Definition of Engagement Team and Independence of Component Auditors in a Group Audit—Issues and Proposals

I. Background

IESBA Strategy and Work Plan, 2019-2023

1. During the IESBA’s consultation on its Strategy and Work Plan for 2019-2023 (SWP), many respondents expressly supported an enhanced level of strategic and technical coordination with the other SSBs, particularly the International Auditing and Assurance Standards Board (IAASB), with transparency provided about the work and status of such efforts. Among the responses to the SWP consultation paper, there was also an encouragement for the IESBA to consider a project to address practical issues encountered by group and component auditors in applying the independence standards in the audit of group financial statements. The IESBA Planning Committee was of the view that it would be appropriate for the Board to explore the need for clarifications in this area, in coordination with the IAASB’s project to revise its group audits standard (International Standard on Auditing (ISA) 600).1

Matters Identified by the Emerging Issues and Outreach Committee (EIOC)

2. As part of its monitoring of the external environment for emerging issues or developments, the EIOC has identified a number of questions relating to the application of the independence requirements with respect to component auditors. These include the following:

- The implications when a parent entity is a public interest entity (PIE) but a component is not and that component is audited by a non-network firm, in particular whether the component auditor would need to follow the independence requirements that apply to PIEs or non-PIEs.

- The practical implications when there is a breach of independence at the component auditor, but the group auditor intends to rely on the component auditor’s work,2 and what the reporting requirements would be for such a breach.

- Consideration of intra-firm reporting when the group auditor is from one network firm and the component auditor is from another network firm. The Code appears to assume that the “firm” is from the same network, but this may not always be the case. With mandatory audit firm rotation already in place in some jurisdictions, the frequency of multiple network firms being involved may increase.

---

1 International Standard on Auditing (ISA) 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)

2 From an audit perspective, extant ISA 600, paragraph 20, states the following: “If a component auditor does not meet the independence requirements that are relevant to the group audit, or the group engagement team has serious concerns about the other matters listed in paragraph 19(a)–(c), the group engagement team shall obtain sufficient appropriate audit evidence relating to the financial information of the component without requesting that component auditor to perform work on the financial information of that component.”
Relevant Developments Pertaining to the IAASB’s Agenda

3. Respondents to the IAASB’s December 2015 Invitation to Comment (ITC), Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism, Quality Control and Group Audits were supportive of a project to modernize ISA 220 for an evolving environment, including changes in audit delivery models and the use of technology.

4. As a result, the IAASB issued the exposure draft Proposed ISA 220 (Revised) in February 2019. ED-220 (Revised) proposed changing the definition of an engagement team as follows:

   Engagement team – All partners and staff performing the audit engagement, and any individuals who perform audit procedures on the engagement, including individuals engaged by the firm or a network firm, who perform audit procedures on the engagement. This engagement team excludes an auditor’s external expert engaged by the firm or a network firm. The term “engagement team” and also excludes individuals within the client’s internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013).

5. In ED-220 (Revised), the IAASB proposed changing the definition of engagement team to recognize different and evolving engagement team structures to address the concerns identified in the ITC and the project proposal. Importantly, the IAASB wanted to recognize that, regardless of the location or employment status of the individuals involved in the audit, if they are performing audit procedures their work needs to be appropriately directed, supervised and reviewed.

The Interaction Between ISAs 220 and 600

6. ED-220 (Revised) is designed to operate as part of the broader system of quality management established by the IAASB’s Quality Management standards and ISA 600 at both the firm and engagement level. It was noted from responses to the ITC that some stakeholders view the interaction of the requirements, definitions, and guidance in ISAs 220 and 600 as causing difficulty in practice. In particular, there was a view that it would be necessary to consider how the definition of “group engagement team” relates to the definition of “engagement team” in ISA 220.

7. In addition to clarifying the links between ISAs 220 and 600, respondents also requested clarification as to which engagement participants fall within or outside the definitions of “group engagement team” and “component auditor” given different and evolving team structures, including when a group engagement team also functions as component auditor(s).

8. As a result, as part of the IAASB’s project to strengthen the auditor’s approach to planning and performance of a group audit, the IAASB has undertaken to clarify the interaction of ISA 600 with ISA 220 and the other ISAs.

---

3 ISA 220, Quality Control for an Audit of Financial Statements
4 ED-220 (Revised), paragraph 10(d)
5 International Standard on Auditing (ISA) 600, Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)
Responses to ED-220 (Revised) Relevant to IESBA-specific Matters

9. Respondents to ED-220 (Revised) were generally supportive of the proposed changes in the ED. The ED asked respondents:

   Does ED-220 deal adequately with the modern auditing environment, including the use of different audit delivery models and technology?

10. Many respondents used this question to comment on the change to the definition of an engagement team. In particular, with regard to the interactions of the proposed revised definition with relevant ethical requirements, some raised practical concerns related to alignment with the independence requirements in the Code. Respondents suggested the need for coordination with the IESBA in this regard. (See summary of the relevant comments from respondents to ED-220 (Revised) included in the September 2019 IESBA agenda material.)

11. The definition of engagement team in the Code was developed based on the engagement team definition in extant ISA 220. Accordingly, changing the definition in ISA 220 (Revised) to include component auditors has several practical implications with respect to compliance with the independence requirements of the Code in the context of group audits.

12. For example, as the IESBA coordination representatives explained to the ISA 220 Task Force, for component auditors that do not belong to the group auditor’s network, it would not be practicable for the group auditor to implement the monitoring and disciplinary procedures necessary to ensure the component auditors’ compliance with all applicable independence requirements, as the component auditors are outside the group auditor’s control. These independence requirements apply to every member of the engagement team and include those relating to, for example, financial interests, business relationships and employment relationships. Many of the independence requirements also apply to immediate and close family members of the relevant individuals. Thus, a breach of an independence requirement at a component could result in a breach of independence for the entire group audit.

13. The IESBA coordination representatives also explained to the ISA 220 Task Force that including component auditors in the engagement team definition may result in the IAASB setting de facto independence requirements for component auditors. For instance, some of the personal independence requirements (such as in relation to financial interests) in the Code apply to engagement team members within the firm and network firms but not to individuals at component auditors outside the network. Including component auditors in the engagement team would extend those requirements to them.

II. Proposed Way Forward

ISA 220 Task Force’s Proposed Changes to ED-220 (Revised)

14. The ISA 220 Task Force is of the view that the principles behind the definition set out in ED-220 (Revised) should continue to underpin the revised definition for the following main reasons:

   • This is the approach generally supported by most respondents, including the Monitoring Group and other regulatory respondents.

   • It is the same approach as the US Public Company Accounting Oversight Board (PCAOB) is proposing in its project on Supervision of Audits Involving Other Auditors, which will reduce differences for firms that need to apply both sets of auditing standards.
It is preferable for the scope of the engagement team to be dealt with in proposed ISA 220 (Revised), as it is a foundational standard and the definitions are intended to apply to all audit engagements, regardless of their nature or circumstance.

15. However, as a result of the feedback provided by the IESBA coordination representatives, the ISA 220 Task Force and ISA 600 Task Force agreed to work towards “decoupling” the quality management objectives in proposed ISA 220 (Revised) from the independence considerations with respect to the expanded engagement team definition. This would make clear that the IAASB’s intent in revising the definition of an engagement team is to address audit quality matters, including in a group audit context (that is, dealing with the implications for the audit if a component auditor does not meet the independence requirements that are relevant to the audit of the group financial statements\(^7\)), leaving it to the Code to deal with setting the independence requirements with respect to component auditors working on the group financial statements.

16. To clarify that the IAASB’s intent is to include component auditors in the engagement team definition but to avoid the practical consequence of setting independence requirements for them, the ISA 220 Task Force provided the IESBA coordination representatives with three options. The first two options included an explicit reference to component auditors in the definition itself, with application material to a varying level of detail that decoupled the quality considerations from the independence considerations for component auditors.

17. The third option took a more generic approach to the definition, focusing only on all those who perform audit procedures on the engagement, with application material explaining that this would include component auditors and that relevant ethical requirements would address the independence considerations that would apply to them.

18. The IESBA coordination representatives preferred the third option as that would provide the greatest flexibility for the IESBA to address the relevant independence considerations applicable to component auditors in the Code. Taking into account this input, the ISA 220 Task Force is proposing changes to ED-220 (Revised) that reflects that option (see the Appendix). The revised text will be considered at the December 2019 IAASB meeting.

Recommended Way Forward for the IESBA

19. Subject to Board members’ views on the ISA 220 Task Force’s proposed changes to ED-220 (Revised) as set out in the Appendix and the IAASB’s further deliberations, the IESBA coordination representatives recommend that the Board consider taking up the proposed revised engagement team definition in the Code but address the implications for component auditors’ independence as part of a broader project linked to coordination with the ISA 600 project.

20. Should the Board support this recommendation, the IESBA coordination representatives recommend that the Board form a working group with the view to developing a project proposal for the Board’s consideration and approval at the March 2020 meeting.

\(^7\) ISA 600, paragraph 20
Matters for IESBA Consideration

1. IESBA members are asked for views on the ISA 220 Task Force’s proposed changes to ED-220 (Revised) as set out in the Appendix insofar as they relate to independence.

2. Does the IESBA agree with addressing the implications of the revised engagement team definition and the independence considerations pertaining to component auditors as part of a new project linked to coordination with the ISA 600 project?
APPENDIX

[Extract from IAASB December 2019 Board Paper Agenda Item 9-A]

Proposed International Standard on Auditing (ISA) 220 (Revised), Quality Management for an Audit of Financial Statements

Definitions

10. For purposes of the ISAs, the following terms have the meanings attributed below:

(a) …

(d) Engagement team – All partners and staff performing the audit engagement, and any other individuals who perform audit procedures on the engagement. The engagement team excludes an auditor’s external expert engaged by the firm or a network firm, and internal auditors who provide direct assistance on an engagement. (Ref: Para. A16–A19A)

…

Requirements

…

Relevant Ethical Requirements, Including Those Related to Independence

14. The engagement partner shall have an understanding of the relevant ethical requirements, including those related to independence, that are applicable given the nature and circumstances of the audit engagement. (Ref: Para. A31–A35, A41)

15. The engagement partner shall take responsibility for other members of the engagement team having been made aware of relevant ethical requirements that are applicable given the nature and circumstances of the audit engagement, and the firm’s related policies or procedures, including those that address: (Ref: Para. A32A–A37)

(a) Identifying, evaluating and addressing threats to compliance with relevant ethical requirements, including those related to independence;

(b) Circumstances that may cause a breach of relevant ethical requirements, including those related to independence, and their responsibilities when they become aware of actual or suspected breaches; and

(c) Their responsibilities when they become aware of an instance of actual or suspected non-compliance with laws and regulations.

16. If matters come to the engagement partner’s attention that indicate that a threat to compliance with relevant ethical requirements exists, the engagement partner shall evaluate the threats through

---

8 ISA 620, Using the Work of an Auditor’s Expert, paragraph 6(a), defines the term “auditor’s expert.”

9 ISA 610 (Revised 2013), Using the Work of Internal Auditors, establishes limits on the use of direct assistance. It also acknowledges that the external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. Therefore, the use of direct assistance is restricted to situations where it is permitted.

10 ISA 250 (Revised), Considerations of Laws and Regulations in an Audit of Financial Statements
complying with the firm’s policies or procedures, using relevant information from the firm, the
engagement team or other sources, and take appropriate action. (Ref: Para. A36–A37)

17. The engagement partner shall remain alert throughout the audit engagement, through observation
and making inquiries as necessary, for actual or suspected breaches of relevant ethical requirements
or the firm’s related policies or procedures by members of the engagement team. (Ref: Para. A38)

18. If matters come to the engagement partner’s attention through the firm’s system of quality
management, or from other sources, that indicate that relevant ethical requirements applicable to the
nature and circumstances of the audit engagement have not been fulfilled, the engagement partner,
in consultation with others in the firm, shall take appropriate action. (Ref: Para. A39)

19. Prior to dating the auditor’s report, the engagement partner shall take responsibility for determining
whether relevant ethical requirements, including those related to independence, have been fulfilled.
(Ref: Para. A31 and A40)

…

* * *

Application and Other Explanatory Material

…

Definitions

Engagement Team (Ref: Para. 10(d))

A16. Engagement teams may be organized in a variety of ways. For example, engagement team members
may be located together or across different geographic locations, and may be organized in groups
by the activity they are performing. Regardless of how the engagement team is organized, any
individual who performs audit procedures on the audit engagement is a member of the engagement
team.

A16A. The definition of an engagement team focuses on individuals who perform audit procedures on the
audit engagement. Audit procedures include risk assessment procedures and further audit
procedures. As explained in ISA 500, audit procedures include inspection, observation, confirmation, recalculation, reperformance, analytical procedures and inquiry, often performed in
some combination. As explained in ISA 330, audit evidence obtained from previous audits may, in
certain circumstances, provide appropriate audit evidence where the auditor performs audit
procedures to establish its continuing relevance.

---

11 ISA 500, Audit Evidence, paragraph A10
12 ISA 315 (Revised 2019) provides requirements related to risk assessment procedures
13 ISA 330, The Auditor’s Responses to Assessed Risks, provides requirements related to further audit procedures, including tests of controls and substantive procedures
14 ISA 500, paragraphs A14–A25
15 ISA 330, paragraph A35
A16B. Engagement teams may include individuals who perform audit procedures from:

(a) The firm or network firms.
(b) Firms that are not network firms.

For example, such individuals may perform audit procedures on the financial information of a component in a group audit engagement, attend a physical inventory count or inspect physical fixed assets at a remote location.

A17. Engagement teams may also include individuals from service delivery centers who perform audit procedures. For example, the firm may determine that specific tasks that are repetitive or specialized in nature can be performed by a group of appropriately skilled personnel and the engagement team may therefore include such individuals. Service delivery centers may be established at the firm level, at the network level, or by another firm or group of firms from within the same network. For example, a centralized function may be used to facilitate external confirmation procedures.

A17A. Engagement teams may include individuals with expertise in a specialized area of accounting or auditing who perform audit procedures on the audit engagement, for example, individuals with expertise in accounting for income taxes, information technology or in using automated tools to analyze complex data or to perform statistical analysis. An individual with such expertise is not a member of the engagement team if that individual’s involvement with the engagement is limited to consultation. Consultations are addressed in paragraphs 32 and A84–A87.

A19. If the audit engagement is subject to an engagement quality review, the engagement quality reviewer, and any other individuals performing the engagement quality review, are not members of the engagement team. Such individuals may be subject to specific independence requirements.

A19A. An internal auditor providing direct assistance and an auditor’s external expert whose work is used in the engagement are not members of the engagement team.\(^{16}\) ISA 610 and ISA 620 provide requirements and guidance for the auditor when using the work of an external expert or when using the work of internal auditors in a direct assistance capacity. Compliance with these ISAs requires the auditor to perform audit procedures on the work of an auditor’s expert and obtain sufficient appropriate audit evidence on the work performed by an internal auditor providing direct assistance.

…

Relevant Ethical Requirements, Including Those Related to Independence (Ref: Para. 14–19)

Relevant Ethical Requirements

Note: A31 provides a link to ISA 600 for when the engagement team includes component auditors. This sentence was added in response to comment letters.

---

\(^{16}\) See ISA 620, paragraphs 12–13 and ISA 610 (Revised 2013), paragraphs 21–25
A31. ISA 200\textsuperscript{17} requires that the auditor comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements may vary depending on the nature and circumstances of the engagement. For example, certain requirements related to independence may be applicable only when performing audits of listed entities. ISA 600 includes additional requirements and guidance to those in this ISA regarding communications about relevant ethical requirements with component auditors.

A32. Based on the nature and circumstances of the audit engagement, certain relevant ethical requirements, or aspects of law or regulation, may be significant to the engagement, for example law or regulation dealing with money laundering, corruption or bribery.

The Application of Firm Policies or Procedures to Members of the Engagement Team

\begin{itemize}
\item \textbf{Note:} A32A sets up the principle that firm policies or procedures may vary depending on how the engagement team is organized, and that those policies or procedures may require different interactions with individuals outside the firm.
\end{itemize}

A32A.Under proposed ISQM 1, the firm is required to identify and assess quality risks to provide a basis for the design and implementation of responses (i.e., policies or procedures). That identification and assessment of quality risks takes into account the nature and circumstances of the firm, including whether the firm is part of a network as well as the nature and circumstances of engagements. Accordingly, firm policies or procedures may also vary depending on how the engagement team is organized. In particular, the firm's policies or procedures relevant to the firm's personnel will, in certain circumstances, be different from those that address the interaction of the firm's personnel with individuals who are part of the network firm or another firm.

\begin{itemize}
\item \textbf{Note:} A32B expands on the previous paragraph to provide examples of matters that firm policies or procedures may cover. It is compliant with requirements in extant ISA 600.
\end{itemize}

A32B.In particular, firm policies or procedures may require the firm or the engagement partner to take different actions to those used within the firm when obtaining an understanding of whether an individual from a network firm or another firm:

\begin{itemize}
\item Has the appropriate competence and capabilities, including sufficient time, to perform the audit engagement. For example, the individual would not be subject to the firm's recruitment and training processes and therefore the firm's policies or procedures may state that this determination can be made through other actions such as obtaining information about the individual's professional body or from group management in the case of a group audit. Paragraphs \textcolor{blue}{19 and A38} of ISA 600 contain guidance on the competence and capabilities of component auditors.
\item Understands the ethical requirements that are relevant to the group audit engagement. For example, the individual would not be subject to the firm's training in respect of the firm's policies or procedures for relevant ethical requirements. The firm's policies or procedures may state that this understanding is obtained through other actions such as providing information, manuals or guides containing the provisions of the relevant ethical requirements applicable to the audit engagement directly to the individual concerned.
\end{itemize}

\[\textsuperscript{17} \text{ISA 200, paragraphs 14 and A16–A19}\]
• Will comply with relevant ethical requirements, and, in particular, is independent of the group engagement. For example, individuals from another firm may not be able to complete independence declarations directly on the firm’s independence systems. The firm’s policies or procedures may state that such individuals can provide evidence of their independence in relation to the audit engagement in other ways, such as written confirmation.

• Note: A32C explains how firm policies or procedures may need to be communicated to those outside of the network so that the audit quality implications of, for example, a need to consult on a difficult or contentious matter is appropriately addressed across the audit of the group financial statements.

A32C. Where firm policies or procedures require specific activities to be undertaken in certain circumstances (e.g., in relation to an audit engagement where the firm’s policies or procedures require consultation on specific matters), it may be necessary for the firm’s policies to be communicated to individuals who are not firm personnel so that such individuals are able to alert the engagement partner about the matter, and the engagement partner is able to follow the firm’s policies or procedures. For example, in a group audit engagement, if a component auditor is performing audit procedures on the financial information of a component and identifies a difficult or contentious matter that is relevant to the group financial statements and subject to consultation under the group auditor’s policies or procedures, the component auditor is able to alert the group engagement team about the matter.

• Note: A33 is largely unchanged from ED-220, except to remove a point about the firm’s information system in response to IESBA representatives’ comments.

A33. The information and communication component of the firm’s system of quality management and the resources provided by the firm may assist the engagement partner and other members of the engagement team in understanding and fulfilling relevant ethical requirements applicable to the nature and circumstances of the audit engagement in accordance with paragraphs 14–19. For example:

• Communicating the independence requirements to all engagement team members subject to independence requirements, as applicable.

• Providing training for engagement team members on relevant ethical requirements.

• Establishing manuals and guides (i.e., intellectual resources) containing the provisions of the relevant ethical requirements and guidance on how they are applied in the circumstances of the firm and the engagements it performs.

• Assigning personnel (i.e., human resources) to manage and monitor compliance with relevant ethical requirements (e.g., ISQM 1 requires that the firm obtain, at least annually, a documented confirmation of compliance with the independence requirements from all personnel required by relevant ethical requirements to be independent) or to provide consultation on matters related to relevant ethical requirements.

• Establishing policies or procedures for engagement team members to communicate relevant information to appropriate parties within the firm or to the engagement partner, such as requirements for engagement team members to:

18 See paragraph 32
Communicate information about client engagements and the scope of services, including non-assurance services, to enable the firm to identify threats to independence during the period of the engagement and during the period covered by the subject matter.

Communicate circumstances and relationships that may create a threat to independence, so that the firm can evaluate whether such a threat is at an acceptable level and if it is not, address the threat by eliminating it or reducing it to an acceptable level.

Promptly communicate any breaches of the relevant ethical requirements, including those related to independence.

A34. The engagement partner may take into account the information, communication and resources described in paragraph A33 when determining whether, and if so, the degree to which, the engagement partner may depend on the firm’s policies or procedures in complying with relevant ethical requirements.

A35. Open and robust communication between the engagement partner and the members of the engagement team about relevant ethical requirements may also assist in:

- Drawing the attention of engagement team members to relevant ethical requirements that may be of particular significance to the audit engagement; and
- Keeping the engagement partner informed about matters relevant to the engagement team’s understanding and fulfillment of relevant ethical requirements and the firm’s related policies or procedures.

Identifying and Evaluating Threats to Compliance with Relevant Ethical Requirements (Ref: Para. 15–16)

A36. In accordance with proposed ISQM 1, the firm’s responses to address the quality risks in relation to relevant ethical requirements, including those related to independence for engagement team members, include policies or procedures that address the identification and evaluation of threats to compliance with the relevant ethical requirements and how identified threats should be addressed.

A37. Relevant ethical requirements may contain provisions regarding the identification and evaluation of threats and how they should be dealt with. For example, the IESBA Code explains that a self-interest threat to compliance with the fundamental principle of professional competence and due care may arise if the fee quoted for an audit engagement is so low that it might be difficult to perform the engagement in accordance with professional standards.

Actual or Suspected Breaches of Relevant Ethical Requirements (Ref: Para. 17)

A38. In accordance with proposed ISQM 1, the firm is required to establish policies or procedures that address the identification, communication, evaluation and reporting of breaches and actions to address the causes and consequences of the breaches.

Taking Appropriate Action (Ref: Para. 18)

A39. Appropriate actions may include, for example:

- Following the firm’s policies or procedures regarding breaches of relevant ethical requirements, including communicating to or consulting with the appropriate personnel within the firm so that appropriate action can be taken, including as applicable, disciplinary action(s).
• Communicating with those charged with governance.
• Communicating with regulatory authorities. In some circumstances, communication with regulatory authorities may be required by law or regulation.
• Seeking legal advice.
• Withdrawing from the audit engagement, when withdrawal is possible under applicable law or regulation.

Prior to Dating the Auditor’s Report (Ref: Para. 19)

A40. ISA 700 (Revised) requires that the auditor’s report include a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit, and that the auditor has fulfilled the auditor’s other ethical responsibilities in accordance with these requirements. Performing the procedures required by paragraphs 14–19 of this ISA provides the basis for these statements in the auditor’s report.

Considerations Specific to Public Sector Entities

A41. Statutory measures may provide safeguards for the independence of public sector auditors. However, public sector auditors or audit firms carrying out public sector audits on behalf of the statutory auditor may, depending on the terms of the mandate in a particular jurisdiction, need to adapt their approach to promote compliance with the spirit of paragraph 14. This may include, where the public sector auditor’s mandate does not permit withdrawal from the audit engagement, disclosure through a public report of circumstances that have arisen that would, if they were in the private sector, lead the auditor to withdraw.

\[\text{\footnotesize 19} \text{ ISA 700 (Revised), \textit{Forming an Opinion and Reporting on Financial Statements}, paragraph 28(c)}\]