



15 November 2010

James Gunn
Technical Director
IAASB
545 Fifth Avenue, 14th Floor
New York, New York 10017
USA

Ref.: AUD/HvD/HB/LA/SH

Dear Mr. Gunn,

Re: FEE Comments on IAASB Exposure Draft on Proposed ISA 610 (Revised), Using the Work of Internal Auditors and ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment

FEE is pleased to provide you below with its comments on the Proposed ISA 610 (Revised), *Using the Work of Internal Auditors* (ED ISA 610) and ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment* (ED ISA 315).

FEE supports the initiative to revise this standard given the developments noted in the explanatory memorandum, especially as the last revision dates from 1994. Also, we support the inclusion of material in relation to direct assistance in this standard, which is scoped out of the current ISA 610, as we agree that it is not necessarily in the public interest to allow the ambiguity relating to direct assistance to continue.

We support the view that using the work of internal audit can contribute to ensuring the level of external audit quality in the relevant areas used and can also lead to a reduction in the extent of work performed by the external audit or by preventing duplication of effort, provided that appropriate safeguards are in place.

With regard to the proposed standards, FEE sees a need for clarifications in some of the areas, for instance in relation to inclusion of definitions for internal audit, the work of internal audit used by external audit and direct assistance. Also, we see a need for further clarity on when the external auditor “*uses the work of internal audit*” and “*obtains direct assistance*” and which requirements apply in either of these two situations, and/or whether internal audit is part of the engagement team of the external audit or when direct assistance is obtained. Also, more prominence could be given to the ethical and independence issues which can be viewed as the main issue when discussing the use of work of internal audit and direct assistance. In this context, FEE supports the approach taken in the exposure draft which underlines that the decision of whether and, if so, to what extent to obtain direct assistance is solely to be taken by the external auditor who retains sole responsibility for all work to be performed. However, the overarching concern related to direct assistance rests with issues related to independence, as members of the internal

audit function are not considered as independent as members of the engagement team in accordance with the IESBA Code of Ethics.

Our comments to the proposed standard are set out below in main comments and detailed comments, respectively. Where our comments relate to a question raised by the IAASB in the explanatory memorandum, the reference to the comment is included in the responses to the questions.

1. Main comments

1.1 Definition of internal audit

As is the case in the current ISA 610, FEE sees a need for inclusion of a definition of the internal audit function to ensure that all users have the same understanding of this concept. Including a definition will also ensure a more consistent application of the standard which is highly preferable considering the future effectiveness of the standard.

A description of the term is proposed in paragraph A101 of ISA 315 which is fairly clear on what the external auditor needs to consider in determining whether a function exists for the purposes of the ISAs, but a more prominent place for this comment would be preferable. The additional text proposed in paragraph 6 of ISA 315 is qualified with the term “if the function exists” and will lead to a significantly more workable requirement with a definition allowing auditors to determine if such a function exists. However, also with regards to the proposed ISA 610 we recommend the inclusion of a definition based on the terms set out in A101 of ISA 315. This definition needs to encompass the traditional audit function as well as other compliance functions they may have within the company.

In addition, the IAASB may consider the use of the terminology in ISA 610 when it comes to the title and the contents of it, as for instance in relation to:

- The title of the standard is “*Using the Work of Internal Auditors (emphasis added)*”;
- The headlines above paragraphs 13 and 18 state the requirements apply to “... *Use of the Work of the Internal Audit Function” (emphasis added)*”;
- Paragraph 13 (a) refers to “*objectivity of the internal auditors”*, whilst paragraphs 14 and 15 refer to “*objectivity and level of competence of the internal audit function”*”;
- In relation to direct assistance the standard talks about “*Obtaining Direct Assistance from Internal Auditors”* (emphasis added) as stated in the headline and in paragraph 20, etc.;
- In paragraph A101 of ED ISA 315, the term “internal auditing” is used (emphasis added).

With the aim of consistent understanding and application of the standard, FEE recommends the IAASB to consider aligning these terms and decide whether the standard applies to the “*internal audit function*” or “*internal auditors*” or both. If the standard applies to both, the IAASB should consider clarifying the difference between the two terms.

When doing so, FEE would like to make the IAASB aware that the term “function” has a double meaning in English, as it applies to the person(s) or group who perform the function as well as to the function itself performed by this person or group. This double meaning might cause difficulties in translation, especially in the first instance where it is supposed to be persons or a group who perform the internal audit function, as a function itself cannot execute any audit work.

Therefore, FEE would recommend that the IAASB reviews the title and the use of the headlines in the section of “Requirements” in the standard. To underline that paragraphs 13-17 apply in both situations, i.e. when using the work of the internal audit and when obtaining direct assistance, the headings above paragraph 13 and paragraph 18, respectively, should not contain the same wording with regards to “using the work of the Internal Audit Function” as paragraphs 18 and 19 only apply when using the work of internal audit and not when obtaining direct assistance. FEE therefore suggests, subject to the comments above, that the title be expanded to read: “Using the Work of the Internal Audit Function and Obtaining Direct Assistance from Internal Auditors” and the headings and subheadings preceding the general requirements in paragraphs 13-17 be amended along similar lines.

These comments relate to question 9 of the explanatory memorandum.

1.2 Use of the work of internal audit or direct assistance – paragraphs 16-18 vs. 20-24 of ED ISA 610

Compared to the current ISA, the exposure draft includes requirements related to the use of the work of internal audit and related to direct assistance. To our understanding the exposure draft proposes no substantial changes in the scope of the requirements regarding use of the work of internal audit, although some changes to the structure and the details are proposed. Only the requirements regarding direct assistance are new.

However, this approach is not entirely clear in the way the exposure draft is structured. There is a need to clearly state that the standard now covers two different scenarios that apply under two different sets of circumstances as the external auditor either:

1. uses the work internal audit has performed previously; or
2. uses direct assistance.

Accordingly, FEE would recommend an amendment to paragraph A24 of ED ISA 610 as paragraph A24 states that “... the external auditor may discuss matters such as the extent to which the work of internal auditors will be used on the audit engagement, including the planned use of direct assistance.”. To avoid the indication that “direct assistance” is a sub section of “using the work of internal auditors” and to underline that the two concepts are two different work streams, the word “including” should be replaced with an “and” in the quoted sentence from A24 above.

To underline the difference between use of the work of internal audit and direct assistance, FEE proposes inclusion of definitions of the two concepts. This will facilitate a better understanding of the use of direct assistance and its limits, compared to the use of the work of internal audit, which is already well known by practitioners and is not proposed to change with this exposure draft.

FEE understands the difference between the two concepts as related to whether internal audit is under direct instruction of, and supervision and review by (i.e. accountable to), the external auditor or not. In addition, the difference is based on whether those charged with governance are involved in designing and approving the work that internal audit carries out. To our understanding management and/or those charged with governance would approve and receive reporting of the work done by internal audit in case of the “use of the work of internal audit”. In case of direct assistance, neither management nor those charged with governance receive reports or approve the work done by internal audit, as external

audit uses internal audit staff resources directly to help complete the external auditor's audit work and internal audit is thus accountable only to the external auditor.

To recognise this difference, FEE proposes the following definitions of the two concepts:

“Using the work of internal auditors occurs in those cases where the work of the internal audit is performed in accordance with the (annual) work plan of internal audit and agreed with management and/or those charged with governance and is incorporated in processes of the planning, performance and reporting of the external audit.”

“Direct assistance is carried out by internal audit under the direct instructions of, and supervision and review by, the external auditor in carrying out audit procedures directly on the engagement which would otherwise be performed by the external auditors themselves and is not part of the (annual) work plan or the reporting responsibilities for internal audit agreed between internal audit and those charged with governance.”

These comments relate to question 4 of the explanatory memorandum.

1.3 Direct assistance – paragraphs 20-24 of ED ISA 610

The proposed ISA 610 addresses the provision of direct assistance to the external auditors by the internal auditors. The existing version of the standard specifically excludes that topic. FEE finds it appropriate to include material regarding direct assistance in the standard, as, although direct assistance might be becoming more commonly used in Europe, it is still more widespread in jurisdictions other than Europe, especially in the US. Therefore, European practitioners will be more involved with direct assistance as far as companies and subsidiaries in Europe and elsewhere are concerned as the practice develops.

FEE supports the approach taken in the exposure draft which underlines that the decision of whether and, if so, to what extent to obtain direct assistance is solely to be taken by the external auditor who retains sole responsibility for all work to be performed. The overarching concern related to direct assistance is related to independence, as members of the internal audit function are not considered as independent as members of the engagement team in accordance with the IESBA Code of Ethics. This is further elaborated below.

These comments relate to question 4 of the explanatory memorandum.

1.4 Engagement team – paragraph A27 of ED ISA 610

Paragraph A27 of the proposed ISA 610 appears to indicate that internal auditors are not part of the engagement team when performing direct assistance, as it is stated that “... audit procedures performed by the internal auditors will ordinarily be more extensive than if members of the engagement team perform the work.”

In this context, it would be relevant to firstly clearly state, either as part of a definition, as part of ISA 220¹ with reference to the glossary of terms, or under requirements in ISA 610 that internal audit staff are not to be considered as members of the engagement team, defined in ISA 220 and in the glossary of terms², when resources of internal audit are obtained as direct assistance to external audit, secondly, as discussed below, include measures to ensure that internal audit staff will report directly to the external auditor and, thirdly, are not de facto treated as part of the team.

Internal audit is employed by the audited entity and cannot be independent in the way that the engagement team is independent under ISAs. In addition, internal audit is responsible for reporting to management, regardless of whether external audit obtains direct assistance or not. If internal audit were to be members of the engagement team as defined in ISA 220, they would be subject to other requirements and responsibilities in accordance with other ISAs that they will not be in a position to fulfil, due to the lack of independence of the audited entity.

In addition, to mitigate this lack of independence, some requirements to govern the relationship between the audit engagement team and the staff of internal audit when providing direct assistance would be needed. For example, written agreement between the external auditor and management and/or those charged with governance and internal audit would need to ensure that staff of internal audit in such cases:

- Would agree to follow the instructions of external audit and, where applicable, they will keep confidential specific matters as instructed by the audit team and report directly to the audit team rather than to the entity's management or those charged with governance ;
- Would inform external audit of any threats regarding independence of external audit, such as risk of self review.

Also, the written agreement should ensure that management and/or those charged with governance would not intervene in the work carried out by internal audit staff as direct assistance.

It would also be necessary to ensure that individual internal audit staff members were not, for example, privy to engagement team discussions that could compromise the effectiveness of the audit (e.g., unannounced audit procedures to add an element of surprise as required by ISA 240, or other sensitive information).

These comments relate to question 4 of the explanatory memorandum.

1.5 Ethical issues and independence of internal audit – paragraph 14 of ED ISA 610

The main issue related to the use of work of internal auditors and direct assistance is the level of independence of the internal auditors which in the proposed standard as well as in the existing ISA 610 is referred to as “*objectivity*”.

¹ ISA 220, Quality Control for an Audit of Financial Statements

² *Engagement team*—All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform procedures on the engagement. This excludes external experts engaged by the firm or a network firm.

As mentioned under 1.4 above, internal audit cannot be independent in the way that independence is defined for the engagement team, due to their employment with the audited entity.

FEE appreciates the inclusion of the application material regarding “*objectivity*” in A5 and A6. However, FEE would recommend that the clarification as to objectivity in A5 is given a more prominent place to clearly display this important concept in the standard. Also, the IAASB might find it worthwhile to elaborate on the understanding of objectivity referred to in A5 by adding more guidance on what internal auditors can do (and cannot do) without risk of loss of objectivity. For example, whilst it is easy to understand that the less competent the staff member is, the simpler the tasks he or she should be requested to perform, it is not clear how such a sliding-scale approach could relate to objectivity, if at all. In our view, each individual staff member needs to have sufficient objectivity for the external auditor to allow him or her to provide direct assistance. In this context, some examples might be useful, for instance to highlight that when fraud is detected by internal auditors, this is an area with the highest threat to the objectivity of the internal auditors.

These comments relate to question 4 of the explanatory memorandum.

1.6 Impact analysis – Explanatory Memorandum

FEE supports the introduction of impact analyses of new standards. The impact analysis in ED ISA 610 is in our view a very good example of how such impact analyses within the remit of the IAASB should be carried out.

However, we would recommend that a more detailed scale is used in order to qualify the direction and magnitude of the impact. A scaling indication of the impact with numbers 1 – 5, where 1 is a good result, would be preferable.

These comments relate to questions 11-14 of the explanatory memorandum.

2. Detailed comments

ISA 610

Paragraph 2 - Scope of ISA 610

Paragraph 2 of ED ISA 610 refers to ISA 315 and gives additional guidance on inquiries made of internal audit as part of the external auditor’s risk assessment. The paragraph contains guidance on the boundaries of the standard, as it addresses both when the standard applies (second sentence) and when the standard does not apply (third and fourth sentence). It could be considered that the latter (third and fourth sentences) is not essential for the scope as defined in the second sentence. If retained, the third and fourth sentences setting the negative scope would be best placed in a separate paragraph.

Paragraphs 14 and 21 - Competence of the internal audit function

The exposure draft may give the impression that external auditors only use the work of internal auditors reluctantly and with some caution, due to the general competence of the internal audit function. In practice, however, it is quite common in many larger entities for internal audit to have very experienced and highly qualified staff. This is recognised in paragraphs A10-A13 of the ED ISA 610.

Paragraph 17 - Resources and planning

Where external auditors decide to use the work of internal audit or obtain direct assistance from internal auditors, there are budget and time implications for the resources of the internal audit function. Such matters need to be agreed early in the year in the planning phase (ISA 610 paragraph 17 or in A14-15) between external audit, internal audit and those charged with governance.

Because of limited resources (human and financial), particularly where there is a total budget for internal and external audit, and where it is decided that internal audit will assist external audit, some items in the internal audit project list will not get done. This may be particularly relevant to the audit committee and the board(s) of directors where internal audit does not spend much time on financial audit and their efforts are directed to controls over non-financial reporting risks (which are often more important to running the business). This should be recognised in taking decisions on the manner and extent to which to use internal auditors.

Paragraph 25-26 - Documentation

Considering the structure of the standard it might be worthwhile to clarify that paragraph 25 is relevant for the application of paragraphs 18-19 whilst paragraph 26 is relevant when applying paragraphs 20-24.

These comments relate to question 4 of the explanatory memorandum.

Paragraph A23 and A25 - Application material

FEE offers a few comments in relation to the application material of ED ISA 610:

- Paragraph A23 adds guidance to paragraph 16 regarding the sole responsibility of the external auditor. However, the application material in A23 seems to be duplicative of the requirement itself in paragraph 16 and could therefore be omitted.
- Similarly, paragraph A25 seems duplicative of paragraphs 20 and 21 and does not add more guidance compared to what is already stated in the requirements themselves.

ISA 315

We note that should the auditor not plan to use the work of internal audit at all ISA 610 would not apply. This means that the auditor would not be required to consider factors such as the objectivity and competence of internal audit. In our opinion, such factors are also relevant to the degree the external auditor may place reliance on information received from internal audit, and should therefore be introduced in ISA 315 also.

Paragraph A71a - Management's response to internal audit findings

FEE recommends making it more clear when an auditor could not be required to consider how management has responded to the findings and the recommendations of the internal audit function regarding identified weaknesses in internal control relevant to the audit. In accordance with the clarity conventions such a procedure would be relevant to include as a conditional requirement, provided an appropriate threshold is used.

These comments relate to question 1 of the explanatory memorandum.

For further information on this FEE³ letter, please contact Hilde Blomme at +32 2 285.40.77 or via email at hilde.blomme@fee.be or Lotte Andersen at +32 2 285.40.80 or via email at lotte.andersen@fee.be from the FEE Secretariat.

Yours sincerely,



Hans van Damme
FEE President

³ FEE is the Fédération des Experts comptables Européens (Federation of European Accountants). It represents 43 professional institutes of accountants and auditors from 32 European countries, including all of the 27 EU Member States. In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 500.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent and sustainable European economy.

FEE's objectives are:

- To promote and advance the interests of the European accountancy profession in the broadest sense recognising the public interest in the work of the profession;
- To work towards the enhancement, harmonisation and liberalisation of the practice and regulation of accountancy, statutory audit and financial reporting in Europe in both the public and private sector, taking account of developments at a worldwide level and, where necessary, promoting and defending specific European interests;
- To promote co-operation among the professional accountancy bodies in Europe in relation to issues of common interest in both the public and private sector;
- To identify developments that may have an impact on the practice of accountancy, statutory audit and financial reporting at an early stage, to advise Member Bodies of such developments and, in conjunction with Member Bodies, to seek to influence the outcome;
- To be the sole representative and consultative organisation of the European accountancy profession in relation to the EU institutions;
- To represent the European accountancy profession at the international level.

Appendix

Questions raised by the IAASB

Question 1

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?

Please see our comments to paragraph A71a of the proposed ED ISA 315 under detailed comments above.

Question 2

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?**

Please see our detailed comments under sections 1.3 and 1.4 above.

Question 3

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?

We have no further comments in this regard.

Question 4

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 recognizes they are not independent of the entity?**

Please see our comments to 1.2-1.5 above with regards to direct assistance.

Question 5

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

We have no further comments in this regard.

Question 6

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.

We have no further comments in this regard.

Question 7

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.

We have no further comments in this regard.

Question 9

Translations—Recognizing 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.

Please see our comments to 1.1 Definition of Internal Audit above with regards to the term “internal audit function”.

Question 11

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?

Question 12

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?

Question 13

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

Question 14

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

Please see our comments to 1.6 impact analysis above.