

**PROJECT PROPOSAL**  
**Revision of ISA 610 (Redrafted), “Using the Work of Internal Auditors”**

**I. Subject**

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

**II. Background and Relevant Developments****A. Background**

2. The extant ISA 610<sup>1</sup> was last revised in March 1994. Conforming amendments were made to the standard when the IAASB issued the audit risk standards (ISAs 315,<sup>2</sup> 330,<sup>3</sup> and 500<sup>4</sup>) 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)<sup>5</sup> in October 2008.

**B. Relevant Developments****B.1 CALLS FROM STAKEHOLDERS AND FUTURE STRATEGIC INITIATIVE**

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.
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.<sup>6</sup> 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.

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<sup>1</sup> ISA 610, “Considering the Work of Internal Audit.”

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

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

<sup>4</sup> ISA 500, “Audit Evidence.”

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

<sup>6</sup> IAASB 2009-2011 Strategy and Work Program.

## B.2 DEVELOPMENTS IN THE INTERNAL AUDIT FUNCTION

6. Since the extant ISA 610 was last revised, there have been developments in the internal audit function that have resulted in changes to the work requirements of internal auditors. For example, the IIA has developed its International Professional Practices Framework which includes a revised definition of internal auditing, a Code of Ethics, and *International Standards for the Professional Practice of Internal Auditing*. Comments received from respondents during the redrafting of the extant ISA 610 suggest that a number of the references to internal audit activities in the extant ISA are inconsistent with the IIA's international standards on internal auditing.
7. In addition, a PwC report issued in November 2007,<sup>7</sup> based on a survey of Chief Audit Executives of Fortune 250 companies, indicates that where high-performing internal audit functions are observed, external auditors tend to employ the assistance of internal auditors in a number of areas such as identifying key risks facing the entity, assessing the effectiveness of mitigating controls, providing insight into the adequacy of financial controls, and executing a risk-based audit plan addressing financial risks and relevant IT controls. In addition to the practice of using the work of internal auditors where appropriate to do so, the survey results indicate that external auditors are also engaging the assistance of internal auditors in the external audit, consistent with the observations made at the March 2008 IAASB-NSS meeting.
8. There is therefore a need to research and consider how recent developments in the internal audit function may affect the relevance and usefulness of ISA 610 (Redrafted).

## B.3 DEVELOPMENTS IN NATIONAL AUDITING STANDARDS

9. Auditing standards addressing the external auditor's use of the work of internal auditors that have been issued by certain NSS currently deal with a number of issues that are not addressed in ISA 610 (Redrafted). For example:
  - The Australian Auditing and Assurance Standard Board (AAASB)'s ASA 610<sup>8</sup> addresses the external auditor's consideration of whether internal auditors have reported identified issues and risks to the relevant governing body, as part of the external auditor's responsibility to evaluate the specific work of the internal audit function.
  - The Canadian Auditing and Assurance Standards Board (CAASB)'s Section 5050<sup>9</sup> includes recommendations and supporting guidance relating to the provision of direct assistance to the external auditor by internal auditors.
  - The US Public Company Accounting Oversight Board's (PCAOB) interim standard AU section 322/ AICPA Auditing Standards Board's AU section 322<sup>10</sup> contain guidance on the external auditor's use of internal auditors to provide direct assistance in the conduct of the external audit.

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<sup>7</sup> On November 12, 2007, PricewaterhouseCoopers (PwC) issued *Internal Audit 2012 – A Study Examining the Future of Internal Auditing and the Potential Decline of a Controls-Centric Approach*.

<sup>8</sup> ASA 610, "Considering the Work of Internal Audit."

<sup>9</sup> Assurance Section 5050, "Using the Work of Internal Audit."

<sup>10</sup> AU section 322, "The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements."

10. There is therefore a need to consider whether best practices exist at the national level that are not currently addressed in ISA 610 (Redrafted), and whether it would be appropriate to adopt and codify these practices in a revised ISA to enhance the performance of external auditors relative to their consideration and use of internal auditors' work, and therefore the quality of audits internationally.

### **III. Project Objective and How it Serves the Public Interest**

#### **A. Project Objective**

11. 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.

#### **B. How the Project Objective Serves the Public Interest**

12. 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 assistance<sup>11</sup> 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.

### **IV. Outline of the Project**

#### **A. Project Scope**

13. 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.

#### **B. Major Problems and Key Issues that Will be Addressed**

14. Without prejudice to any matters that the project task force may bring to the IAASB for inclusion in the project, the issues that will need to be dealt with in a revision of ISA 610 (Redrafted) include the following.

##### **B.1 INTERACTIONS BETWEEN THE EXTERNAL AND INTERNAL AUDITORS**

##### *Using the Work of the Internal Auditor*

15. 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

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<sup>11</sup> Subject to the expansion of the scope of the ISA in this regard.

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,<sup>12</sup> 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.

16. 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*

17. 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.<sup>13</sup> Some aspects which may be considered in the project include:
- Nature of cooperation between the external auditor and internal auditor.
  - 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*

18. 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

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<sup>12</sup> 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.

<sup>13</sup> Proposals in this regard would be subject to the remit of the ISAs which does not extend to internal auditors.

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.

19. 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 Auditor*

20. 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.

**B.2 OTHER SPECIFIC MATTERS**

21. The project will consider a number of other matters that respondents have noted during the redrafting of the extant ISA. These include, in particular:
- Whether the definition of "internal audit function" should be expanded to include other departments within the entity that serve the same purpose as that of internal audit (for example, internal control testing teams established by management), and the nature and extent of the external auditor's responsibilities when using the internal audit work performed by such departments. In connection to this, consideration will be given to the potential implications arising from amendments to the definition in the case of smaller entities where instead of an internal audit department, internal audit functions are performed by members of staff.
  - The nature and extent of the external auditor's responsibilities in circumstance where the entity has outsourced its internal audit function.
  - Whether the external auditor should be required to evaluate information relevant to the auditor's risk assessment obtained from the internal auditors even after the external auditor has determined that the work of the internal auditors is not adequate for purposes of the audit.

**C. Impact Assessment Considerations**

22. 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 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.

23. 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.
24. 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.

## **V. Implications for any Specific Persons or Groups**

25. 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.

## **VI. Development Process, Public Consultation, Project Timetable and Project Output**

### **A. Development Process**

26. It is anticipated that the project will follow the normal developmental process of the IAASB for revising an ISA.

### **B. Public Consultations**

27. Due to the nature of the ISA and the scope of the revision, there are a number of stakeholders whose views will be important to have as input to the revision of the ISA. For example, consideration will be given to the need to consult with members of the internal audit community or with particular sectors during the process of revising the ISA.

28. The project will specifically consider the need for a consultation paper or other forms of consultation (for example, focus groups or roundtables) in order to obtain the views of stakeholders who are not ordinarily respondents to the IAASB's exposure drafts but whose input would be important to obtain for this project. In particular, obtaining input from members of the internal audit and banking communities will be considered.

**C. Project Timetable**

29. The following project timetable is proposed (subject to whether the project Task Force and the IAASB determine the need for a consultation paper or other forms of consultation before exposure of the proposed revised ISA):

Project Stage	Timing
Consideration of issues (including issuance of consultation paper or other forms of consultation)	April 2009 – December 2009
First read of draft revised ISA 610	March 2010
Approval of revised ISA 610 for exposure	September 2010
Review of respondents' comments	June 2011
Second read of proposed revised ISA 610 post-exposure	September 2011
Approval of proposed revised ISA 610	December 2011

30. 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.

**D. Project Output**

31. A revised ISA 610 (Redrafted).

**VII. Resources Required**

32. 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.
33. Consideration will also be given to the need for relevant expertise, in particular internal audit expertise.
34. IAASB technical staff will provide support to the project Task Force.

**VIII. Relevant Sources of Information that Address the Matter Being Proposed**

35. Relevant sources of information include the following:
- AAASB's ASA 610, "Considering the Work of Internal Audit"
  - CAASB's Assurance Section 5050, "Using the Work of Internal Audit"

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- IAASB’s “Strategy and Work Program 2009-2011”
- The IIA’s “International Professional Practices Framework” (October 2008)
- The IIA Research Foundation’s “Implementing the Professional Practices Framework” (2<sup>nd</sup> Edition)
- IAASB’s ISA 610 (Redrafted), “Using the Work of Internal Auditors”
- PwC’s “Internal Audit 2012 – A Study Examining the Future of Internal Auditing and the Potential Decline of a Control-Centric Approach”
- Respondents’ comments on the proposed IAASB Strategy and Work Program 2009-2011
- Respondents’ comments on the IAASB’s exposure draft of proposed redrafted ISA 610
- US PCAOB’s Auditing Standard No. 5, “An Audit of Internal Control Over Financial Reporting That is Integrated With an Audit of Financial Statements”
- US PCAOB/AICPA ASB AU section 322, “The Auditor’s Consideration of the Internal Audit Function in an Audit of Financial Statements”

**APPENDIX A**

**COMMENTS BY TECHNICAL MANAGERS**

The comments of Technical Manager from each technical area are required before this Project Proposal is considered by the board or committee proposing to undertake the project.

**Technical Manager to the Compliance Advisory Panel**

No specific comments on the technical aspects and priority level.

Signed Sylvia Barrett

Date 12/02/2008

**Technical Manager to the Developing Nations Committee**

No specific comment on the technical aspects. It may be of interest to note that there may be less clarity and understanding in some developing and emerging economies on the role of internal auditing. In clarifying the reliance of external auditors on the work of internal auditors, the revised ISA should help auditors in better understanding the two different forms of auditing.

Signed Sylvia Barrett

Date 12/02/2008

**Technical Manager to the IAESB**

The proposed revised ISA 610 (Redrafted) is outside the scope of the current IAESB's 2007-2009 work program and would not be expected to directly impact the IAESB's pronouncements.

Signed David McPeak

Date 12/18/2008

**Technical Manager to IESBA**

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 there may be ethical considerations. Under the Code, members of the audit team are prohibited from being employees of the client. Consideration should be given to having an IESBA member join the Task Force.

Signed Jan Munro

Date 01/02/2009

**Technical Manager to the PAIB Committee**

No comments.

Signed Stathis Gould

Date 12/29/2008

### Technical Manager to the IPSASB

These issues are relevant also in the public sector. The external auditor may be an auditor general's office or it may be an accounting firm. The relationship with the internal auditor may vary depending on the circumstances.

Signed Stephenie Fox

Date 01/07/2009

### Technical Manager to the SMP Committee

There are three SME/SMP specific issues with internal audit:

1. Keeping the scope statement such that, where the SME client has no internal audit function, the whole ISA can stay unopened.
2. Making sure that 'internal audit function' is kept conceptually separate from any activities of a checking nature undertaken by SME management/those charged with governance. There appears to be some risk of this given there is the following reference above:

*"The nature and extent of the external auditor's responsibilities when the external auditor uses internal audit work performed by such departments (e.g. internal control testing teams established by management)."*

3. The perceived cost of audit and impact on the audit exemption/threshold. The IAASB appears to be under pressure from some national standard setters to increase requirements, guidance and costs and, in turn, further increase the perception of cost of the audit even if SME audits are not directly affected. For example, we note the following above:

*"In this respect, the project will consider the relevance of the approach of the PCAOB's AS 5 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."*

We hope that the IAASB resists moving towards accepting the PCAOB's 'integrated audit' with corresponding reports (published or not) on the effectiveness of internal financial control which stands to greatly increase the cost of audit.

Signed Paul Thompson

Date 12/10/2008

### Technical Manager to the Transnational Auditors Committee

No comments

Signed Barry Naik

Date 12/11/2008