

AU-C Section 610

Using the Work of Internal Auditors

Source: SAS No. 128.

Effective for audits of financial statements for periods ending on or after December 15, 2014.

Introduction

Scope of This Section

.01 This section addresses the external auditor's responsibilities if using the work of internal auditors. Using the work of internal auditors 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.

.02 This section does not apply if the entity does not have an internal audit function. (Ref: par. .A1–.A2)

.03 If the entity has an internal audit function, the requirements in this section relating to using the work of the internal audit function in obtaining audit evidence do not apply if

- a. the responsibilities and activities of the function are not relevant to the audit, or
- b. based on the external auditor's preliminary understanding of the function obtained as a result of procedures performed under section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, the external auditor does not expect to use the work of the function in obtaining audit evidence.

Nothing in this section 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 the external auditor's decision to establish the overall audit strategy.

.04 Furthermore, the requirements in this section relating to using internal auditors to provide direct assistance do not apply if the external auditor does not plan to use internal auditors to provide direct assistance.

Relationship Between Section 315 and This Section

.05 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 those charged with governance. Section 315 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. Section 315¹ also explains how effective communication between the internal and external auditors creates an environment in which the external auditor can be informed by the internal auditor of significant matters that may affect the external auditor's work.

.06 The external auditor may be able to use the work of the internal audit function in obtaining audit evidence in a constructive and complementary manner depending on

- the level of competency of the internal audit function,
- whether the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors, and
- whether the function applies a systematic and disciplined approach, including quality control.

This section addresses the external auditor's responsibilities when, based on the external auditor's understanding of the internal audit function obtained as a result of procedures performed under section 315, the external auditor expects to use the work of the internal audit function in obtaining audit evidence (see paragraphs .13–.24 of this section). 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.

.07 This section also addresses the external auditor's responsibilities if the external auditor is considering using internal auditors to provide direct assistance under the direction, supervision, and review of the external auditor (see paragraphs .25–.32).

.08 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 control activities, and obtaining evidence regarding the effectiveness of such controls would be part of the external auditor's responses to assessed risks in accordance with section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

The External Auditor's Responsibility for the Audit

.09 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 in obtaining audit evidence or use of internal auditors to provide direct assistance on the engagement. Although the function 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 section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.² This section, therefore, defines the

¹ Paragraph .A120 of section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*.

² Paragraph .15 of section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*.

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

.10 This section is effective for audits of financial statements for periods ending on or after December 15, 2014.

Objectives

.11 The objectives of the external auditor, when the entity has an internal audit function and the external auditor expects to use the work of internal auditors to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor, are as follows:

- a. To determine whether to use the work of the internal audit function in obtaining audit evidence or to use internal auditors to provide direct assistance, and if so, in which areas and to what extent
- b. If using the work of the internal audit function in obtaining audit evidence, to determine whether that work is adequate for purposes of the audit
- c. If using internal auditors to provide direct assistance, to appropriately direct, supervise, and review their work

Definitions

.12 For purposes of generally accepted auditing standards, the following terms have the meaning attributed as follows:

Direct assistance. The use of internal auditors to perform audit procedures under the direction, supervision, and review of the external auditor.

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: par. .A1–.A4)

Requirements

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

Evaluating the Internal Audit Function

.13 The external auditor should determine whether the work of the internal audit function can be used in obtaining audit evidence by evaluating

- 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: par. .A5–.A11)
- b. the level of competence of the internal audit function; and (Ref: par. .A5–.A9)
- c. the application by the internal audit function of a systematic and disciplined approach, including quality control. (Ref: par. .A12–.A14)

.14 The external auditor should not use the work of the internal audit function in obtaining audit evidence 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: par. .A15–.A17)

Determining the Nature and Extent of Work of the Internal Audit Function That Can Be Used in Obtaining Audit Evidence

.15 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 should consider the nature, timing, and extent 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: par. .A18–.A23)

.16 The external auditor should make all significant judgments in the audit engagement, including when using the work of the internal audit function in obtaining audit evidence. (Ref: par. .A18)

.17 To prevent undue use of the internal audit function in obtaining audit evidence, the external auditor should plan to use less of the work of the function and perform more of the work directly: (Ref: par. .A19–.A24)

- a. The more judgment is involved in
 - i. planning and performing relevant audit procedures or
 - ii. evaluating the audit evidence obtained (Ref: par. .A24)
- b. the higher the assessed risk of material misstatement at the assertion level, with special consideration given to significant risks; (Ref: par. .A25–.A27)
- c. the less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors; and
- d. the lower the level of competence of the internal audit function.

.18 The external auditor should also evaluate whether, in aggregate, using the work of the internal audit function in obtaining audit evidence to the extent planned, together with any planned use of internal auditors to provide direct assistance, would result in the external auditor still being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed. (Ref: par. .A18–.A27 and .A44)

Communicating With Those Charged With Governance

.19 In communicating an overview of the planned scope and timing of the audit to those charged with governance in accordance with section 260,

The Auditor's Communication With Those Charged With Governance,³ the external auditor should communicate how the external auditor has planned to use the work of the internal audit function in obtaining audit evidence. (Ref: par. .A28)

Using the Work of the Internal Audit Function in Obtaining Audit Evidence

.20 If the external auditor plans to use the work of the internal audit function in obtaining audit evidence, the external auditor should discuss the planned use of the work with the function as a basis for coordinating their respective activities. (Ref: par. .A29–.A32)

.21 The external auditor should read the reports of the internal audit function, which relate to the work of the function that the external auditor plans to use to obtain an understanding of the nature and extent of audit procedures the internal audit function performed and the related findings.

.22 The external auditor should perform sufficient audit procedures on the body of work of the internal audit function as a whole that the external auditor plans to use to determine its adequacy for purposes of the audit, including evaluating whether

- a. the work of the function was properly planned, performed, supervised, reviewed, and documented;
- b. sufficient appropriate evidence was obtained to enable the function to draw reasonable conclusions; and
- c. conclusions reached are appropriate in the circumstances, and the reports prepared by the function are consistent with the results of the work performed. (Ref: par. .A33–.A36)

.23 The nature and extent of the external auditor's audit procedures should be responsive to the external auditor's evaluation of

- a. the amount of judgment involved in
 - i. planning and performing relevant audit procedures and
 - ii. evaluating the audit evidence obtained;
- b. the assessed risk of material misstatement;
- c. the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors; and
- d. the level of competence of the function. (Ref: par. .A33–.A35) (see paragraphs .16–.17)

The external auditor should also reperform some of the body of work of the internal audit function that the external auditor intends to use in obtaining audit evidence. (Ref: par. .A36)

.24 Before the conclusion of the audit, the external auditor should evaluate whether the external auditor's conclusions regarding the internal audit function in paragraph .13 and the determination of the nature and extent of use of the work of the function for purposes of the audit in paragraphs .16–.18 remain appropriate.

³ Paragraph .11 of section 260, *The Auditor's Communication With Those Charged With Governance*.

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 If the external auditor plans to use internal auditors to provide direct assistance on the audit, the external auditor should evaluate the existence and significance of threats to the objectivity of the internal auditors who will be providing direct assistance, as well as any safeguards applied to reduce or eliminate the threats, and the level of competence of the internal auditors who will be providing such assistance. (Ref: par. .A37–.A41)

.26 The external auditor should not use an internal auditor to provide direct assistance if

- a. the internal auditor lacks the necessary objectivity to perform the proposed work, or
- b. the internal auditor lacks the necessary competence to perform the proposed work. (Ref: par. .A37–.A41)

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 providing direct assistance and the nature, timing, and extent of direction, supervision, and review that is appropriate in the circumstances, the external auditor should consider

- a. the external auditor's evaluation of the existence and significance of threats to the internal auditors' objectivity, the effectiveness of the safeguards applied to reduce or eliminate the threats, and the 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 obtained. (Ref: par. .A42–.A43)

Communicating With Those Charged With Governance

.28 In communicating an overview of the planned scope and timing of the audit with those charged with governance in accordance with section 260,⁴ the external auditor should communicate how the external auditor plans to use internal auditors to provide direct assistance.

Using Internal Auditors to Provide Direct Assistance

.29 The external auditor should evaluate whether, in aggregate, using internal auditors to provide direct assistance to the extent planned, together with any planned use of the work of the internal audit function in obtaining audit evidence, would result in the external auditor still being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed. (Ref: par. .A44)

⁴ See footnote 3.

.30 Prior to using internal auditors to provide direct assistance, the external auditor should obtain written acknowledgment from management or those charged with governance, as appropriate, that internal auditors providing direct assistance to the external auditor 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. (Ref: par. .A45)

.31 The external auditor should direct, supervise, and review the work performed by internal auditors on the engagement in accordance with section 220, *Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards*. In so doing

- a. the nature, timing, and extent of direction, supervision, and review should be responsive to the outcome of the evaluation of the factors in paragraph .27 of this section;
- b. the external auditor should instruct the internal auditors to bring accounting and auditing issues identified during the audit to the attention of the external auditor; and
- c. the review procedures should include the external auditor testing some of the work performed by the internal auditors. (Ref: par. .A46–.A47)

.32 When directing, supervising, and reviewing the work performed by internal auditors, the external auditor should remain alert for indications that the external auditor's evaluations in paragraphs .25 and .29 are no longer appropriate.

Documentation

.33 If the external auditor uses the work of the internal audit function in obtaining audit evidence, the external auditor should include the following in the audit documentation:⁵

- a. The results of the evaluation of
 - i. the function's organizational status and relevant policies and procedures to adequately support the objectivity of the internal auditors;
 - ii. the level of competence of the function; and
 - iii. the application by the function of a systematic and disciplined approach, including quality control
- b. The nature and extent of the work used (including the period covered by, and the results of, such work) and the basis for that decision
- c. The audit procedures performed by the external auditor to evaluate the adequacy of the work used, including the procedures performed by the external auditor to reperform some of the body of work of the internal audit function in obtaining audit evidence

.34 If the external auditor uses internal auditors to provide direct assistance on the audit, the external auditor should include the following in the audit documentation:

- a. The evaluation of the existence and significance of threats to the objectivity of the internal auditors, as well as any safeguards applied to reduce or eliminate the threats, and the level of competence of the internal auditors used to provide direct assistance

⁵ Paragraphs .08–.12 and .A8 of section 230, *Audit Documentation*.

- b. The basis for the 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 internal auditors' work (including the testing, by the external auditor, of some of the work performed by the internal auditors) in accordance with section 230, *Audit Documentation*
- d. The working papers prepared by the internal auditors who provided direct assistance on the audit engagement

.35 If the external auditor uses either the work of the internal audit function in obtaining audit evidence or internal auditors to provide direct assistance, or both, the external auditor should include in the audit documentation the external auditor's evaluation of (see paragraphs .18 and .29) whether, either individually or in aggregate as applicable, using the work of the internal audit function in obtaining audit evidence and use of internal auditors to provide direct assistance resulted in the external auditor still being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed.

Application and Other Explanatory Material

Definition of *Internal Audit Function* (Ref: par. .02 and .12)

.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, risk management, and internal control processes, such as the following:

Activities Relating to Governance Process

- 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 Process

- 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 Process

- *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 control, including those controls 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 nonfinancial 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.

Not all the activities discussed in this paragraph need to be present for an internal audit function to be used in the audit of the financial statements. The external auditor may be able 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 in obtaining audit evidence if the nature of the internal audit function's responsibilities and assurance activities is related to the entity's financial reporting, as further discussed in section 315.⁶

.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 the external auditor can use the work of internal auditors. Rather, it is the nature of the activities, the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors, competence of the internal auditors, and systematic and disciplined approach of the function that are relevant. References in this section to the work of the internal audit function include relevant activities of other functions or third-party providers that have these characteristics.

.A3 However, 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 section, although they may perform control activities that can be tested in accordance with section 330.⁷ For this reason, monitoring controls performed by an owner-manager would not be considered equivalent to an internal audit function.

.A4 Although 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 both 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, section 315⁸ requires the external auditor

⁶ Paragraph .A117 of section 315.

⁷ Paragraph .10 of section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*.

⁸ Paragraphs .06a and .24 of section 315.

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).

- The external auditor, after appropriate evaluation, may decide to use work that has been performed by the internal audit function that is relevant to the period being audited to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly by the external auditor (that is, the external auditor can use the work of the internal audit function in partial substitution for audit evidence to be obtained directly by the external auditor) (see paragraphs .13–.24 of this section).

In addition, 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 section) (see paragraphs .25–.32 of this section).

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

Evaluating the Internal Audit Function

Objectivity and Competence (Ref: par. .13a–b)

.A5 The external auditor exercises professional judgment in determining whether the work of the internal audit function can be used in obtaining audit evidence and the nature and extent to which the work of the internal audit function can be used in the circumstances.

.A6 The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors and the level of competence of the function are particularly important in determining whether to use the work of the internal audit function in obtaining audit evidence and, if so, the nature and extent of the use of the work of the function that is appropriate in the circumstances.

.A7 *Objectivity* refers to the ability to perform tasks without allowing bias, conflict of interest, or undue influence of others to override professional judgments. Factors that may affect the external auditor's evaluation of objectivity 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 function reports to management, whether it 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 any constraints or restrictions placed on the internal audit function by management or those charged with governance exist (for example, in communicating the internal audit function's 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

.A8 *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 with the appropriate level of quality. Factors that may affect the external auditor's determination about competence 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 established policies for hiring, training, and assigning internal auditors to internal audit engagements exist.
- Whether the internal auditors have adequate technical training and proficiency in auditing. Relevant criteria that 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 or have certifications that oblige them to comply with the relevant professional standards, including continuing professional education requirements.

.A9 Objectivity and competence may be viewed as a continuum. The more the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors and the higher the level of competence of the function, the more likely the external auditor may make use of the work of the function in obtaining audit evidence and make use of it in more areas. However, an organizational status and relevant policies and procedures that provide strong support for the objectivity of the 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 an organizational status and policies and procedures that do not adequately support the objectivity of the internal auditors. Additionally, neither a high level of competence nor strong support for the objectivity of the internal auditors compensate for the lack of a systematic and disciplined approach.

Considerations Specific to Governmental Entities (Ref: par. .13a)

.A10 *Generally Accepted Government Auditing Standards* (GAGAS), established by the U.S. Government Accountability Office, addresses the evaluation of the internal audit function in a government environment, including consideration of whether the internal audit function

- reports to senior management, such as a city manager or finance director,
- reports to the governing body,
- is elected, and, thus, is accountable to the citizens, or
- reports to an audit committee, which may comprise the governing body or a subcommittee thereof, members of senior management, appointed citizens, or any combination thereof.

.A11 The GAGAS conceptual framework approach provides auditors a practicable approach to address threats to independence and can be applied to varying circumstances that could potentially create threats to independence. The GAGAS conceptual framework may be useful in evaluating the objectivity of the internal audit function of a governmental entity.

Application of a Systematic and Disciplined Approach, Including Quality Control (Ref: par. .13c)

.A12 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.

.A13 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 nature and size of the internal audit function relative to the complexity of the entity.
- Whether the internal audit function has appropriate quality control policies and procedures (for example, those relating to leadership, human resources, and engagement performance) or quality control requirements in standards set by relevant professional bodies for internal auditors. Such bodies may also establish other appropriate requirements, such as conducting periodic external quality assessments.

.A14 The external auditor's determination of whether the internal audit function applies a systematic and disciplined approach is intended to address the risk that the external auditor inappropriately uses internal audit-like work performed in an informal, unstructured, or ad hoc manner. However, the level of formality of an acceptable approach may vary depending on the nature and size of the internal audit function relative to the complexity of the entity.

Circumstances in Which Work of the Internal Audit Function Cannot Be Used (Ref: par. .14)

.A15 The external auditor's evaluation of whether the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors, the level of competence of the internal audit 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.

.A16 Consideration of the factors in paragraphs .A7–.A8 and .A13, 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 example, the internal audit function's organizational status is particularly important in evaluating threats to the objectivity of the internal auditors. If the internal audit function reports to management other than in an administrative capacity, this may impair the function's objectivity absent safeguards applied to reduce or eliminate the threat (for example, having direct access and performance accountability to those charged with governance).

.A17 In addition, 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, a self-review threat is created in regards to the external auditor's independence. 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.

Determining the Nature and Extent of Work of the Internal Audit Function That Can Be Used in Obtaining Audit Evidence

Factors Affecting the Determination of the Nature and Extent of the Work of the Internal Audit Function That Can Be Used (Ref: par. .15–.18)

.A18 Because the external auditor has sole responsibility for the audit opinion expressed, the external auditor is required to make the significant judgments in the audit engagement in accordance with paragraph .16. Significant judgments include, but are not limited to, 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 and whether substantial doubt exists about the entity's ability to continue as a going concern for a reasonable period of time
- Evaluating significant accounting estimates
- Evaluating the adequacy of disclosures in the financial statements and other matters affecting the external auditor's report

.A19 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 section 300, *Planning an Audit*.

.A20 In accordance with section 330, the external auditor is required to design and perform further audit procedures whose nature, timing, and extent are based on, and responsive to, the assessed risks of material misstatement at the relevant assertion level.⁹ Further audit procedures comprise tests of controls

⁹ Paragraph .06 of section 330.

and substantive procedures. Procedures planned or performed by the internal audit function may be the same as, or be similar to, the further audit procedures that the external auditor would design and perform. Accordingly, subject to the requirements of this section, the external auditor may determine that it is appropriate to use the work of the internal audit function to modify the nature or timing, or reduce the extent, of further audit procedures to be performed directly by the external auditor. The internal audit function may have performed, or may be planning to perform

- tests of relevant controls upon which the external auditor intends to rely in determining the nature, timing, and extent of substantive procedures. For example, the work of the internal audit function may include tests of relevant controls that address the risks of material misstatement related to the completeness of accounts payable. The results of the internal audit function's tests may provide evidence about the effectiveness of controls and, accordingly, the external auditor may be able to use such tests of controls performed by the internal audit function to modify the nature or timing, or reduce the extent of, testing of controls the external auditor would otherwise have performed directly.
- substantive procedures. For example, the internal audit function, as part of its work, may confirm certain accounts receivable and observe certain physical inventories. By using such work of the internal audit function in obtaining audit evidence, the external auditor may be able to change the timing of the confirmation procedures, the number of accounts receivable to be confirmed, or the number of locations of physical inventories to be observed.

The internal audit function's plan may also include procedures related to financial information of components of a group. The external auditor may coordinate work with the internal auditors (in accordance with paragraph .20 of this section) and reduce the number of the entity's components at which the external auditor would otherwise need to perform audit procedures in accordance with the requirements of section 600, *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)*.

.A21 Other examples of work of the internal audit function that can be used in obtaining audit evidence by the external auditor include the following:

- Tracing transactions through the information system relevant to financial reporting
- Testing of compliance with regulatory requirements

.A22 The external auditor's determination of the planned nature and extent of use of the work of the internal audit function in obtaining audit evidence will be influenced by the external auditor's evaluation of the extent to which the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors and the level of competence of the internal audit function in paragraph .13. In addition, the amount of judgment needed in planning, performing, and evaluating such work and the assessed risk of material misstatement at the assertion level are inputs to the external auditor's determination. Further, as described in paragraph .14, circumstances exist in which the external auditor cannot use the work of the internal audit function in obtaining audit evidence for purpose of the audit.

.A23 When evaluating whether, in aggregate, using the work of the internal audit function to the extent planned, together with any use of internal auditors to provide direct assistance, would result in the external auditor still being sufficiently involved in the audit, the external auditor may consider the external auditor's responsibility to address all relevant requirements of this section, as well as the other standards (for example, in accordance with paragraph .16, the external auditor is required to make all significant judgments). It is not anticipated that the external auditor's evaluation of using work of the internal audit function would be based on a quantitative analysis (for example, percentage of hours spent by internal audit personnel in respect of the work being used by the external auditor relative to total engagement hours).

Judgments in Planning and Performing Audit Procedures and Evaluating Results (Ref: par. .17a)

.A24 As the degree of judgment involved in planning and performing the audit procedures or evaluating the audit evidence increases, the need for the external auditor to perform more procedures directly in accordance with paragraph .17 increases.

Assessed Risk of Material Misstatement (Ref: par. .17b)

.A25 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 .17 and, accordingly, make less use of the work of the internal audit function in obtaining sufficient appropriate audit evidence. Furthermore, as explained in section 200,¹⁰ 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.

.A26 As explained in section 315,¹¹ 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 restricted to procedures that involve limited judgment. In addition, when the risks of material misstatement is other than low, the use of the work of the internal audit function in obtaining audit evidence 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.

.A27 Carrying out procedures in accordance with this section may cause the external auditor to reevaluate the assessment of the risks of material misstatement. Consequently, this may affect the external auditor's determination of whether and how to use the work of the internal audit function in obtaining audit evidence.

Communicating With Those Charged With Governance (Ref: par. .19)

.A28 In accordance with section 260,¹² the external auditor is required to communicate an overview of the planned scope and timing of the audit with those charged with governance. The planned use of the work of the internal

¹⁰ Paragraph .A33 of section 200.

¹¹ Paragraph .04 of section 315.

¹² Paragraph .11 of section 260.

audit function in obtaining audit evidence is an integral part of the external auditor's overall audit strategy and, therefore, is relevant to those charged with governance for their understanding of the proposed audit approach.

Using the Work of the Internal Audit Function in Obtaining Audit Evidence

Discussion and Coordination With the Internal Audit Function in Obtaining Audit Evidence (Ref: par. .20)

.A29 In discussing the planned use of the work of the internal audit function in obtaining audit evidence, as a basis for coordinating the respective activities, it may be useful to address the following:

- The timing of such work
- 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

.A30 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 function.
- the external auditor is advised of, and has access to, relevant reports of the internal audit function and is informed of any significant matters that come to the attention of the 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.

Although the external auditor is not precluded from using work that the internal audit function has already performed, coordination of activities between the external auditor and internal audit function is likely to be most effective when appropriate interaction occurs before the internal audit function performs the work.

.A31 Section 200¹³ addresses the importance of the external 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.

.A32 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.¹⁴

¹³ Paragraphs .17 and .A22 of section 200.

¹⁴ Paragraph .A120 of section 315.

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 may be 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 section 240, *Consideration of Fraud in a Financial Statement Audit*.

Procedures to Determine the Adequacy of the Work of the Internal Audit Function (Ref: par. .22–.23)

.A33 The external auditor's audit procedures on the body of work of the internal audit function as a whole that the external auditor plans to use provide a basis for evaluating the overall quality of the function's work and the objectivity with which it has been performed.

.A34 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

.A35 The more judgment involved, the higher the assessed risk of material misstatement, the less the internal audit function's organizational status and relevant policies and procedures adequately support the objectivity of the internal auditors, or the lower the level of competence of the internal audit function, the more audit procedures are needed to be performed by the external auditor on the overall body of work of the internal audit function to support the decision to use the work of the function in obtaining sufficient appropriate audit evidence on which to base the audit opinion.

Reperformance (Ref: par. .23)

.A36 For purposes of this section, *reperformance* involves the external auditor's independent execution of procedures to validate the conclusions reached by the internal audit function. This objective may be accomplished by examining items already examined by the internal audit function or sufficient other similar items not actually examined by the internal audit function. Reperformance provides more persuasive evidence regarding the adequacy of the work of the internal audit function compared to other procedures the external auditor may perform, as described in paragraph .A34. Although it is not necessary for the external auditor to reperform some of the work of the internal audit function in each area that is being used, some reperformance is required on the body of work of the internal audit function as a whole that the external auditor intends to use in accordance with paragraph .23. 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 and in areas of higher risk of material misstatement.

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: par. .25–.26)

.A37 The external auditor may obtain direct assistance from the internal auditors to carry out audit procedures that 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.

.A38 In accordance with paragraph .25, the external auditor evaluates the existence and significance of any threats to the objectivity and level of competence of the internal auditors who will be providing direct assistance on the audit before assigning them to specific tasks. Evaluating the existence and significance of threats to objectivity includes evaluating safeguards applied to reduce or eliminate the threats.

.A39 As stated in paragraph .A7, *objectivity* refers to the ability to perform the proposed work without allowing bias, conflict of interest, or undue influence of others to override professional judgments. In evaluating the existence and significance of any threats to the objectivity of an individual internal auditor, the external auditor may consider the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors, including, for example, policies and procedures addressing association with the division or department in the entity to which the work relates. Additionally, other matters may come to the external auditor's attention that may be relevant to the external auditor's evaluation of the objectivity of the internal auditor.

.A40 In evaluating the level of competence of an internal auditor, many of the factors in paragraph .A8 may also be relevant but in the context of individual internal auditors and the work to which they may be assigned.

.A41 The external auditor may determine it is necessary to specifically instruct the internal auditors to keep confidential specific matters, as instructed by the external auditor, and to inform the external auditor of any threat to their objectivity. In some situations, the external auditor may determine it to be necessary to request written acknowledgment from the internal auditors of having understood such instruction by the external auditor.

Determining the Nature and Extent of Work That Can Be Assigned to Internal Auditors Providing Direct Assistance (Ref: par. .27)

.A42 Paragraphs .A18–.A27 also provide relevant guidance in determining the nature and extent of work that may be assigned to the internal auditors providing direct assistance. As the materiality of the financial statement amounts increases and either the assessed risks of material misstatement or the amount of judgment involved increases, the need for the external auditor to perform procedures directly increases. As these factors decrease, the need for the external auditor to perform procedures directly decreases.

.A43 In determining the nature of work that may be assigned to internal auditors providing direct assistance, the external auditor is careful to limit such work to those areas that would be appropriate for internal auditors to be assigned. Examples of activities and tasks that would not be appropriate for internal auditors to provide direct assistance include the following:

- Making required inquiries of entity personnel or those charged with governance related to the identification of fraud risks and determining the procedures to respond to such risks¹⁵
- Determination of unpredictable audit procedures as addressed in section 240

**Using Internal Auditors to Provide Direct Assistance
(Ref: par. .18 and .29–.31)**

.A44 If the external auditor plans to use the internal audit function in obtaining audit evidence and also plans to use internal auditors to provide direct assistance, only one evaluation would be necessary to address the requirements of paragraphs .18 and .29.

.A45 The written acknowledgment required by paragraph .30 may be included within the audit engagement letter (or other suitable form of written agreement of the terms of engagement)¹⁶ or could be included in a separate document prepared by the external auditor and acknowledged in writing by management or those charged with governance, as appropriate.

.A46 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 sufficient appropriate audit evidence has been obtained to support the conclusions based on that work. Because 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 may be of a different nature or more extensive than if members of the engagement team perform the work.

.A47 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 objectivity and the level of competence of, and the nature and extent of audit procedures to be performed by, the internal auditors. Directing and supervising the internal auditors involves informing them of their responsibilities, the objectives of the procedures they are to perform, and matters that may affect the nature, timing, and extent of audit procedures, such as possible accounting and auditing issues. In reviewing the work performed by the internal auditors, the external auditor's considerations include whether the evidence obtained is sufficient and appropriate in the circumstances, and that it supports the conclusions reached.

¹⁵ Paragraphs .17–.21 of section 240, *Consideration of Fraud in a Financial Statement Audit*.

¹⁶ See paragraph .10 of section 210, *Terms of Engagement*.