

## **Exposure Draft**

February 2012

*Comments due: May 31, 2012*

# Proposed Change to the Definition of “Engagement Team”

**IESBA**

International  
Ethics Standards  
Board for Accountants

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The objective of the IESBA is to serve the public interest by setting high-quality ethical standards for professional accountants and by facilitating the convergence of international and national ethical standards, including auditor independence requirements, through the development of a robust, internationally appropriate code of ethics.

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## REQUEST FOR COMMENTS

This Exposure Draft, *Proposed Change to the Definition of “Engagement Team”* was developed and approved by the International Ethics Standards Board for Accountants (IESBA).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by May 31, 2012.**

Respondents are asked to submit their comments electronically through the IESBA website, using the “Submit a Comment” link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. Although the IESBA prefers that comments be submitted via its website, comments can also be sent to Jan Munro, IESBA Deputy Director at [janmunro@ethicsboard.org](mailto:janmunro@ethicsboard.org).

This publication may be downloaded free of charge from the IESBA website: [www.ethicsboard.org](http://www.ethicsboard.org). The approved text is published in the English language.

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# EXPLANATORY MEMORANDUM

## Introduction

This memorandum provides background for, and an explanation of, the proposed change to the definition of “engagement team” in the IESBA *Code of Ethics for Professional Accountants* (the Code). The International Ethics Standards Board for Accountants (IESBA) approved these proposed changes in February 2012 for exposure.

## Background

The International Auditing and Assurance Standards Board (IAASB) has revised ISA 610 *Using the Work of Internal Auditors*. Its objective was to “revise [the clarified] ISA 610 to reflect developments in the internal audit environment and changes in practice regarding the interactions between external and internal auditors.”

The issues the IAASB considered included:

- The external auditor’s assessment of the competence and objectivity of the internal audit function; and
- Expansion of the scope of ISA 610 to address instances of internal audit staff providing direct assistance to the auditor.

A number of respondents to the IAASB’s exposure draft of a revised ISA 610 commented on the apparent inconsistency between the use of internal auditors to perform external audit procedures and the requirement under the Code for external auditors to be independent of the audit client. Some of these respondents expressed the view that internal auditors performing external audit procedures, by definition, would be part of the engagement team and noted that the Code required the engagement team to be independent of the audit client. The IESBA concluded that it should consider the comments related to direct assistance and the definition of the engagement team.

## Significant Matters Considered During the Review

Both the IAASB and the IESBA have carefully considered the requirements and guidance on direct assistance in ISA 610 and whether the safeguards outlined in the revised standard adequately address the threats to the external auditor’s objectivity. In particular, the requirements of ISA 610 now include a number of restrictions on internal auditors providing direct assistance to external auditors. In addition, a new requirement was introduced at the suggestion of the IESBA regarding the need to communicate to those charged with governance 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. The IESBA felt this was a necessary safeguard because, notwithstanding the direction, supervision, and review by the external auditor, excessive direct assistance by internal auditors may affect perceptions regarding the independence of the audit.

The IESBA is now proposing to amend the Code to avoid any perception that the Code is in conflict with the ISA.

The paragraphs from the revised ISA, approved by the IAASB in December 2011, that address the threats to independence of using internal auditors for direct assistance and the related safeguards designed to reduce such threats to an acceptable level are as follows:

28. The external auditor shall not use an internal auditor to provide direct assistance if:
- (a) There are significant threats to the objectivity of the internal auditor; or
  - (b) The internal auditor lacks sufficient competence to perform the proposed work. (Ref: Para. A32–A33)

*Determining the Nature and Extent of Work that Can Be Assigned to Internal Auditors Providing Direct Assistance*

29. 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; and
    - (ii) Evaluating the audit evidence gathered;
  - (b) The assessed risk of material misstatement; and
  - (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. (Ref: Para. A34–A38)
30. The external auditor shall not use internal auditors to provide direct assistance to perform procedures that:
- (a) Involve making significant judgments in the audit; (Ref: Para. A19)
  - (b) 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; (Ref: Para. A37)
  - (c) 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; or
  - (d) Relate to decisions the external auditor makes in accordance with this ISA regarding the internal audit function and the use of its work or direct assistance. (Ref: Para. A34–A38)
31. The external auditor shall, in communicating with those charged with governance an overview of the planned scope and timing of the audit in accordance with ISA 260,<sup>1</sup> 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. (Ref: Para. A38)

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<sup>1</sup> ISA 260, *Communication with Those Charged with Governance*, paragraph 15

### Using Internal Auditors to Provide Direct Assistance

32. Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:
  - (a) Obtain 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; and
  - (b) Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.
33. The external auditor shall direct, supervise and review the work performed by internal auditors on the engagement in accordance with ISA 220.<sup>2</sup> In so doing:
  - (a) 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 29 of this ISA; and
  - (b) 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. (Ref: Para. A39–A40)

### Definition of engagement team

During the development by the IAASB of the revised ISA 610, the IESBA considered whether individuals in the internal audit function providing direct assistance would be included within the definition of the engagement team, and therefore be required to be independent of the audit client. The IESBA concluded that such individuals do not meet the definition of a member of the engagement team because they are not partners or a member of the professional staff of the firm or network firm, nor are they engaged by the firm or network firm. Comments from several respondents to the IAASB exposure draft, however, indicated that there was uncertainty as to whether the definition would capture these individuals as part of the engagement team.

The IESBA proposes the following change to the definition of engagement team. It clarifies that individuals in an internal audit function providing direct assistance do not meet the definition of the engagement team under the Code. This should help to avoid any perceived incompatibility between the Code and the ISAs:

*Engagement team*—All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform assurance procedures on the engagement. This excludes external experts engaged by the firm or by a network firm. It also excludes individuals within an audit client's internal audit function providing direct assistance on the engagement in accordance with ISA 610 Using the Work of Internal Auditors.

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<sup>2</sup> ISA 220, *Quality Control for an Audit of Financial Statements*

Subject to comments received on exposure, the IAASB will make a similar amendment to the definition of engagement team in the ISAs and ISQC 1 so as to align with the IESBA Code.

For interested parties, the full approved wording of ISA 610 (Revised) is available on the IAASB's website.<sup>3</sup>

## **Analysis of the Overall Impact of the Proposed Changes**

The proposed revision to the definition of engagement team clarifies that internal auditors providing direct assistance in accordance with ISA 610 *Using the Work of Internal Auditors* are not to be considered part of the engagement team for purposes of the Code and, accordingly, are not required to meet the independence requirements that apply to members of the engagement team. An impact of the revision would be that where such use is not in accordance with the ISA, the use of internal auditors for direct assistance would impair the independence of the firm. The extent of the impact would depend on the extent of the use of direct assistance that is not in accordance with ISA 610. Otherwise, the impact of the change in the definition is expected to be minimal.

## **Effective Date**

The IESBA proposes that the change be effective three months after approval of the final change to the Code.

## **Project Timetable**

Subject to comments received on exposure, the IESBA expects to finalize the revision to the Code in the first half of 2012.

## **Guidance to Respondents**

The IESBA welcomes comments on all matters addressed in the exposure draft. Comments are most helpful when they include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed wording changes. When a respondent agrees with proposals in the exposure draft (especially those calling for modification in current practice), it is helpful for the IESBA to be made aware of this view.

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<sup>3</sup> ([http://www.ifac.org/sites/default/files/meetings/files/20111209-IAASB-Updated\\_Agenda%20Item%204-D-ISA\\_610\\_Revised-final\\_0.pdf](http://www.ifac.org/sites/default/files/meetings/files/20111209-IAASB-Updated_Agenda%20Item%204-D-ISA_610_Revised-final_0.pdf))



# EXPOSURE DRAFT

## DEFINITIONS

The definition of “engagement team” would be changed to:

*Engagement team*—All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform assurance procedures on the engagement. This excludes external experts engaged by the firm or by a network firm. It also excludes individuals within an audit client’s internal audit function providing direct assistance on the engagement in accordance with ISA 610 Using the Work of Internal Auditors.



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