

Audit & Assurance Alert

CAS

FEBRUARY 2015

CAS 610—Using the work of internal auditors to provide direct assistance on the audit

This Audit & Assurance Alert is being issued to raise awareness about the requirements pertaining to the use of internal auditors to provide direct assistance on the audit in accordance with Canadian Auditing Standard (CAS) 610, *Using the Work of Internal Auditors*, which are effective for audits of financial statements for periods ending on or after December 15, 2014. This Alert reminds auditors of related requirements and application and other explanatory material in the *CPA Canada Handbook—Assurance* and provides potential actions to assist auditors in complying with the requirements. The Alert does not address all aspects relating to CAS 610, and other CASs contain additional requirements auditors must comply with.

What has changed?

CAS 610 now addresses the external auditor’s responsibilities when considering the use of internal auditors to provide direct assistance under the direction, supervision and review of the external auditor. The objectives of these requirements are to determine whether direct assistance from internal auditors can be used, and if so, in which areas and to what extent. If using internal auditors to provide direct assistance, the objectives are to appropriately direct, supervise and review their work.

Direct assistance is defined as “the use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.”

The following requirements in CAS 610 pertain to the use of internal auditors to provide direct assistance on the audit:

- Determining whether internal auditors can be used to provide direct assistance for purposes of the audit (paragraphs 26-28 and A31-34).
- Determining the nature and extent of work that can be assigned to internal auditors providing direct assistance (paragraphs 29-32 and A35-39).
- Using internal auditors to provide direct assistance (paragraphs 33-35 and A40-41).
- Documentation (paragraph 37).

When are these requirements effective?

These requirements are effective for audits of financial statements for periods ending on or after December 15, 2014.

When can an internal auditor be used to provide direct assistance for purposes of the audit?

The external auditor may be able to use the work of an internal auditor, but only when the external auditor is satisfied that:

- There are no significant threats to the objectivity of the internal auditor.
- The internal auditor possesses sufficient competence to provide such assistance.

If there are significant threats to the objectivity of the internal auditor or they lack sufficient competence to perform the proposed work, the external auditor shall not use them to provide direct assistance.

If a group audit is being performed and components are located in foreign jurisdictions, an external auditor should consider if there are laws or regulations that prohibit the use of internal auditors to provide direct assistance in the foreign jurisdiction.

How might an external auditor perform the evaluation of the internal auditor?

In evaluating the existence and significance of threats to objectivity of the internal auditor, it should be noted that 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. The following are some factors that may be relevant to perform this evaluation:

- The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors.
- Family and personal relationships with an individual working in, or responsible for, the aspect of the entity to which the work relates.
- Association with the division or department in the entity to which the work relates.

- Significant financial interests in the entity other than remuneration on terms consistent with those applicable to other employees at a similar level of seniority.

In evaluating the competence¹ of the internal auditor, many of the factors used to evaluate the competence of the internal audit function may also be relevant, applied in the context of the individual internal auditor and the work to which they may be assigned. The following are some factors that may be relevant to perform this evaluation:

- Whether the internal audit function is adequately and appropriately resourced relative to the size of the entity and the nature of its operations.
- Whether there are established policies for hiring, training and assigning internal auditors to internal audit engagements.
- Whether the internal auditor has 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 auditor's possession of a relevant professional designation and experience.
- Whether the internal auditor possesses the required knowledge relating to the entity's financial reporting and the applicable financial reporting framework and the necessary skills (for example, industry-specific knowledge) to perform work related to the entity's financial statements.
- Whether the internal auditor is a member of relevant professional bodies that oblige them to comply with relevant professional standards including continuing professional development requirements.

What work can be assigned to internal auditors providing direct assistance on the audit?

Considerations for the external auditor

In determining the nature and extent of work that may be assigned to internal auditors and the nature, timing and extent of direction, supervision and review that is appropriate in the circumstances, the external auditor shall consider:

- The amount of judgment involved in:
 - planning and performing relevant audit procedures
 - evaluating the audit evidence gathered
- The assessed risk of material misstatement.
- The external auditor's evaluation of the existence and significance of threats to the objectivity and level of competence of the internal auditors who will be providing such assistance.

¹ Paragraph A8 of CAS 610 states that 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 in accordance with applicable professional standards.

Paragraphs A15-22 of the Application and Other Explanatory Material in CAS 610 provide relevant guidance in determining the nature and extent of work that may be assigned to internal auditors.

Required communications by the external auditor

When the external auditor communicates an overview of the planned scope and timing of the audit in accordance with CAS 260, *Communication with Those Charged with Governance*, they shall also communicate the nature and extent of the planned use of internal auditors to provide direct assistance so as to reach a mutual understanding that such use is not excessive in the circumstances of the engagement. Notwithstanding the direction, supervision and review by the external auditor, excessive use of internal auditors to provide direct assistance may affect perceptions regarding the independence of the external auditor.

Taking a step back and looking at the big picture

The external auditor shall evaluate whether, in aggregate, using internal auditors to provide direct assistance to the extent planned, together with the planned use of the work of the internal audit function, would still result in the external auditor being sufficiently involved in the audit, given the external auditor's sole responsibility for the audit opinion expressed.

Are there areas that internal auditors should not be used to provide direct assistance on the audit?

Yes, the external auditor shall not use internal auditors to provide direct assistance to perform procedures that:

- Involve making significant judgments in the audit such as:
 - assessing the risks of material misstatement
 - evaluating the sufficiency of tests performed
 - evaluating the appropriateness of management's use of the going concern assumption
 - evaluating significant accounting estimates
 - evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor's report
- Relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited. For example, in circumstances where the valuation of accounts receivable is assessed as an area of high risk, it would not be appropriate to assign the evaluation of the adequacy of the provision to an internal auditor providing direct assistance as it involves more than limited judgment.
- Relate to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function.

- Relate to decisions the external auditor makes in accordance with CAS 610 regarding the internal audit function and the use of its work or direct assistance. For example, some activities and tasks that would not be appropriate to be assigned to an internal auditor providing direct assistance include:
 - The discussion of fraud risks addressed in CAS 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*.
 - The determination of unannounced audit procedures addressed in CAS 240, *The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements*.
 - The maintenance of control over external confirmation requests and the evaluation of the results of external confirmation procedures addressed in CAS 505, *External Confirmations*. However, internal auditors may assist in assembling information necessary for the external auditor to resolve exceptions in confirmation responses.

What must be done before using the internal auditors to provide direct assistance?

Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor must obtain written agreement on the following matters, as outlined below:

- Written agreement from an authorized representative of the entity that the internal auditors 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.
- Written agreement from the internal auditors agreeing that they will keep specific matters confidential as instructed by the external auditor and inform the external auditor of any threat to their objectivity.

What is required when using internal auditors to provide direct assistance?

The external auditor shall direct, supervise and review the work performed by internal auditors on the engagement in accordance with CAS 220, *Quality Control for an Audit of Financial Statements*. In so doing:

- The nature, timing and extent of direction, supervision, and review shall recognize that the internal auditors are not independent of the entity and be responsive to the outcome of the evaluation of the factors in paragraph 29² of CAS 610.
- The review procedures shall include the external auditor checking back to the underlying audit evidence for some of the work performed by the internal auditors.

The direction, supervision and review by the external auditor of the work performed by the internal auditors shall be sufficient in order for the external auditor to be satisfied that the internal auditors have obtained sufficient appropriate audit evidence to support the conclusions based on that work.

2 Paragraph 29 of CAS 610 states that in determining the nature and extent of work that may be assigned to internal auditors and the nature, timing and extent of direction, supervision and review that is appropriate in the circumstances, the external auditor shall consider:

- a) The amount of judgment involved in:
 - i) planning and performing relevant audit procedures
 - ii) evaluating the audit evidence gathered.
- b) The assessed risk of material misstatement.
- c) The external auditor's evaluation of the existence and significance of threats to the objectivity and level of competence of the internal auditors who will be providing such assistance.

In directing, supervising and reviewing the work performed by internal auditors, the external auditor shall remain alert for indications that the external auditor's evaluations of the existence and significance of threats to objectivity and the level of competence of the internal auditor are no longer appropriate.

Are there applicable documentation requirements?

Yes. If the external auditor uses internal auditors to provide direct assistance on the audit, the external auditor shall include in the audit documentation:

- The evaluation of the existence and significance of threats to the objectivity of the internal auditors, and the level of competence of the internal auditors used to provide direct assistance.
- The basis for the decision regarding the nature and extent of the work performed by the internal auditors.
- Who reviewed the work performed and the date and extent of that review in accordance with CAS 230, *Audit Documentation*.
- The written agreements obtained from an authorized representative of the entity and the internal auditors under paragraph 33 of this CAS.
- The working papers prepared by the internal auditors who provided direct assistance on the audit engagement.

Other Resources

1. Canadian Auditing Standard (CAS) 610, *Using the Work of Internal Auditors*
2. Basis for Conclusions: CAS 610, *Using the Work of Internal Auditors*
3. **Basis for Conclusions: 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**

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