Using internal auditors and experts

MODULE 3 | 3.6.2 | STUDENT COMPANION

An external auditor can draw on three kinds of help: the entity's **internal audit function**, an **auditor's expert** and information from **management's expert**. Each needs a different evaluation before it counts as evidence, and none of them reduces the auditor's **sole responsibility** for the opinion. In Australia, internal auditors can't give direct assistance on the external audit.

Three kinds of help, side by side

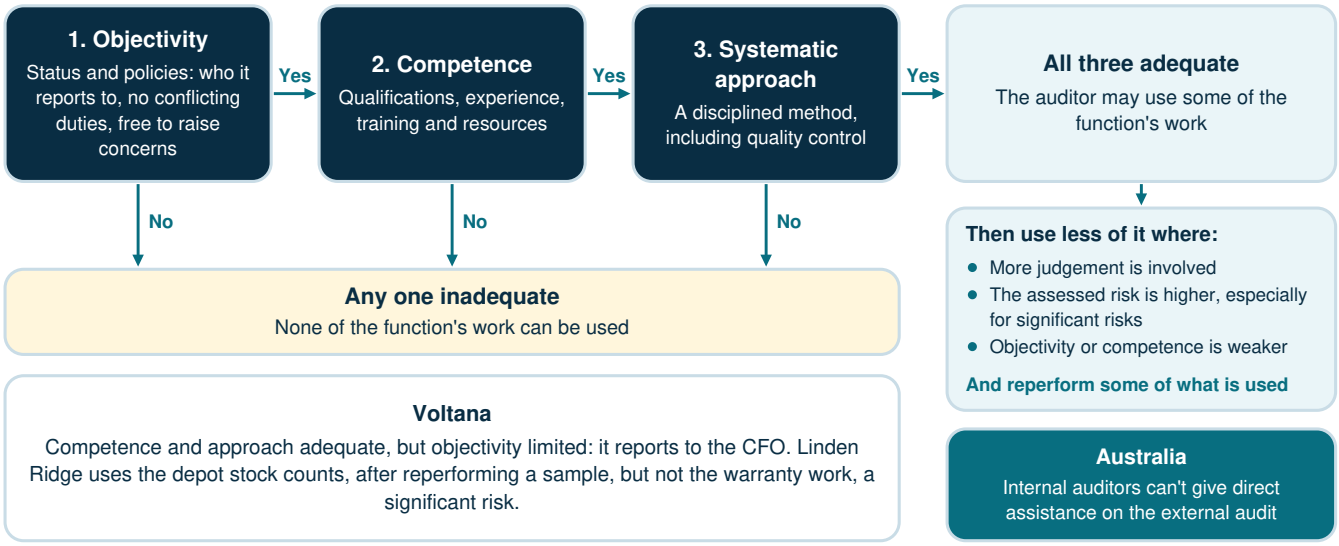
	Internal audit function ASA 610	Auditor's expert ASA 620	Management's expert ASA 500
Who they are	Part of the entity: evaluates the effectiveness of its governance, risk management and internal control	Skilled in a field outside accounting and auditing, such as engineering, valuation, actuarial science or IT; inside the audit firm or engaged from outside	Works for the entity, helping management prepare the financial statements, such as a valuer of property
What the auditor evaluates	Objectivity, competence and a systematic, disciplined approach	Competence, capabilities and objectivity; agreed terms of the work; whether the work is adequate	Competence, capabilities and objectivity; the work; whether it is appropriate evidence
At Voltana	Two experienced staff, reporting to the chief financial officer	The external engineer who reviewed battery failure rates	The property valuer the board engaged to assess the factory rent

In every case, the auditor keeps sole responsibility for the opinion

Internal audit

Internal audit's work can only be considered if it is relevant to the external audit. The auditor then evaluates the function as a whole: its **organisational status and policies** (do they support objectivity?), its **competence**, and whether it applies a **systematic and disciplined approach**, including quality control. If any of the three is inadequate, none of its work can be used.

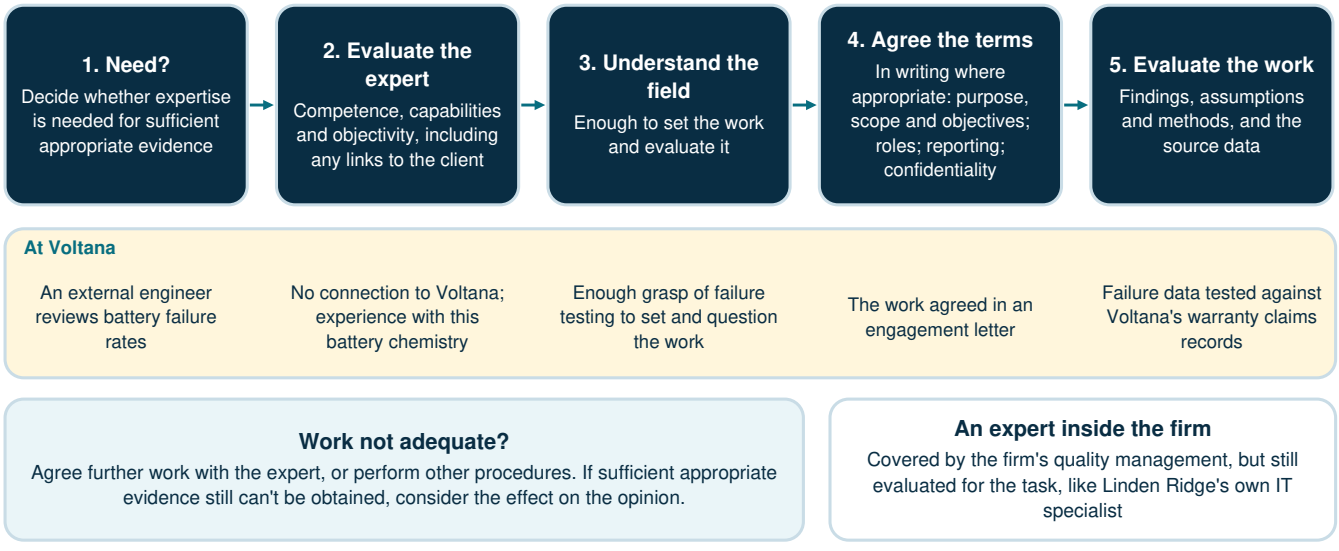
Can internal audit's work be used?



Using the work. The auditor discusses the planned use with internal audit, reads its reports, and performs procedures on the specific work it uses, including reperforming some of it. **Direct assistance**, where internal auditors work under the external auditor's direction on the external audit itself, is allowed by the international standard but not by the Australian one.

Voltana in one line: the reporting line to the CFO, whose conduct is now in question, limits objectivity, so Linden Ridge uses only lower-risk work it can check, and recommends that internal audit report directly to the audit committee in future.

Using an auditor's expert



Evaluating an expert's work

Look at	Questions to ask
Findings	Are they relevant and reasonable, and consistent with the other evidence?
Assumptions and methods	Are they appropriate for this purpose, and how sensitive is the answer to them?
Source data	Is the data the expert used relevant, complete and accurate? At Voltana, the failure data is tested against the warranty claims records

Management's expert

When information prepared by **management's expert** is used as audit evidence, the auditor evaluates the expert's competence, capabilities and objectivity, understands the work, and judges whether it is appropriate evidence for the assertion concerned. For Voltana's factory lease, the team checks the valuer's qualifications and independence from the chief executive, reads the valuation's assumptions, and compares its market rent with rents for similar industrial buildings nearby. Management's expert works for management, so scepticism needs to be at least as sharp as for any other management information.

The report. An unmodified auditor's report doesn't mention an expert unless the law requires it. A reference is allowed only where it helps explain a modified opinion, and then the report makes clear that it doesn't reduce the auditor's responsibility.

Practice questions

MODULE 3 | 3.6.2 | TRY THESE BEFORE THE WORKED ANSWERS

Question 1 - Can Fretwell's internal audit be used?

Fretwell Music Ltd (imagined) sells instruments, sheet music and lessons through 64 stores. Its external auditor would like to use internal audit's store visits, which include stock counts and checks on cash handling. **Reporting line:** the head of internal audit reports to the audit committee, which approves the annual plan and her appointment and pay; day-to-day administration runs through the CFO. **Staff:** the head is a chartered accountant with 14 years' experience; of three auditors, two are part-way through professional qualifications, and one joined last year from store operations, where he managed the Victorian stores. **Methods:** a written audit manual; all working papers reviewed by the head; an external quality assessment two years ago found the function generally conforms with internal auditing standards; store visits are announced a week ahead. Evaluate whether, and how, the external auditor can use internal audit's work.

Question 2 - Terms for an auditor's expert

Ellerby Family Investments Pty Ltd (imagined) holds shares, property and a collection of about 40 Australian paintings, carried at valuation at about $9 million. Its auditor will engage an independent art valuer, as an auditor's expert, to value the collection at 30 June. Draft the key terms of the agreement with the valuer.

Question 3 - A management's expert

Glenmora Property Ltd (imagined) owns a business park of six industrial buildings, carried at fair value as investment property at $84 million. Management engaged a valuer from a national firm; the valuation is dated 31 May, and the valuer's firm also manages the leasing of two of the buildings for a fee. How would you evaluate the valuer and the valuation?

Worked answers

MODULE 3 | 3.6.2 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Question 1 - Fretwell Music (suggested)

Gate	Evaluation
Objectivity	Generally supported: the head reports to the audit committee, which approves the plan and her appointment and pay (administration through the CFO is common). But the former manager of the Victorian stores would be reviewing his own past work, so his visits to those stores aren't used
Competence	Adequate: an experienced, qualified head, and developing staff whose work she reviews
Systematic approach	Adequate: a manual, review of every file and a recent external quality assessment; but announcing visits a week ahead weakens the stock counts

- **Conclusion.** Some work can be used, but less where judgement or risk is higher, such as slow-moving stock or any significant risk. Discuss it with the head, read the reports, and reperform a sample: attend some visits and recount items.
- **No direct assistance.** In Australia, internal auditors can't perform procedures for the external audit under the external auditor's direction.

Question 2 - Key terms with the art valuer

Term	What it should say
Nature, scope and objectives	Value each painting at fair value at 30 June; which works are covered; inspect each one; report any doubts about condition or authenticity
Roles and responsibilities	The valuer inspects the works and uses market evidence such as auction results; the audit team tests management's list of works, purchase records and proof of ownership
Communication and reporting	Timetable and meetings; a written report giving each value, the method, the sales evidence used and any works not inspected
Confidentiality	Client information, including where the works are kept, stays confidential and secure
In writing	An engagement letter suits an external valuer and a material balance. Also agree: no links to the family or past dealings in these works; a fee not tied to the values; deadlines

Question 3 - Glenmora's valuer

- **Competence and capabilities.** Qualifications and membership (such as a Certified Practising Valuer), experience with industrial property in that market, and enough resources.
- **Objectivity.** The valuer works for management, and the leasing fees add a self-interest threat. Ask about all fees, how the valuer was appointed, any links to directors, and any fee tied to the value.
- **Understand the work.** The terms and any limits management set; the method (income capitalisation, discounted cash flow or sales comparison); key assumptions such as capitalisation rates, market rents and vacancies; the valuation standards followed.
- **Evaluate it as evidence.** Test the rent roll against signed leases; compare rates and rents with market data and recent sales; consider changes between 31 May and 30 June; check the amount and the disclosures. If doubts remain, engage the auditor's own valuation expert.