

15 November 2010

Mr James Gunn
Technical Director
International Auditing and Assurance Standards Board
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

Dear James,

Proposed International Standards on Auditing
ISA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement* and
ISA 610 (Revised) *Using the Work of Internal Auditors*

The Australian Auditing and Assurance Standards Board (AUASB) is pleased to provide you with its comments relating to the IAASB's Exposure Draft on the Proposed International Standards on Auditing ISA 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement* and ISA 610 (Revised) *Using the Work of Internal Auditors*.

The AUASB welcomes and supports the proposed revisions to ISA 315 and ISA 610. The AUASB believes that these proposed changes adequately address the recent developments in the nature and extent of interaction between internal and external auditors.

The AUASB's comments on specific areas addressed in the Explanatory Memorandum are included in the Attachment to this letter.

Please do not hesitate to contact me if you have questions regarding any of the points raised in the Attachment.

Yours sincerely,

Richard Mifsud
Executive Director

Attachment

cc: Merran Kelsall
AUASB Chairman

Attachment**AUASB COMMENTS****Request for Specific Comments**

Q1 Do respondents believe it is appropriate to require the external auditor to make inquiries of appropriate individuals within the internal audit function? If so, do respondents agree such a requirement is appropriately placed in ISA 315?

Yes, it is appropriate. It is also appropriate to place it in ISA 315, given the emphasis of this standard on the external auditor identifying and assessing the risks of material misstatement through understanding the entity and its environment. As stated in paragraph A6a in ISA 315, making enquiries of appropriate individuals within the internal audit function will likely provide the external auditor with useful insight into the entity's operations and business risks, which will be particularly helpful in the external auditor's risk assessment process.

Q2 Do respondents believe that appropriate factors have been proposed to be evaluated by the external auditor in determining:

- (a) Whether the work of the internal audit function can be used for purposes of the audit engagement; and**
- (b) The planned use of the work of the internal audit function?**

(a) Yes, the factors (as outlined in ISA 610, paragraph 13) to be evaluated by the external auditor in determining whether the work of the internal audit function can be used for purposes of the audit, are appropriate. There are two issues, however, that we would like to highlight in respect of these factors:

- (i) In paragraph 13(a) of ISA 610, the external auditor is required to evaluate the level of competence of the internal audit function; however, paragraph A6 of ISA 610, which provides guidance on the factors to be considered by the external auditor in evaluating competence, refers to the competence of internal auditors. As the requirement pertains to *competence*, we believe that the appropriate term to be used in paragraph 13(a) is internal auditors (or the individuals performing the internal audit function).

Paragraph A6 adequately provides examples of factors that the external auditor should consider in evaluating the competence of internal auditors.

- (ii) To determine whether the work of the internal auditor can be used for purposes of the audit, ISA 610 (paragraph 13) requires the external auditor to evaluate the internal audit function's objectivity, competence and whether it uses a systematic and disciplined approach, including quality control, in its work. ISA 610 (paragraph 14) then explicitly requires the external auditor not to use the work of the internal audit function if it has a low degree of objectivity or a low level of competence.

ISA 610, however, does not specifically direct the external auditor not to use the internal audit function's work if it does not apply a systematic and disciplined approach. Nevertheless, ISA 610 recognises (via paragraphs 10 and A8) that the application of a systematic and disciplined approach, including quality control, is a significant characteristic of the internal audit function's work that differentiates it from other monitoring control activities within the entity.

In view of the above, we recommend that ISA 610 should:

- clarify, via a requirement in paragraph 14, whether the external auditor is required not to use the work of the internal audit function when the function does not apply a systematic and disciplined approach, including quality control; and
 - provide additional related guidance in respect of this matter.
 - For example, the guidance material may emphasise that the absence of a systematic and disciplined approach impacts the ability of the internal auditors to perform their activities in an objective and competent manner.
- (b) Yes, the factors (as outlined in ISA 610, paragraph 15) to be evaluated by the external auditor in determining their planned use of the work of the internal audit function, are appropriate.

Q3 Do respondents believe it is appropriate to require the external auditor to read reports produced by the internal audit function relating to the work of the internal audit function that is planned to be used by the external auditor?

Yes it is appropriate. The AUASB, however, believes that it would be helpful to include additional guidance in this area. In particular, in addition to reading the internal audit reports, the external auditor (subject to agreement with the appropriate individuals within the internal audit function) may also consider reading planning and risk assessment documents prepared by the internal auditors relating to the internal audit reports. This may assist the external auditor in understanding the context for which the reports were written (for example, their terms of reference, and the purpose for which they was written), particularly in circumstances where these are not specified in the internal audit reports.

Q4 Do respondents believe that it is desirable for the scope of ISA 610 to be expanded to address the matter of direct assistance? If so, do respondents believe that when obtaining the direct assistance of internal auditors the external auditor should be required to:

- (a) Consider the factors that have been proposed in determining the work that may be assigned to individual internal auditors; and
- (b) Direct, supervise, and review the audit procedures performed by the internal auditors in a way that recognises they are not independent of the entity?

In Australia, it is not considered best practice for the external auditor to obtain direct assistance from internal auditors. However, from a global perspective, obtaining direct assistance from internal auditors may be appropriate in some circumstances, provided that there are adequate

safeguards and parameters that clearly define the nature and extent of direct assistance which the external auditor may obtain from internal auditors.

It is noteworthy that ISA 610 does not require the external auditor to obtain direct assistance from internal auditors, but permits the external auditor to do so in certain circumstances, subject to specific parameters (as outlined in paragraphs 20-24).

The AUASB supports the proposed requirements for the external auditor to:

- (a) consider certain factors in determining the work that may be assigned to internal auditors (outlined in paragraph 22); and
- (b) direct, supervise and review the audit procedures performed by the internal auditors in a way that recognises their lack of independence.

In respect of independence, the AUASB recommends that ISA 610 should emphasise, where the internal audit function is outsourced, that it is considered inappropriate for the internal audit function to be performed by the firm that also conducts the external audit engagement.

The AUASB also believes that it would be helpful if ISA 610 provides further guidance on, and examples of, the type of direct assistance work that may ordinarily be obtained by the external auditor from internal auditors.

Request for Comments on Other Matters

Q5 Public Interest Concerns – Respondents are asked to address whether there are any public interest concerns that have not been addressed.

The AUASB has no public interest concerns that have not been addressed.

Q6 Special Considerations in the Audit of Smaller Entities – Respondents are asked to comment whether, in their opinion, guidance addressing special considerations in the audit of smaller entities should be provided in the proposed revised ISAs. If so, respondents are asked to explain why and to suggest the nature of any such considerations.

The AUASB believes that no further guidance relating to audit of smaller entities is needed in the proposed revised standards.

Q7 Special Considerations in the Audit of Public Sector Entities – Respondents are asked to comment whether, in their opinion, special considerations in the audit of public sector entities have been dealt with appropriately in the proposed revised ISAs.

The AUASB believes that there are no particular public sector issues that need to be addressed in the proposed revised standards.

Q8 Developing Nations – Recognising that many developing nations have adopted or are in the process of adopting the ISAs, the IAASB invites respondents from these nations to comment, in particular, on any foreseeable difficulties in applying the proposed revised ISAs in a developing nation environment.

Not applicable to Australia.

Q9 Translations – Recognising that many respondents intend to translate the final revised ISAs for adoption in their own environments, the IAASB welcomes comment on potential translation issues noted in reviewing the proposed revised ISAs.

Not applicable. No translation issues in Australia.

Q10 Effective Date – Respondents are asked to comment whether, in their opinion, the provisional effective date is appropriate for supporting effective adoption and implementation of the proposed revised ISAs at the national level.

The AUASB does not have concerns in respect of the proposed effective date.

Request for Comments on Analysis of Impacts

Q11 Is the analysis of impact presented in Section 4 of this Explanatory Memorandum helpful to respondents in understanding the anticipated impacts of the IAASB's proposals?

Yes, the analysis is helpful. It provides the respondents with a clear understanding of the key aspects of the proposed revisions in ISA 610 and ISA 315, and their impact on various stakeholders.

Q12 Do respondents agree with the impact analysis as presented? Are there any other stakeholders, or other impacts on stakeholders, that should be considered and addressed by the IAASB?

We recommend that management and those charged with governance of entities with internal audit functions be included as stakeholders in the analysis. In particular, it would be helpful if it includes an analysis of the impact of the proposed changes in the standards on the interaction and communication between the external auditor, management and those charged with governance.

Q13 Are there any changes to the narrative or tabular presentation of the impact analysis that would be helpful to respondents?

We believe that the tabular presentation is a better form of presenting the impact analysis as it is easier to read and understand. It highlights the key issues addressed by the proposed revisions in the standards and their anticipated impact on various stakeholders.

We also believe that the analysis would be more helpful if it also highlights significant changes between the proposed revised auditing standards as compared with the extant auditing standards, as well as their impact on the various stakeholders.

We believe, however, that the columns “Directions and Magnitude of Impact”, “Variability by Size/Nature of Entity Subject to Audit” and “Duration of Impact” are of limited use in these circumstances due to the following reasons:

- (a) The proposed revised standards apply to all types of engagements, regardless of the entity’s size and nature of operations (e.g. publicly listed, private, public sector, small, or medium-sized) and complexity of the audit engagement.
- (b) The requirements and guidance of the proposed revised standards apply to an audit engagement if they are relevant to the circumstances of such engagement, regardless of whether it was their first or subsequent year(s) of application.

Q14 Would respondents find such an approach useful at the national level?

Yes, this approach is helpful.

The AUASB uses a different approach for analysing the effects of new or revised auditing standards. The analysis is focused on “what is new” in terms of requirements and significant guidance (in the case of new standards), or key changes in the requirements and significant guidance (in the case of revised standards). The analysis provides a commentary on the nature and effect of the new or revised requirements and guidance, to assist readers in understanding the new or revised auditing standards.

Other Comments

The AUASB recommends that the IAASB consider including the following in the proposed revised ISA 610:

- (a) Definition of the terms *internal audit function* and *internal auditors*, similar to the extant ISA 610;
- (b) Rewording of paragraph 21 to emphasise the use of professional judgement by the external auditor when considering obtaining direct assistance from internal auditors;
 - (i) The proposed additions to paragraph 21 are shown in italics below:
“The external auditor shall not obtain the direct assistance of an internal auditor, if, *in the external auditor’s professional judgement, they consider* the internal auditor has...”

and

- (c) When the external auditor reads internal audit reports, there should be a requirement for the external auditor to document:
 - (i) key information and/or findings relevant to the external auditor's work that they have read in the internal audit reports; and
 - (ii) how this information is used by the external auditor for purposes of the audit engagement.