

**STATEMENT OF AUDITING STANDARDS
500A
CONSIDERING THE WORK OF INTERNAL AUDITING**

*(Effective for audits of financial statements for periods beginning before 15 December 2004)**

<i>Contents</i>	<i>Paragraphs</i>
Introduction	1 - 4
Scope and objectives of internal auditing	5
Relationship between internal auditing and the external auditors	6 - 8
Understanding and assessment of internal auditing	9 - 13
Timing of liaison and coordination	14 - 15
Evaluating and testing the work of internal auditing	16 - 20
Compliance with International Standards on Auditing	21
Effective date	22

* HKSA 610 “Considering the Work of Internal Audit” is effective for audits of financial statements for periods beginning on or after 15 December 2004.

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*Statements of Auditing Standards (SASs) are to be read in the light of SAS 010 "The scope and authority of auditing pronouncements". In particular, they contain basic principles and essential procedures, (auditing standards), indicated by paragraphs in **bold italic type**, with which auditors are required to comply in the conduct of any audit including those of companies applying section 141D of the Companies Ordinance. SASs also include explanatory and other material which is designed to assist auditors in interpreting and applying auditing standards.*

Introduction

1. The purpose of this Statement of Auditing Standards (SAS) is to establish standards and provide guidance to external auditors in considering the work of internal auditing. This SAS does not deal with instances when personnel from internal auditing assist the external auditors in carrying out external audit procedures. The procedures noted in this SAS apply only to internal auditing activities which are relevant to the audit of the financial statements.
2. ***The external auditors should consider the activities of internal auditing and their effect, if any, on external audit procedures. (SAS 500.1)***
3. "Internal auditing" means an appraisal activity established within an entity as a service to the entity. Its functions include, amongst other things, examining, evaluating and monitoring the adequacy and effectiveness of the accounting and internal control systems.
4. While the external auditors have sole responsibility for the audit opinion expressed and for determining the nature, timing and extent of external audit procedures, certain parts of internal auditing work may be useful to the external auditors.

Scope and objectives of internal auditing

5. The scope and objectives of internal auditing vary widely and depend on the size and structure of the entity and the requirements of its management. Ordinarily, internal auditing activities include one or more of the following:
 - a. review of the accounting and internal control systems: the establishment of adequate accounting and internal control systems is a responsibility of management which demands proper attention on a continuous basis. Internal auditing is ordinarily assigned specific responsibility by management for reviewing these systems, monitoring their operation and recommending improvements thereto;
 - b. examination of financial and operating information: this may include review of the means used to identify, measure, classify and report such information and specific enquiry into individual items including detailed testing of transactions, balances and procedures;
 - c. review of the economy, efficiency and effectiveness of operations including non-financial controls of an entity; and
 - d. review of compliance with laws, regulations and other external requirements and with management policies and directives and other internal requirements.

Relationship between internal auditing and the external auditors

6. The role of internal auditing is determined by management, and its objectives differ from those of the external auditors who are appointed to report independently on the financial statements. The internal audit function's objectives vary according to management's requirements. The external auditors' primary concern is whether the financial statements are free of material misstatements.
7. Nevertheless some of the means of achieving their respective objectives are often similar and thus certain aspects of internal auditing may be useful in determining the nature, timing and extent of external audit procedures.
8. Internal auditing is part of the entity. Irrespective of the degree of autonomy and objectivity of internal auditing it cannot achieve the same degree of independence as required of the external auditors when expressing an opinion on the financial statements. The external auditors have sole responsibility for the audit opinion expressed, and that responsibility is not reduced by any use made of internal auditing. All judgements relating to the audit of the financial statements are those of the external auditors.

Understanding and assessment of internal auditing

9. *The external auditors should obtain a sufficient understanding of internal audit activities to assist in planning the audit and developing an effective audit approach. (SAS 500.2)*
10. Effective internal auditing often allows a modification in the nature and timing, and a reduction in the extent of procedures performed by the external auditors but cannot eliminate them entirely. In some cases however, having considered the activities of internal auditing, the external auditors may decide that internal auditing would have no effect on external audit procedures.
11. *During the course of planning the audit the external auditors should perform an assessment of the internal audit function if they consider that it may be possible and desirable to rely on certain internal audit work in specific audit areas for the purpose of the external audit of the financial statements. (SAS 500.3)*
12. The external auditors' assessment of the internal audit function influences the external auditors' judgement about the use which may be made of internal auditing in modifying the nature, timing and extent of external audit procedures.
13. When obtaining an understanding and performing an assessment of the internal audit function, the important criteria are set out below.
 - a. *Organisational status*

Specific status of internal auditing in the entity and the effect this has on its ability to be objective. In the ideal situation, internal auditors report to the highest level of management or audit committee and be free of any other operating responsibility. Any constraints or restrictions placed on internal auditing by management would be carefully considered. In particular, the internal auditors need to be free to communicate fully with the external auditors.
 - b. *Scope of function*

The nature and extent of internal auditing assignments performed. The external auditors would also consider whether management acts on internal audit recommendations and how this is evidenced.

c. *Technical competence*

Whether internal auditing is performed by persons having adequate technical training and proficiency as internal auditors. The external auditors may, for example, review the policies for hiring and training the internal auditing staff and their experience and professional qualifications.

d. *Due professional care*

Whether internal auditing is properly planned, supervised, reviewed and documented. The existence of adequate audit manuals, work programmes and working papers may be considered.

Timing of liaison and coordination

14. When planning to use the work of internal auditing, the external auditors would consider internal auditing's tentative plan for the period and discuss it at as early a stage as possible. Where the work of internal auditing is to be a factor in determining the nature, timing and extent of the external auditors' procedures, it is desirable to agree in advance the timing of such work, the extent of audit coverage, test levels and proposed methods of sample selection, documentation of the work performed and review and reporting procedures.
15. Liaison with internal auditing is more effective when meetings are held at appropriate intervals during the period. The external auditors seek to be advised of and have access to relevant internal auditing reports and be kept informed of any significant matter that comes to the internal auditors' attention which may affect the work of the external auditors. Similarly, the external auditors ordinarily inform the internal auditors of any significant matters which may affect internal auditing.

Evaluating and testing the work of internal auditing

16. *When the external auditors intend to use specific work of internal auditing, they should evaluate that work to confirm its adequacy for their purposes. (SAS 500.4)*
17. The evaluation of specific work of internal auditing involves consideration of the adequacy of the scope of work and related programmes and whether the assessment of the internal auditing remains appropriate. This evaluation may include consideration of whether:
 - a. the work is performed by persons having adequate technical training and proficiency as internal auditors and the work of assistants is properly supervised, reviewed and documented;
 - b. sufficient appropriate audit evidence is obtained to afford a reasonable basis for the conclusions reached;
 - c. conclusions reached are appropriate in the circumstances and any reports prepared are consistent with the results of the work performed;
 - d. any exceptions or unusual matters disclosed by internal auditing are properly resolved; and
 - e. there is a need to test the work of internal auditing to confirm its adequacy.
18. The nature, timing and extent of the testing, if any, of the specific work of internal auditing which the external auditors consider necessary depends on the external auditors' judgement as to the risk and materiality of the area concerned, the assessment of the internal auditing and the results of other evaluation of the specific work by internal auditing. Such tests may include examination of items already examined by internal auditing, examination of other similar items and observation of internal auditing procedures.

19. The external auditors would record conclusions regarding the specific internal auditing work that has been evaluated and tested.
20. In the event that the external auditors conclude that the work of internal auditing is not adequate for their purposes, they extend their procedures beyond those originally planned to ensure that sufficient appropriate audit evidence is obtained to support the conclusions reached.

Compliance with International Standards on Auditing

21. With the exception that SAS 500.4 paragraph 16 does not include a requirement to test the work of internal auditing to confirm its adequacy, as the adequacy of such work can often be assessed using some of the other procedures outlined in paragraph 17 and the criteria for determining whether to test the work of internal auditing are set out in paragraph 18, compliance with the auditing standards contained in this SAS ensures compliance in all material respects with the basic principles and essential procedures in International Standard on Auditing 610 "Considering the Work of Internal Auditing".

Effective date

22. This SAS is effective for audits of financial statements for periods beginning before 15 December 2004.