Auditing Standards Committee Comment Letter

Proposed International Standards on Auditing, Revisions to ISA 315 and ISA 610

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INTRODUCTION

The Auditing Standards Committee of the Auditing Section of the American Accounting Association is pleased to provide comments on the Proposed International Standards on Auditing, Revisions to ISA 315 and ISA 610 exposure draft. We very much appreciate the opportunity to provide input.

The views expressed in this letter and attachments are those of the members of the Auditing Standards Committee and do not reflect an official position of the American Accounting Association. In addition, the comments reflect the overall consensus view of the Committee, not necessarily the views of every individual member.

We hope that our attached comments and suggestions are helpful and will assist in finalizing the proposed guidance. If the Board has any questions about our input, please feel free to contact our committee chair for additional follow-up.

Comments related to revised IAS 610

We believe that it would be helpful for the board to provide more concrete examples of situations in which it would never be appropriate for internal auditors to assist directly in the work of the external auditor. For example, while external auditors may make inquiries of internal auditors about fraud risks in the organization, internal auditors should never be participants in the discussion of fraud risks by the external auditors. Likewise, we would suggest that internal auditors should not be apprised beforehand of any audit procedures that are to be performed on a surprise basis. Similarly, internal auditors should not be made aware of, in advance, of the locations chosen for the observation of inventory counts, for clients with multiple locations. Internal auditors should never participate in the discussion of the type of audit opinion being considered by the external auditors. This discussion, should the board determine to include it, could also appear after paragraph A22.

The Public Company Accounting Oversight Board, in its proposed new standard on confirmation evidence, specifically excludes internal auditors from participating in the confirmation process. We are of the opinion that the PCAOB policy is too restrictive and that internal auditors could be used in certain circumstances by external auditors for such tasks as gathering evidence on exceptions noted on confirmation forms and checking addresses, for instance. However, we believe that internal auditors should not be involved in the preparation, control, or sending of confirmations, nor in the receipt of confirmations from confirmers.
The revision does not explicitly address common circumstance of an internal audit function that has been outsourced to a third party service provider (OSP). Instead the guidance suggests that objectivity, competence and the nature of the activities performed should be assessed independently of the title or source of the work. OSPs (as long as they are truly independent of the auditee) possess a qualitatively different ‘organizational position’. It may be helpful to external auditors to provide additional guidance with respect to OSPs regarding which criteria would be appropriate to consider when making this evaluation. This would potentially alleviate some of the cost impact involved in assessing organizational position.

In paragraph 12b, it is stated that the external auditors’ objective is to “determine whether that work is adequate for purposes of the audit”. Could this be stated more specifically, perhaps with wording such as “determine whether that work is adequate to support the proposed reduction in extent of testing”?

In paragraphs 13a, the determination of organizational status is discussed. In the related materials A6, organizational status is understood by reference, in part, to reporting lines and employment decisions. It may be helpful to provide additional criteria regarding the definition of reporting line, as that term may refer to either what officer the internal audit function reports to administratively, or to the recipients of the internal audit reports. Second, we suggest that consideration be given to directing the external auditors’ attention to the assignment of budget oversight authority for the internal auditors. Budgetary oversight assigned to a sufficiently high level within the auditee enhances organizational position by protecting internal audit from potential budget-related pressure.

Also related to the guidance in A6 regarding organizational status, we believe it may be helpful to further clarify the terminology of ‘those charged with governance’, as that term relates to the determination of organizational status. ISA 260 provides a thorough description of the variety of institutional arrangements that exist and provides guidance for the auditor in identifying those parties. In some instances, those meeting the ISA 260 definition are clearly not independent of the organization and the preparation of its financial statements. In that instance, the reference in A6 to ‘whether the internal audit function reports to those charged to governance’ as an indicator of organizational status may not sufficiently clarify how the external auditor should consider instances where internal audit reports to parties involved in the preparation of financial statements.

We believe that paragraph 18 and the related guidance in A16 may be slightly too narrow. Paragraph 18 directs the external auditor to read the reports of the function relating to the work that the external auditor plans to use. We believe audit effectiveness would be enhanced by directing the external auditor to read the audit reports related to the specific areas under audit. In this way, the external auditor will be able to access the internal auditor’s knowledge of the subject areas, even if electing not to use the work of the function directly.

Paragraph 16b states that the external auditor must “plan to perform sufficient procedures to be able to draw reasonable conclusions on which to base the external auditor’s opinion”. This statement appears to potentially constrain the external auditor from actually relying on the internal auditors’ work, if they always must directly perform enough procedures to base an opinion.
Comments related to revised IAS 315:

The committee fully supports the addition of a requirement for the external auditors to make inquiries of the internal audit personnel.