

Exposure Draft

February nn, 2012

Comments requested by May nn, 2012

*International Ethics Standards Board for
Accountants*

Proposed Change to the Definition
of “Engagement Team”

REQUEST FOR COMMENTS

The IESBA approved this Exposure Draft, Proposed Change to the Definition of “Engagement Team”, for publication at its February 2012 meeting. This proposal may be modified in light of comments received before being issued in final form.

Respondents are asked to submit their comments **electronically** through the IFAC website (www.ifac.org), using the “Submit a Comment” link on the Exposure Drafts and Consultation Papers page. 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 IFAC website. Although the IESBA prefers that comments be submitted electronically, comments also may be submitted by e-mail to janmunro@ifac.org.

Comments should be submitted by < May nn, 2012>.

Copies of this Exposure Draft may be downloaded free of charge from the IESBA website at www.ethicsboard.org

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CONTENTS

	Page
Explanatory Memorandum	4
Exposure Draft	
Proposed Change to the Definition of “Engagement Team”	7

EXPLANATORY MEMORANDUM

Introduction

This memorandum provides a background to, 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) had a project to revise ISA 610 *Using the Work of Internal Auditors*. The objective of the project 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.

The IAASB issued an exposure draft in July 2010. A number of respondents to the exposure draft commented on the apparent inconsistency between the use of internal auditors to perform the 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 the Code required that the engagement team be independent of the audit client.

In light of the comments the IAASB received on exposure, IESBA concluded that it should consider the comments related to direct assistance and the definition of 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 the proposed new ISA 610 and consider that the safeguards outlined in the new standard adequately address the threats to the external auditor’s objectivity. In particular, the requirements now include a number of restrictions on when direct assistance can be used. 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 of the engagement. The IESBA felt this was a necessary safeguard because, notwithstanding the direction, supervision and review by the external auditor, excessive use of internal auditors to provide direct assistance may affect perceptions regarding the independence of the external audit engagement.

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 260,¹ 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)

¹ 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 220.² 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)

The IESBA proposes the following change to the definition of engagement team to make it clear that internal auditors providing direct assistance are not considered to be part of the engagement team under the Code, and to avoid any apparent 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 procedures on the engagement. This excludes external experts engaged by the firm or a network firm and internal auditors providing direct assistance on the engagement.

Subject to comments received on exposure, IAASB would 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.³

Analysis of the Overall Impact of the Proposed Changes

The impact depends on whether and to what extent direct assistance is used, but overall there is expected to be little change.

² ISA 220, *Quality Control for an Audit of Financial Statements*

³ (http://www.ifac.org/sites/default/files/meetings/files/20111209-IAASB-Updated_Agenda%20Item%204-D-ISA_610_Revised-final_0.pdf)

However, there will be clarification of the ambiguity regarding whether the practice of direct assistance is allowed under the ISAs. This will avoid situations where direct assistance was not used even though appropriate in circumstances because the Code definition of engagement team had been interpreted to imply that internal auditors may not provide direct assistance.

Effective Date

The IESBA proposes that the change be effective three months after approval.

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 refer to specific paragraphs, 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.

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 procedures on the engagement. This excludes external experts engaged by the firm or a network firm and internal auditors providing direct assistance on the engagement.

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