



CANADIAN PUBLIC ACCOUNTABILITY BOARD  
CONSEIL CANADIEN SUR LA REDDITION DE COMPTES

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November 12, 2010

Technical Director  
International Auditing and Assurance Standards Board  
International Federation of Accountants  
45 Fifth Avenue, 14<sup>th</sup> Floor  
New York, New York 10017  
USA

Dear Sir:

**Re: Proposed International Standards on Auditing  
ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement  
through Understanding the Entity and Its Environment**

**ISA 610 (Revised), Using the Work of Internal Auditors**

The Canadian Public Accountability Board (CPAB) is pleased to comment on the International Auditing and Assurance Standards Board's (Board's) proposed International Standards on Auditing ISA 315 (revised) and ISA 610 (revised).

CPAB is Canada's independent audit regulator responsible for overseeing audit firms that audit Canadian reporting issuers. Our mandate is to promote high quality independent auditing which contributes to public confidence in the integrity of reporting issuers' financial reporting. We accomplish our mandate by inspecting audit firms and audit working paper files which provides us with insights into the application of auditing standards and how they might be improved.

CPAB has identified three key issues with the proposed revised ISA 610 that we believe need to be addressed to strengthen the standard relative to the external auditor's use of the work of internal audit.

#### Consideration of the Assessed Risk of Material Misstatement

In determining the planned use of the work of the internal audit function, CPAB believes the external auditor should also consider the assessed risk of material misstatement at the assertion level. While the relationship between the assessed risk of material misstatement and the degree of judgment in planning and performing the audit procedures is discussed in the

application guidance, CPAB believes the consideration of the assessed risk of material misstatement should be part of the required considerations when determining the planned use of the work of the internal audit function in paragraph 15 of the proposed standard. Consideration of the assessed risk of material misstatement at the assertion level is a requirement in the extant ISA 610 and CPAB views its removal as a lowering of the standard.

Also with respect to determining the planned use of the internal audit function, CPAB believes there should be an additional requirement that for those assertions where the assessed risk of material misstatement is high (in particular for significant risks) the use of the internal auditor's work alone cannot reduce audit risk to an acceptable level. In these circumstances the external auditor should also perform tests of those assertions directly.

#### Determination of the Adequacy of Internal Audit Work

CPAB believes the requirements with respect to the audit procedures the external auditor must perform to have a sufficient basis to support the use of work of the internal audit function are weak and need to be further clarified. The application material in paragraph A18 describes procedures the external auditor may perform to appraise the quality of the internal audit work. In CPAB's view the guidance in paragraph A18 should be elevated to a requirement and strengthened by stating that the external auditor shall perform one or more of the three procedures listed to appraise the quality of the work performed and the conclusions reached.

#### Direct Assistance from Internal Auditors

CPAB believes the restrictions on the use of direct assistance from internal auditors in paragraph 23 should include areas assessed at a high risk of material misstatement at the assertion level (in particular for significant risks) due to the fact that internal auditors are not independent of the entity.

Paragraph 24 requires the external auditor to direct, supervise and review the work performed by internal auditors at a level that recognizes that internal auditors are not independent. CPAB believes paragraph 24 should also require the external auditor to evaluate and test the work of the internal auditor in addition to direct, supervise and review.

An appendix to this letter contains a further discussion of these three issues as well as CPAB's other comments which are incorporated into responses to the questions listed in the request for specific comments.

CPAB appreciates the opportunity to provide input to the Board on these important proposed revisions to International Standards on Auditing and believes consideration of the matters raised above in respect of ISA 610 will improve audit quality.

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We would be pleased to discuss further any of the above comments.

Very truly yours,

A handwritten signature in black ink, appearing to read "B. Hunt".

Brian Hunt, FCA  
Chief Executive Officer

cc: Bruce Winter, FCA  
Chair, Auditing and Assurance Standards Board  
The Canadian Institute of Chartered Accountants

Greg Shields, CA  
Director, Auditing and Assurance Standards  
The Canadian Institute of Chartered Accountants

**APPENDIX:** Response to the request for specific comments:

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?**

CPAB believes it is appropriate to require the external auditor to make inquiries of appropriate individuals within the internal audit function as they often have insight into the entity that would assist in planning the audit. CPAB also agrees that such a requirement should be placed in ISA 315 as it is part of the risk assessment activities and is distinct from the consideration of whether or not to use the work of the internal audit function.

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**

The factors in application paragraph A6 that the external auditor may consider in making their assessment of the competence of the internal audit function should be expanded to include an assessment of the quality of work performed and related reports and recommendations. These additional factors would enable the external auditor to assess how effective the internal audit function was in performing its tasks diligently and in accordance with applicable professional standards.

- (b) **The planned use of the work of the internal audit function?**

The first sentence of paragraph A12 discusses the relationship between a higher assessed risk of material misstatement at the assertion level and the degree of judgment involved in planning and performing the audit procedures and evaluating the results thereof. However, consideration of the risk of material misstatement is fundamental to effective application of the audit risk model and to every decision the external auditor must make and therefore should be included in the requirements of paragraph 15 when determining the planned use of the work of internal audit to give it equal weighting to the consideration of the amount of judgment involved.

The second sentence of paragraph A12 notes the higher the risk of material misstatement the less likely that the external auditor can make substantial use of the work of the internal audit function in obtaining sufficient appropriate audit evidence. CPAB believes this is a critical consideration that should be added as an additional requirement stating that for those assertions where the assessed risk of material misstatement is high (in particular for significant risks) the consideration of the internal auditor's work alone cannot reduce audit risk to an acceptable level. In these circumstances the external auditor should perform tests of those assertions directly.

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?**

While it is appropriate to require the external auditor to read the reports produced by the internal audit function that is only the first step in evaluating the basis for using the work of internal audit. Paragraph 19 provides the objectives of the external auditor in determining the adequacy of the work of the internal audit function for purposes of the audit engagement however CPAB believes the requirements need to be strengthened with respect to specific audit procedures the external auditor should perform to appraise the quality of the internal audit work. In CPAB's view there should be an additional requirement that the auditor shall perform "one or more" of the procedures listed in paragraph A18. The use of "one or more" would still allow the exercise of judgment by the external auditor to give consideration to the significance of the work of internal audit to the overall evidence obtained to support the audit opinion.

With respect to using the work of the internal audit function, CPAB is not in favour of the inclusion of the list of examples provided in application paragraph A17. Such a list could be viewed as circumstances where it is always appropriate to use the work of internal audit without further consideration.

**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:**

CPAB believes that it is desirable for the scope of ISA 610 to be expanded to address the matter of direct assistance as the ambiguity under the extant ISA 610 is not in the public interest.

**(a) Consider the factors that have been proposed in determining the work that may be assigned to individual internal auditors; and**

Given that internal auditors are not independent of the entity, CPAB believes the restrictions on the use of direct assistance from internal auditors in paragraph 23 should include areas assessed at a high risk of material misstatement at the assertion level (in particular for significant risks).

**(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?**

CPAB believes that in addition to "more extensive" direction, supervision and review paragraph 24 should require the external auditor to evaluate and test the work of the internal auditor.

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

CPAB believes that if the concerns raised in the body of our comment letter with respect to consideration of the assessed risk of material misstatement, determining the adequacy of internal audit's work and direct assistance are not addressed the resulting standard will be lower than current practice which is not in the public interest.

- 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.**

It is unlikely in the audit of smaller entities that there will be an internal audit function for which the external auditor could either use their work or obtain direct assistance therefore we do not believe further guidance needs to be developed.

- 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.**

Not relevant to our jurisdiction.

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

Not relevant to our jurisdiction.

- 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.**

Not relevant to our jurisdiction.

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

CPAB believes this consideration should be for the standard setters and practitioners to decide allowing for appropriate time for the revised standard to be implemented effectively.

- 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?**

See response to question 12.

- 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?**

Canada is adopting International Standards on Auditing for audits of financial statements for periods ending on or after December 14, 2010. Our inspections commencing in 2011 will assess audit firm compliance with the International Standards on Auditing. We annually update our inspection methodology to incorporate significant changes in professional standards.