default expert. Indeed, risk-based internal auditing by definition is built on providing assurance on risk management and internal control. Internal audit planning, resource allocation and focus — in close consultation with senior management and the board — are driven by the significance and likelihood of these risks.

Once reliability has been determined — based on conformance to IIA *Standards* and an examination of the oversight role of the audit committee — that reliability is absolute across the work of internal audit. It does not lessen because more judgement has been required or the risks are higher. Once again, this direction in ISA 315 and ISA 610 raises the risk, or perception, of self-interest bias.

The IAASB should consider providing the external auditor an “apply-or-explain” option with regard to reliance on the work of internal audit. An external auditor that concludes the work of internal audit is not reliable should provide details for how that conclusion was reached. For example, the work of internal audit may not cover or fully cover the scope of what the external auditor is seeking to address. Without such an “apply-or-explain” option, the risk or perception of self-interest bias remains.

It may be beneficial to examine the parallel direction in IIA *Standards* on reliance on outside assurance providers. IIA Standard 2050: Coordination and Reliance addresses how a CAE should approach and assess the work of other assurance providers.

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<sup>4</sup> ISA 610, paragraph A21

*The chief audit executive should share information, coordinate activities, and consider relying upon the work of other internal and external assurance providers to ensure proper coverage and minimize duplication of efforts.*

Not unlike ISA 610, the related interpretation of the standard identifies the need for the CAE to consider “the competency, objectivity, and due professional care” of the external assurance providers. It also goes on to direct CAEs to have “a clear understanding of the scope, objectives, and results of the work performed.” However, it does not limit reliance on the work of the external assurance provider, once its reliability is established.

## **Conclusion**

The IIA wishes to thank IAASB for the opportunity to comment on ISA 315 revisions involving identification and assessment of risks of material misstatement. This response raises pertinent questions about the IAASB’s direction to PAIBs regarding reliance on the work of internal audit. The IIA encourages IAASB to consider a thorough review of ISA 610 to examine whether that direction leads to inconsistency, subjectivity, the potential for repeating internal audit’s work unnecessarily, and whether this creates a perception of self-interest.

The IIA values greatly the relationship our two organizations have built over many years and wishes to express its unwavering support for IAASB’s continuing efforts to provide guidance to PAIBs on relevant issues.

Sincerely,

A handwritten signature in black ink that reads "Richard F. Chambers". The signature is written in a cursive, flowing style.

Richard F. Chambers, CIA, QIAL, CGAP, CCSA, CRMA  
President/CEO  
The Institute of Internal Auditors