

Definition of Engagement Team Compilation of Exposure Draft Comments (Suggested Revisions or Objections)

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1.	DTT	We fully support the proposed change in the definition of engagement team. We agree that it is not appropriate to require internal auditors to comply with the Code; however, we also believe it is important to consider safeguards to address the external auditor's objectivity when internal auditors provide direct assistance to external auditors.	See Agenda Item 4-A, Issue C.
2.	ICAEW	With respect to the effective date for the change, we note the need to align this with the date that the new (shaded) paragraphs in ISA 610 will come into effect,	See Agenda Item 4-A, Issue D.
3.	FEE	The IESBA could use the proposed change in the ED as an opportunity to expand the clarification of the definition of "engagement team" in the Code in this respect.	The scope of this project is limited to addressing the perceived inconsistency between the Code and ISAs when internal auditors are used to provide direct assistance.
4.	FSR	Like FEE we find that the word "direct" in the additions to the definition of Engagement Team implies a too narrow scope of the exclusion of internal auditors. "providing direct assistance" should be expanded to cover also indirect assistance. We suggest the wording "... and internal auditors whether providing direct assistance or not direct assistance on the engagement".	See Agenda Item 4-A, Issue B.

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5.	ICJCE	<p>Although we are of the opinion that this change is not necessary because the definition of engagement team is sufficient, we consider this suggestion appropriate.</p> <p>If included we would suggest to also state that the exclusion of the internal audit staff from the definition of Engagement team refers to any kind of work performed and not only the provision of direct assistance to the auditor.</p>	Ditto.
6.	HKICPA	<p>We understand that this amendment to the Code was proposed with the assumption that there are restrictions in place on internal auditors providing direct assistance to external auditors in ISA 610 (Revised). Such restrictions include the requirement 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. Accordingly, we would recommend the IESBA to align the effective dates of the revised Code and ISA 610 (Revised), which is effective for audits of financial statements for periods ending on or after 15 December 2013.</p>	See Agenda Item 4-A, Issue D.
7.	ICAS	<p>Although we appreciate that comments have not been sought on the revisions to ISA 610 we would highlight that the wording in paragraph 32 could lead to potential conflicts of interest for members of an audit client's internal audit function. This may require changes to be made to such individuals' contracts of employment particularly in relation to part (b).</p> <p><i>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.</i></p>	The ISA 610 TF included a member from the Institute of Internal Auditors, who did not raise the same concern.
8.	JICPA	<p>We express basic support for the Exposure Draft which clarifies that individuals in an internal audit function providing direct assistance do not meet the definition of "engagement team". However, we propose that IESBA consider the consistency of the definition in the Code of Ethics for Professional Accountants ("the</p>	See Agenda Item 4-A, Issue B.

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		<p>Code) with the International Standards on Auditing (“ISA”) and the International Standard on Quality Control (“ISQC 1”) by removing the term “assurance” from the definition of “engagement team” in the Exposure Draft.</p> <p>Whereas the definition of “engagement team” in the Code and the Exposure Draft refers to “any individuals engaged by the firm or a network firm who perform <u>assurance procedures</u> on the engagement”, the one in ISA and ISQC 1 refers to “any individuals engaged by the firm or a network firm who perform <u>procedures</u> on the engagement”.</p> <p>We understand that the word “assurance” is included in the Code since IESBA reviewed the definitions, as a part of the IESBA clarity project, at the IESBA meeting in June 2007, and concluded that the phrase “perform audit (assurance) procedures” was clearer than “provide services on the engagement” in relation to the treatments with external experts. Also, we understand that it is because the phrase “engagement team” is mainly used in Section 290 and 291 which deal with assurance engagements.</p> <p>On the other hand, at the August 2008 meeting, where revisions of ISQC 1 were discussed, IAASB agreed that the definition of “engagement team” should refer to both assurance engagements and related service engagements, as the scope of ISQC 1 covers both types of engagement. We comprehend that IAASB decided to delete “assurance” while IAASB realized that this would cause a difference in the definition between ISQC 1 and the Code.</p> <p>Since the phrase “engagement team” used in the paragraphs 100.22, 200.12 and 210.6 of the Code are related to non-assurance engagements, we believe that “engagement team” in the Code does not necessarily refer only to assurance engagements.</p>	
9.	IIA	<p>We concur with the proposal to change the definition of “Engagement Team” as stated below; however, we recommend adding a reference to co-sourced/outsourced staff.</p> <p>“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 <u>by a network firm. It also excludes individuals, or co-sourced/outsourced staff 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.</u></p>	<p>This would introduce unnecessary complexity to the definition (e.g., the concept of “co-sourcing” may not be understood without significant additional guidance).</p>

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		This definition and our proposed addition clarifies that individuals in an internal audit function or staff retained by internal audit in co-sourcing or outsourcing arrangements providing direct assistance are not part of the engagement team under the Code and therefore, are not required to meet the independence requirements that apply to members of the engagement team. This should help to avoid perceived incompatibility between the Code and the International Standards on Auditing (ISAs) on the independence requirements.	
10.	PwC	<p>We agree with the principle of the proposed change.</p> <p>Given that the defined term is also used in the context of non-audit assurance engagements (e.g. see 291.25), we suggest that it would be clearer if the following amendment is made:</p> <p>“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. <u>In the case of an audit engagement</u> it also excludes individuals within <u>the client’s</u> internal audit function providing direct assistance on the engagement in accordance with ISA 610 Using the Work of Internal Auditors”.</p>	See Agenda Item 4-A, Issue B.
11.	SAICA	<p>While SAICA accepts that the proposed definition change was directly in response to ISA 610, it must be noted that the Code does not make references to specific ISAs and thus is inconsistent with the other contents of the Code.</p> <p>We therefore propose the following underlined wording instead:</p> <p><i>Engagement team</i> All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who performs assurance procedures on the engagement. This excludes external experts engaged by the firm or by a network firm. <u>It also excludes individuals within an audit client’s internal audit function providing direct assistance on the engagement in accordance with International Standards on Auditing.</u></p>	See Agenda Item 4-A, Issue B.
12.	ICAA	Overall, the Institute is supportive of the proposed change to the definition of “engagement team”.	Ditto.

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		<p>We note however that it is proposed to make direct reference to ISA 610 in the wording of the definition.</p> <p>The definition in its existing wording excludes “external experts engaged by the firm or a network firm”, without making direct reference to ISA 620 <i>Using the Work of an Auditor’s Expert</i>.</p> <p>We consider that wording which identifies the issue without making reference to the specific International Standard on Auditing is to be preferred. This is because the names and designated numbers of auditing standards typically change over time. In addition, there may be jurisdictions in which the <i>Code of Ethics for Professional Accountants</i> (the Code) has been adopted while the ISA has not.</p>	
13.	CPAA	<p>Currently, the Code refers to International Standards on Auditing (ISAs) and other relevant standards collectively. The proposed change to the definition of Engagement Team will be the first instance where the Code refers to a specific standard. This, we believe, may have the potential of creating complexities in the application of the Code in some jurisdictions, as the status of individuals providing direct assistance would be unclear in a country that has adopted the Code but not ISA 610. We think it is important that the Code remains self-sufficient and coherent as some jurisdictions may not adopt ISA 610 or may only adopt some of its parts. CPA Australia believes that while some relevant considerations are covered in ISA 610 it is important that the Code uses its framework to address the issue of the provision of direct assistance by internal auditors that would apply in all jurisdictions that adopt it.</p> <p>The proposed change to the definition of the Engagement Team is also likely to create issues for audit teams that span different jurisdictions some of which may not have adopted the proposed paragraphs of ISA 610 and how the provision of direct assistance would be addressed in such cases. Similarly, the potential issues of audits that involve subsidiaries in different jurisdictions need to be considered.</p>	Ditto.
14.	NZAuSB	<p>However, we disagree that it is clear that an impact of this revision would be that where use of the internal auditors providing direct assistance is not in accordance with ISA 610, such direct assistance would impair the independence of the firm. The amendment to the definition of the engagement team in no way refers to ISA 610 and the Code of Ethics for Professional Accountants (the Code) does not directly address if or if not the use of the internal auditors providing direct assistance affects the independence of the external auditor. We agree that this is a desirable impact and therefore recommend that it would be</p>	See Agenda Item 4-A, Issue C.

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		<p>appropriate for the Code to address the threats to the external auditor's objectivity. We believe that this would strengthen the Code and emphasises that using an internal auditor to provide direct assistance may threaten the objectivity of the external auditor and that appropriate consideration and safeguards are necessary to ensure that the threats are reduced to an acceptable level.</p> <p>We recommend that the IESBA should make reference in section 280 of the Code to the impact that the use of the internal auditors providing direct assistance would have on independence if such use were not in accordance with ISA 610. A cross reference would suffice as ISA 610 addresses the threats to independence of using internal auditors for direct assistance and the related safeguards designed to reduce such threats to an acceptable level. We would recommend adding the following paragraph to section 280:</p> <p><u>"280.5 A professional accountant in public practice shall not make use of an internal auditor to provide direct assistance on an audit engagement where use of the internal auditors providing direct assistance is not in accordance with ISA 610."</u></p> <p>We support the safeguards outlined in the revised ISA designed to reduce the threats to an acceptable level for the external auditor making use of the internal audit function.</p>	
15.	CPAA	CPA Australia is of the opinion that while the proposed change in the definition of Engagement Team may be appropriate, it is not sufficient. We believe that parts B and C of the Code should address the use of internal auditors to provide direct assistance and include guidance to professional accountants in practice and in business about the potential threats and possible safeguards.	See Agenda Item 4-A, Issue C.
16.	CPAA	The provision of direct assistance by the internal audit function to the Engagement Team creates important considerations and potential threats to independence. These considerations include whether the direct assistance is of such a nature as to impact on the independence of the Engagement Team and the objectivity of the internal auditors involved. While ISA 610 addresses these ramifications to some extent at the engagement level, it is important that the Code addresses the independence issues involved, including the nature of threats and safeguards , should the proposed definitional change be implemented.	Ditto.
17.	ACCA	The intention of the change proposed in the exposure draft is one of clarification. However, it is also important	See Agenda Item 4-A,

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		<p>to address possible negative perceptions regarding the independence of the audit, and so there is a balance to be drawn between achieving both adequate direction and supervision of the internal auditors (to demonstrate their effective independence from the audit client) and making clear the fact that the internal auditors (and other employees of the audit client) are not members of the engagement team.</p> <p>The proposed revised definition of 'engagement team' relies on the reader's understanding of the term 'internal audit function'. This is defined (for the purposes of the ISAs) in paragraph 14 (a) of ISA 610 (Revised) as 'a function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes'. Further, paragraph 10 of ISA 610 (Revised) also attempts to clarify the meaning of 'internal audit function' in the situation in which individuals in an entity perform procedures similar to those performed by an internal audit function. It states that 'unless performed by an objective and competent function that applies a systematic and disciplined approach, including quality control, such procedures would be considered internal controls'.</p> <p>Paragraph A2 of ISA 610 (Revised) states that '[a]ctivities similar to those performed by an internal audit function may be conducted by functions with other titles within an entity.... Neither the title of the function, nor whether it is performed by the entity or a third-party service provider, are sole determinants of whether or not the external auditor can use the work of the function. Rather, it is the nature of the activities; the extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors; competence; and systematic and disciplined approach of the function that are relevant. References in this ISA to the work of the internal audit function include relevant activities of other functions or third-party providers that have these characteristics.'</p> <p>Therefore, we believe that the proposed revised definition does not provide clarification in respect of individuals providing direct assistance on the engagement who fall outside the definition of the internal audit function.</p> <p>Given that internal audit staff are not members of the engagement team regardless of a particular activity that the internal audit staff may be performing at any given time, we believe that the proposed extension to the definition (which is supposed to provide clarity) is unduly complicated. Internal audit staff should not only be</p>	<p>Issue B.</p>

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		<p>excluded from the definition of 'engagement team' when providing direct assistance to the external auditor, but also when not providing such assistance. Therefore, we propose that the definition, in fact, be amended as follows:</p> <p><i>Engagement team</i>—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 <u>by a network firm. It also excludes individuals within an audit client's internal audit function and other individuals within the client entity who perform procedures similar to those performed by an internal audit function.</u></p>	
18.	APESB	<p>APESB is supportive of the changes proposed in the Exposure Draft which aim to clarify that internal auditors providing direct assistance to the external audit function in accordance with ISA 610 <i>Using the Work of Internal Auditors</i> (ISA 610) are not to be considered as part of the Engagement Team and accordingly are not required to meet the independence requirements that apply to Engagement Team members.</p> <p>However, we are concerned that the amendment to ISA 610 proposed by the IAASB to allow external auditors to engage internal auditors to provide direct assistance will result in external auditors more frequently using internal auditors to complete their audit work.</p> <p>In Australia it is rare for the external auditors to obtain direct assistance for the external audit from the internal auditors of a client. Allowing direct assistance from the client's internal audit function for the purposes of the external audit will introduce new risks for external audit engagements in the future.</p> <p>We recommend that the Code directly address ethical considerations which the external auditor and the internal auditor should consider in these circumstances. This should include potential threats that the external auditor and internal auditor should identify and appropriate safeguards that may mitigate those threats in order for the internal audit function of a client to provide direct assistance on the external audit engagement.</p> <p>An appropriate place for the Code to address these threats is under Section 290 <i>Independence – Audit and Review Engagements</i> in a similar manner to other specific situations addressed therein such as <i>Employment with an Audit Client</i>, <i>Recent Service with an Audit Client</i> and <i>Preparing Accounting Records and Financial</i></p>	See Agenda Item 4-A, Issue A.

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		<p><i>Statements.</i> We recommend that the general provisions should describe the self-interest, intimidation or familiarity threats to the fundamental principles of integrity and objectivity which are created if an internal auditor is used for direct assistance on an external audit engagement. Familiarity or intimidation threats will exist if an employee at the client is able to exert significant influence over the work the internal auditor is asked to perform in a direct assistance arrangement. A self interest threat will exist where the internal auditor is asked to review an area of the business where the internal auditor has previously performed internal audit work or the area is of professional interest to the internal auditor (for example, future employment opportunities). We recommend the Code addresses these threats through identification of safeguards such as those used elsewhere in Section 290:</p> <ul style="list-style-type: none"> • Restricting the direct assistance of internal audit to areas where the work performed has minimal impact on the overall audit strategy; • Having a sufficiently experienced Member of the engagement team supervise and review the work of internal audit under a direct assistance arrangement; • Evaluating the relationship between the internal auditor providing direct assistance and the key client personnel in the areas where the work is to be performed in order to identify potential conflicts, if any exist; and • Evaluating the internal auditor's period of employment with the company. 	
19.	APESB	<p>As the Code has higher independence requirements for Public Interest Entities (PIE), IESBA should consider whether direct assistance should be allowed for PIEs and if so, identify safeguards that may eliminate the threats to the fundamental principles or reduce them to an acceptable level. For example, one consideration may be having the internal audit function reporting directly to the audit committee of the PIE.</p> <p>Furthermore, as you are aware there are different approaches around the world regarding the use of internal audit for external audit work, which ISA 610 acknowledges stating that in some countries direct assistance is not be allowed (Paragraph 27). In Australia, whilst the external auditor may and do make use of the work performed by the internal auditor, the practice of the external auditor obtaining direct assistance of the internal audit function to complete external audit work does not generally occur.</p>	See Agenda Item 4-A, Issue C.

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		We acknowledge that ISA 610 specifies the circumstances in which internal audit can be used and in particular that an internal auditor is not allowed to assist in areas that require subjective judgement. Whilst we agree with IESBA's proposed amendments to the definition of the Engagement Team, we believe that IESBA should consider whether ISA 610 is the best place to document threats to the fundamental ethical principles arising from the external auditor obtaining direct assistance from the internal auditor, in which case perhaps the Code should include a reference to ISA 610; or whether the Code itself should address these threats and possible safeguards from the perspective of both the internal and external auditors.	
20.	IOSCO	<p><i>Applicability of the Paper</i></p> <p>Our members' jurisdictions have varying policies regarding whether the use of internal audit by external auditors is or is not acceptable, particularly in regard to direct assistance. We note that paragraph 26 of the IAASB's recent deliberations on ISA 610 states that: "The external auditor may be prohibited by law or regulation from obtaining direct assistance from internal auditors. If so, paragraphs 27–34 and 36 do not apply." As such, our understanding is that the IESBA is not debating this "whether" question in its current project; rather, the IESBA is attempting to make the Code more functional for use in the jurisdictions in which such assistance is allowed. Accordingly, we think the resulting amended Code should make clear that its guidance is provided to help an external auditor conduct its work in situations in which assistance from internal auditors is allowed, versus being provided to establish or imply whether such assistance is appropriate.</p>	See Agenda Item 4-A, Issue A.
21.	IOSCO	<p><i>Independence and Objectivity Considerations</i></p> <p>We have addressed this letter to both the IESBA and the IAASB as we believe a broader issue exists than simply potentially modifying the definition of engagement team that is within the Ethics Code. We believe the considerations associated with using the work of internal auditors is an example of a matter that could benefit from both Boards jointly discussing the broader notion of auditor objectivity. We believe this would help in addressing objectivity concerns, including those associated with independence when using the internal auditor employees to perform audit procedures under the direction of the external auditor.</p> <p>We believe that auditor independence in both fact and appearance is critical to an auditor's objectivity, which</p>	Ditto.

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		is a key to providing reliable audited financial statements and promoting investor confidence in the capital markets. To be credible, the auditor's work effort must be objective, must be performed with integrity and must be absent of any undue influences from the audit client, management or its owners. Public confidence in the audited financial statements will be eroded by evidence of, or a perception that, the auditor was lacking objectivity due to a lack of independence.	
22.	IOSCO	<p><i>Exclusion of Internal Auditors Who Provide Direct Assistance from the Definition of 'Engagement Team' in the Code</i></p> <p>We understand that in examining the term 'engagement team' in this project the emphasis is on how to handle those internal auditors who provide direct assistance in jurisdictions where it is allowed. The issue of whether or not those who provide direct assistance should be included in the definition of engagement team is magnified particularly as a result of the auditor independence requirements that those who provide direct assistance could be subject to, and for which such individuals would be unable to fully comply because they are employees of the audit client. Nonetheless, we believe it is important for the IESBA to carefully consider and establish supportable reasons regarding why they propose these individuals should be excluded from the definition of an engagement team.</p> <p>We note that with respect to individuals in the internal audit function providing direct assistance, in the Paper 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. The IESBA has therefore proposed language to clarify that these individuals do not fall within the definition of the audit engagement team under the Code. However, in reaching this conclusion has the Board considered that from a functional perspective internal auditors providing direct assistance, as defined, are performing procedures under the direction, supervision and review of the external auditor?</p>	Ditto.
23.	IOSCO	<p>We believe the use of direct assistance, where permitted, to conduct the same audit procedures and/or perform the same role as an engagement team member can raise the question of independence in appearance, at a minimum. Given that external auditors are subject to specific independence</p>	See Agenda Item 4-A, Issue C.

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		<p>requirements under the Code it follows that direct assistance, where permitted, should also be subject to specific objectivity requirements of some sort and the application of appropriate safeguards and professional skepticism to mitigate independence concerns. Establishing objectivity requirements would enable external auditors to utilize consistent, specific guidance when assessing the work and environment of the internal audit direct assistance function.</p> <p>One possible way to address this under ISA 610 is to go further in the IAASB's recent deliberations on it. Specifically, to modify the safeguarding requirements included therein along the lines of those included in our letter to the IAASB dated December 2, 2010 regarding the IAASB Exposure Draft of proposed International Standards on Auditing (ISA) 315 (Revised), <i>Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment</i> and ISA 610 (Revised), <i>Using the Work of Internal Auditors</i>. These modifications would be as follows:</p> <ol style="list-style-type: none"> 1. For the work of internal auditors providing direct assistance and the work performed by the internal audit function that is to be relied upon by the external auditor, the external auditor should independently re-perform procedures in the specific audit areas and be satisfied that there is minimum variation of the results. 2. The totality of procedures performed by internal auditors providing direct assistance and by the internal audit function and relied upon by the external auditor should not form a significant portion of the total audit work. 3. Work performed by the internal audit function and relied upon by the external auditor should not include matters that involve high risk or a high need for judgment. 4. The external auditor should not use the work of the internal audit function at all if there are significant threats to the objectivity of the internal audit function besides the threat that internal auditors are employees of the audit client and are therefore not independent. <p>To emphasize the importance of these provisions to the position taken in the Code regarding the role of internal auditors, we believe it would be appropriate to make reference in the Code to the fact that ISA 610 contains them.</p>	

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24.	IOSCO	<p><i>The Definition of Direct Assistance and Its Impact on ISA 610</i></p> <p>We note that direct assistance, and by extension the audit procedures direct assistance performs, are subject to requirements specific to direct assistance within ISA 610. However, if the external auditor uses the reports or other work performed by the internal audit function as audit evidence in executing its compliance and substantive testing but not in a “direct assistance” capacity as that term is defined in ISA 610, then this has a similar effect on its work. As such, we are concerned that the safeguards applied in both scenarios may not be consistent. We therefore suggest that the IAASB consider expanding the definition of direct assistance to include the external auditors’ use of reports and other work performed by the internal audit function as audit evidence in executing its compliance and substantive testing. Alternatively, the IAASB could provide the same safeguards for this use of the internal audit function’s work.</p>	Ditto.
25.	ICAC	<p>As the discussion on direct assistance by Internal Auditors has an impact on the Code of Ethics as developed by IESBA and on the Auditing Standards as developed by IAASB, ICAC considers it necessary to share its comments on the proposed changes to the definition of the Engagement Team and on ISA 610 <i>Using the Work of Internal Auditors</i> with IESBA and IAASB at the same time. As a result we have addressed this letter to both Boards.</p> <p>Without prejudice to the letter ICAC has signed along with other European regulators and agreeing completely with the content of that letter, ICAC wants to express that its main concern is related to the paragraphs that regulate the direct assistance to the external auditor. ICAC does not support the concept of internal auditors providing direct assistance to the external auditor, since the independence of the internal auditor cannot be guaranteed considering that the internal audit function is part of the audit client.</p> <p>The problem that the regulation of the direct assistance, as it is in ISA 610, creates is that it leads to a contradiction. On one side, the internal auditor is carrying out audit procedures for the external auditor, so considering that the internal auditor is not an auditor’s expert, he or she should be considered as part of the engagement team. The contradiction is that, as part of the engagement team, the internal auditor should be independent from the audit client, which is a requirement for all members of the engagement team but that cannot be fulfilled by the internal auditor.</p>	See Agenda Item 4-A, Issue A.

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		<p>The solution to this problem should not be changing the definition of the engagement team so that the internal auditor is not considered as part of it, but eliminating the possibility of the internal auditor providing direct assistance to the external auditor.</p> <p>We have to bear in mind that the internal auditor depends on the audit client and is subject to its instructions, what creates or may create a conflict of interest with the external auditor’s objectives that could be difficult or impossible to eliminate adopting safeguards.</p> <p>The current version of ISA 610 does not include requirements related to the objectivity of the internal auditor, since it is not possible to establish a regulation that obliges the external auditor to assess the internal auditor’s objectivity, since that objectivity cannot be met for the reasons mentioned in the previous paragraph.</p>	
26.	EAIG	<p>A number of independent European audit regulators and/or oversight bodies (“the audit regulators”) appreciates the opportunity to comment on the IESBA’s Exposure Draft, <i>Proposed Change to the Definition of “engagement team”</i> (“the Exposure Draft”). The content of this letter has been discussed and agreed between audit regulators, representing the following countries:</p> <ul style="list-style-type: none"> • Czech Republic – Audit Public Oversight Council • France –Haut Conseil du Commissariat aux Comptes • Luxembourg – Commission de Surveillance du Secteur Financier • Malta – Accountancy Board • The Netherlands – Netherlands Authority for the Financial Markets • Norway – Financial Supervisory Authority of Norway • Portugal – Conselho Nacional de Supervisão de Auditoria • Romania – Council for the Public Oversight of the Activity of the Statutory Audit of Romania • Slovenia – Agencija Republike Slovenije za javni nadzor nad revidiranjem (Agency for Public Oversight of Auditing) • Spain – Instituto de Contabilidad y Auditoria de Cuentas 	Ditto.

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		<ul style="list-style-type: none"> Switzerland – Federal Audit Oversight Authority <p>As European audit regulators we consider it important to pursue continuing improvement of standard setting for professional accountants, including auditing and ethics. Our comments in this letter reflect those matters on which we have achieved a consensus amongst the above mentioned audit regulators; however, they are not intended to include all comments that might be provided by individual regulators and their respective jurisdictions.</p> <p>As the discussion on direct assistance by internal auditors has an impact on the Code of Ethics as developed by IESBA and on the Auditing Standards as developed by IAASB, we consider it necessary to share our comments on the proposed changes to the definition of the Engagement Team and on ISA 610 <i>Using the Work of Internal Auditors</i> with IESBA and IAASB at the same time. As a result, we have addressed this letter to both Boards.</p> <p>We appreciate IESBA's and IAASB's efforts to define how external auditors should deal with the work of internal auditors in its broadest way. However, we still do not support the concept of internal auditors providing direct assistance to the external auditor for the following reasons:</p> <ul style="list-style-type: none"> The independence of the external auditor cannot be ensured as the internal auditors providing direct assistance to the external auditor are not independent of the audit client, as they are employed by the audit client. The competence and objectivity of internal auditors providing direct assistance are not subject to the same level of regulation that applies to external auditors. There is a risk that management of the audit client puts undue pressure on the external auditor to utilize the client's internal audit personnel resources, in order to reduce the audit fee. <p>The Exposure Draft excludes internal auditors that provide direct assistance in accordance with ISA 610 from the Engagement Team definition. We believe it is conceptually inappropriate to exclude internal auditors from the Engagement Team definition, when apparently their work is expected to be subject to the same direction, supervision and review (ref. ISA 220) as the work performed by the ordinary engagement team members. Thus, since the IAASB in this way requires internal auditors providing direct assistance to be treated in the same way as ordinary engagement team members, it is a contradiction in terms to exclude them</p>	

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		from the engagement team definition. In any case, excluding internal auditors that provide direct assistance from the engagement team definition doesn't resolve the lack of independence of these individuals.	
27.	EAIG	In case the Boards, despite our disapproval of direct assistance, still would like to set standards regarding direct assistance, we would like to raise the following concerns on the approach the Boards have chosen to set new standards relating to external auditors requiring direct assistance from internal auditors. We believe that, even in countries where independence regulation may not prohibit direct assistance, the requirements of the revised ISA 610 provide too little guidance concerning threats that would be considered unacceptable versus threats that could be overcome by appropriate safeguards.	See Agenda Item 4-A, Issue C.
28.	EAIG	As a related matter, we see a room for improvement regarding the alignment of the standard setting processes between the IAASB and the IESBA. The proposed changes to the Code are directly related to certain provisions in ISA 610, which is no longer open for comments. Clearly, each Board has its own responsibilities in the standards setting process. However, as there are clear relations between certain standards, we suggest the Boards to cooperate more closely.	See Agenda Item 4-A summarizing the interactions between IESBA and IAASB.
29.	EAIG	Finally, we note that outsourcing of the internal audit function to the external auditor is occurring in certain jurisdictions. We think that outsourcing of the internal audit function creates new challenges and risks, which have not been addressed in the current standards. We believe the standard should clarify that outsourcing of the internal audit function to the external auditor represents a serious threat to the external auditor's independence, and that it is consequently prohibited in some countries.	The Revised Code, issued in July 2009, already severely restricts the provision of internal audit services by a firm to an audit client that is a public interest entity (paragraph 290.200).
30.	WPK	As we already stated in earlier comments we would like to mention that after the comprehensive amendments to the Code of Ethics over the past years, resulting in, at times considerable, demands on the member organizations in terms of implementation and regulation (including translation), generally further	Comment noted.

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		amendments to the Code should be limited to the lowest possible level.	
31.	WPK	<p>The extracts from ISA 610 (# 28 – 33) relating to the direct assistance of internal audit in the Exposure Draft: Proposed Change to the Definition “Engagement Team” are – from our understanding – not included in the revised ISA 610 as of March 2012. We welcome this fact since the concept of “direct assistance” is inconsistent with our understanding of independency requirements especially against the background of independency discussions as consequence of the financial crisis.</p> <p>Only under the above mentioned assumption that the concept of “direct assistance” is not included in ISA 610, we consider the proposed extension of the definition of “Engagement Team” in the Code not as compulsively necessary but as a useful clarification.</p> <p>Otherwise, in our view, a change in the definition of “Engagement Team” would not help reduce the impact which the provision of direct assistance of the internal auditor would have on the independency and objectivity of the external auditor. Since the change of the definition obviously is considered to be the ethical legitimization to allow direct assistance of the internal auditor we would not support this proposal. Instead we ask to refrain from any plans to include this concept into ISA 610.</p>	See Agenda Item 4-A, Issue A.
32.	IDW	<p>While we recognize that some jurisdictions currently permit direct assistance, and that it is common practice in some of these jurisdictions, this in and of itself does not necessarily mean that it is a good practice that is worthy of emulation or that ought to be permitted at an international level. The key public interest issues in relation to direct assistance are the impact on audit quality, or effectiveness, and on auditor independence in appearance and in fact. We are not convinced that the analysis of costs and benefits of direct assistance undertaken by the IAASB as depicted in its Explanatory Memorandum of its Exposure Draft on the revision of ISA 610 appropriately addressed the opportunity costs of permitting direct assistance at an international level (<u>see our comment letter to the IAASB Exposure Draft dated December 15, 2010 on the IAASB’s website</u>). We have concluded that a proper analysis of costs and benefits would result in the costs to audit quality or effectiveness significantly outweighing the benefits and that it is therefore not in the overall international public interest. However, we also recognize that audit quality issues, and auditing standards setting, are beyond the remit of IESBA. Consequently, we will restrict our comments in this comment letter on</p>	See Agenda Item 4-A, Issues A-C.

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		<p>matters relating to independence resulting from the proposed change to the definition of engagement team. However, the issue of the costs and benefits in relation to independence and the public interest does need to be taken into account in IESBA's consideration of the potential impact of the proposed change to the definition.</p> <p>The main issues in relation to the proposed change in definition of engagement team that concern us are:</p> <ol style="list-style-type: none"> 1. Problems arising from wording of the definition of “internal audit function”, from the wording in the proposed change in definition of “engagement team”, and from the resulting nature of the “internal audit function” (we deal with this problem first because its resolution drives the following issue). 2. The contention by IESBA that there is no conflict, but at most a perception of, or uncertainty about, a conflict, between direct assistance and the current requirements of the Code, by which IESBA suggests that its proposed change in the definition of engagement team is in fact not really necessary to make direct assistance acceptable under the Code; 3. The implications for the application of the Code of the arguments used by the IESBA to support this contention (that is, in 2 above) and of the proposed change in definition of “engagement team”; 4. The lack of an overriding public interest justification for the proposed change in definition of “engagement team”; and 5. The dysfunctional political signals that the IESBA sends by explicitly permitting direct assistance, despite the problems noted above. <p>We will address each of these issues in our letter in turn, but provide the detailed arguments supporting the conclusions in the letter in the Appendices to this letter. Throughout our comment letter and its appendices, we use the term “entity” as used by the IAASB, rather than “audit client”, so that no confusion results from using different terms when referring to the same organization.</p>	
33.	IDW	<p>I. Definition of Internal Audit Function and Wording of Proposed Change to Definition of Engagement Team</p> <p>The proposed change to the definition reads as follows:</p>	See Agenda Item 4-A, Issue B.

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		<p>“It [that is, the engagement team] 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.”</p> <p>This means that the situations under which direct assistance would be permissible under the Code, and the implications of the change in the definition of engagement team, then depend upon the meaning of the terms (e.g., “internal audit function”) used in the proposed change to the definition.</p> <p>As explained further in Appendix 1, the definition of “internal audit function” used by the IAASB suffers from the following problems:</p> <ul style="list-style-type: none"> a) The definition does not adequately distinguish the nature of an internal audit function from other internal controls (the definition does not recognize that the internal audit function is a high level monitoring control that is segregated from governance and management processes and from other internal control processes). Consequently, individuals performing monitoring control activities other than internal audit would be permitted to provide direct assistance and be excluded from the engagement team under the proposed change to its definition, even though they are not a part of an “internal audit function” properly defined. b) The reference in the definition to “and consulting activities” means that those internal audit functions that do not engage in consulting activities would not be regarded as internal audit functions as defined by the IAASB. Consequently, individuals in internal audit functions without consulting activities performing direct assistance would not be exempted from the engagement team under the proposed change to its definition, even though they are a part of an “internal audit function” properly defined. c) The use of the connective “and” in the phrase “governance, risk management and internal control processes” implies that if an internal audit function is designed to evaluate and improve the effectiveness of only one of the entity’s governance, risk management or internal control processes, or only any two thereof, then the function is therefore not an internal audit function as defined by the IAASB. Consequently, individuals in these internal audit functions performing direct assistance would not be exempted from inclusion in the proposed changed definition of 	

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		<p>engagement team, even though they are a part of an “internal audit function” properly defined.</p> <p>We are convinced that neither the IAASB nor the IESBA intended the consequences arising from these problems with the wording of the definition of “internal audit function”.</p> <p>Furthermore, in the proposed change to the definition of “engagement team”, IESBA uses the term “individuals”, whereas the IAASB uses the term “internal auditors” in its definition of “direct assistance”. To prevent the unintended consequences as noted further in Appendix 1, we suggest that IESBA use the same term as that used by the IAASB – that is, “internal auditors”.</p> <p>For these reasons and as described in Appendix 1, we believe that IESBA has a cogent case to submit the definition of “internal audit function” to the IAASB for reconsideration, and to suggest that the IAASB define “internal auditors”.</p>	
34.		<p>II. Direct Assistance in Conflict With Current Code</p> <p>As described in Appendix 2, IESBA claims that there is no conflict between the current Code and direct assistance from internal auditors, but suggests that there may have been a perception or an uncertainty about such conflict. Hence, if there is, in fact, no such conflict, but only a perception of uncertainty, then this begs the question as to why IESBA is changing the definition of engagement team.</p> <p>In our comment letter to the IAASB, we did not state that there is a perception or an uncertainty with respect to whether there is a conflict between direct assistance from internal auditors and the Code: we stated that in our view there is in fact a conflict with the Code. Some other comment letters also stated this. We therefore believe that by claiming that commentators only speak of perception or uncertainty, the Explanatory Memorandum does not appropriately reflect the tenor of these comments received.</p> <p>In Appendix 2 to this comment letter, we demonstrate why internal auditors <u>are</u> members of the engagement team under the current Code, regardless of whether those internal auditors are employees of the entity, from the auditor’s firm or network firm, or from another organization. In Appendix 2 we then further demonstrate that direct assistance provided by internal auditors:</p> <ul style="list-style-type: none"> • who are entity employees is clearly in conflict with the current Code, 	Ditto.

Xref	Respondent	Comment	Task Force Comments
		<ul style="list-style-type: none"> from the external auditor's firm or network firm is inconsistent with the current Code, and from other organizations is inconsistent with the principles of the current Code <p>This question is important because it demonstrates why a change in the definition is necessary if direct assistance is to be permitted. However, just because a change in the definition is necessary to permit direct assistance does not mean that such a change is necessarily desirable.</p>	
35.		<p>III. Implications of IESBA Explanations on Exclusion from Engagement Team and Impact of Proposed Change of Definition</p> <p>As we demonstrate in Appendix 3 to this comment letter, IESBA's explanation as to why employees of the entity are not "engaged" to provide direct assistance tears open a massive loophole into the Code by in effect contending that indirect engagement is not engagement. This argument would permit the circumvention of the requirement to include on the engagement team individuals engaged to perform assurance procedures by having audit firms or networks indirectly engage those individuals through an organization or series of organizations. We do not believe that it is IESBA's intention to exclude from the engagement team individuals performing audit procedures that are indirectly engaged by the firm or network firm.</p> <p>More importantly, the proposed change in the definition of engagement team to exclude internal auditors tears open another massive loophole into the Code by excluding from the engagement team partners and staff of the firm or network firm that render internal audit services to the entity, even when the partners and staff are performing the engagement (whether through direct assistance or otherwise) simply because they are providing internal audit services.</p> <p>To prevent the creation of the noted loopholes, it seems to us that IESBA needs to reconsider its argument for claiming that entity employees providing direct assistance are not engaged by the firm or network firm to perform audit procedures on the engagement, and to reconsider the change in definition of engagement team so that it deals appropriately with partners and staff of the firm or network firm that provide internal audit services to the entity.</p>	Ditto.

Xref	Respondent	Comment	Task Force Comments
36.	IDW	<p>IV. Lack of Public Interest Justification for Explicitly Permitting Direct Assistance</p> <p>As noted in our comment letter to the IAASB as described above, the overall recurring decrease in work effort (i.e., less costs) of the external auditor by explicitly permitting direct assistance is posited by the IAASB in its Explanatory Memorandum of its Exposure Draft on ISA 610 on the assumption that greater use of direct assistance is made than is previously the case, which only applies if auditors use direct assistance more than they do now as a result of the standard explicitly permitting direct assistance. The fact that increased recurring audit effectiveness is expected for those cases in which direct assistance is already being used by having introduced a more rigorous framework for its use is not relevant to a decision as to whether it should be explicitly permitted in the first place, because audit effectiveness might be increased even further by prohibiting direct assistance in those cases where it is currently being used: this is a potential opportunity cost not included in the analysis. Hence, the IAASB's impact analysis fails to consider the opportunity costs of not prohibiting direct assistance where it is being applied and the costs to audit effectiveness of introducing direct assistance where it has not been applied before.</p> <p>Furthermore, lower auditor costs due to direct assistance may well be offset somewhat by higher costs due to higher quality audit staff needed for both assessing the competency, objectivity, etc. of internal auditors and in supervising and reviewing the work performed.</p> <p>The question then arises what the public interest justification for explicitly permitting direct assistance is by changing the definition of engagement team in the Code to exclude internal auditors providing direct assistance. Certainly there is no case for claiming greater audit effectiveness or quality, because when providing direct assistance, internal auditors would only be performing those procedures that would otherwise would have been performed by external auditors. Hence, there is no overriding public interest reason in terms of improving audit effectiveness to provide for such an exception.</p> <p>While a potential reduction in the cost of audits is of public benefit, the question arises whether the reduction in costs would be great enough to provide a public interest justification for the proposed change. Furthermore, having internal auditors that are entity employees provide direct assistance has a negative impact on the independence in appearance of auditors.</p> <p>We would like to point out that the situation in this case is very different from the one with respect to the</p>	See Agenda Item 4-A, Issue A.

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		<p>exception for external experts. External experts engaged by the external auditor are providing expertise to the external auditor rather than performing audit procedures. Even if they were considered to be performing audit procedures, an exception was made because the use of external experts is crucial for audit effectiveness for many external audits because internal experts may not be available, even when external auditors are unable to arrange to have external experts meet all of the independence requirements that apply to members of the audit team. There is therefore an overriding public interest reason in relation to audit effectiveness for the exception made for external experts that does not exist for internal auditors.</p> <p>Overall, the questionable benefits of cost reduction in this case do not provide an overriding public interest reason for explicitly permitting direct assistance by providing for an exemption from membership in the engagement team for internal auditors providing direct assistance.</p>	

IDW Comments

The following are the three appendices to the IDW letter referred to above

APPENDIX 1: Definition of Internal Audit Function and Wording of Proposed Change to Definition of Engagement Team

What is the Internal Audit Function?

Under the proposed change to the definition of “engagement team” (see Section I of the comment letter), only individuals *within an audit client’s internal audit function* would be permitted to provide direct assistance on the engagement and remain outside of the engagement team. It is therefore crucial that the definition of internal audit function be accurate and clear so that the Code is clear from which individuals direct assistance is permitted.

The definition of internal audit function in ISA 610 is:

“A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity’s governance, risk management and internal control processes.”

The question arises whether this definition identifies the distinguishing characteristics of an internal audit function as opposed to other functions within the entity to ensure that only those individuals within those functions providing direct assistance that the IESBA intends to be exempted from membership in the engagement team are in fact exempted. First, we note that internal control is defined by ISA 315 as:

“The process designed, implemented and maintained by those charged with governance, management and other personnel *to provide reasonable assurance* about...”

This is broadly in line with the definition in COSO and other internal control frameworks. Consequently, internal control as a whole is also an “assurance function” and the definition of an internal audit function as an assurance function does not assist practitioners or inspectors in distinguishing an internal audit function from other internal controls (we note that the current Code addresses internal audit services under the section entitled “Provision of *Non-assurance* Services to Audit Clients”, which does not appear to be in line with the designation of the internal audit function as an “assurance activity”). Furthermore, the monitoring of internal control as an element of internal control is described in the latest revision of ISA 315 as a process to assess the effectiveness of internal control performance over time (this is not dissimilar from the COSO description of monitoring: COSO also recognizes that internal audit is a part of monitoring, as does ISA 315 by placing the application material in

the subheading on the internal audit function in paragraphs A109 to A116 under the heading of “*Components of Internal Control – Monitoring of Controls*”).

Does this then mean that those individuals engaged in activities to monitor internal control, risk management or governance processes, even when those monitoring activities are integrated within those processes (i.e., process-integrated monitoring controls), can be designated as being part of an internal audit function? ***We do not believe it is the intention of the IAASB, nor would it be the intention of IESBA, to allow any individual performing monitoring control activities (including those integrated within business processes) to be included within the internal audit function. We are not convinced that IESBA intends to extend the permissibility of direct assistance and the exemption from inclusion in the definition of engagement team that widely. However, this is precisely what the proposed definition does.***

It seems to us that the distinguishing characteristic between the internal audit function and other internal controls is the fact that the internal audit function is completely segregated from governance and management and other internal control processes within an entity and that therefore it is a high level monitoring control.

The definition of internal audit function in ISA 610 also adds the words “and consulting activities” at the beginning of its definition with the words “A function of an entity that performs assurance *and consulting activities*...”. Does this then mean that if an internal audit function does not engage in consulting activities, that it is therefore not an internal audit function, even though it meets the other characteristics of an internal audit function? ***It seems to us that the reference to “and consulting activities” is superfluous and actually unduly restricts the application of the proposed changes to the definition of engagement team to internal audit functions that also perform consulting activities.***

The same undue restriction results from the use of the word “and” towards the end of the definition of internal audit function in ISA 610:

“...designed to evaluate and improve the effectiveness of the entity’s governance, risk management and internal control processes.”

The use of the word “and” implies that if an internal audit function is designed to evaluate and improve the effectiveness of only one of the entity’s governance, risk management or internal control processes, or only any two thereof, that it is therefore not an internal audit function within the meaning of the proposed change to the definition of engagement team.

Since the definition of “internal audit function” is subject to these difficulties that may cause the exemption from inclusion in the engagement team to be too wide or too narrow, depending upon the words noted above in question, IESBA has a cogent case to submit the definition of “internal audit function” to the IAASB for reconsideration.

In our view, the definition of internal audit function should therefore be:

“A high-level monitoring control, within an entity, segregated from governance and risk management processes, and from other internal control processes, that is designed to evaluate and improve the effectiveness of one or more of these processes.”

Who are the Individuals Within an Audit Client's Internal Audit Function?

The proposed change to the definition of engagement team also states that the engagement team

“... also excludes *individuals* within an audit client's internal audit function...”

In contrast, ISA 610 defines direct assistance as:

“The use of *internal auditors* to perform audit procedures under the direction, supervision and review of the external auditor.”

There seems to be a disconnect between the two definitions. Not all individuals within an audit client's internal audit function (e.g., administrative staff that work primarily or even just occasionally within the internal audit function) are necessarily internal auditors. On the other hand, ISA 610.28 does not define who internal auditors are, but does restrict direct assistance to those cases in which internal auditors are not subject to significant threats to objectivity or lack sufficient competence to perform the proposed work. We do not believe it to be the intention of IESBA to extend the permissibility of direct assistance and the exemption from the definition of engagement team to administrative staff within the internal audit function. Consequently, IESBA should align its wording with that of the IAASB (that is, replace the word “individuals” with “internal auditors”) to prevent a possible extension of the permissibility of direct assistance and the exemption for membership in the engagement team beyond that intended. Furthermore, it might be helpful for IESBA to consider requesting that the IAASB define “internal auditor”, since not all individuals in an audit function are necessarily internal auditors.

APPENDIX 2:
Direct Assistance In Conflict With Current Code

In the second paragraph of the section entitled “Significant Matters Considered During the Review of the Explanatory Memorandum”, IESBA claims that it is proposing to amend the Code to “avoid any *perception* that the Code is in conflict with the ISA.” Likewise, in the second paragraph of the section entitled “Definition of engagement team” of the Explanatory Memorandum, IESBA claims that changing the definition of engagement team “should help avoid any *perceived* incompatibility between the Code and the ISAs”. Furthermore, in the first paragraph of the same section, IESBA states that several respondents to the IAASB exposure draft “indicated that there was *uncertainty* as to whether the definition would capture these individuals as part of the engagement team”.

In summary, IESBA claims that there is no conflict between the current Code and direct assistance from internal auditors, but suggests that they may have been a perception of an uncertainty about such conflict. In conclusion, IESBA claims that a change in the definition is not really necessary to permit direct assistance from internal auditors.

In our comment letter to the IAASB, we took issue with this contention: we firmly believe that direct assistance is in conflict or is inconsistent with the current Code.

In paragraph 290.04, the Code states:

“In the case of audit engagements, it is in the public interest and, therefore, required by this Code, that members of audit teams, firms and network firms shall be independent of audit clients.”

The definition in the Code of “audit team” includes all members of the engagement team for the audit engagement.

Excluding the issue of external experts, the current definition of “engagement team” in the Code is:

“All partners and staff performing the engagement, and any individuals engaged by the firm or network firm who perform assurance procedures on the engagement”

We will refer to parts of this definition often hereafter in this Appendix.

Consequently, any partners and staff of a firm or network performing the engagement, and any individuals performing audit procedures on an audit engagement, are members of the audit team. Such partners, staff and other individuals must be independent. Whether these individuals are employed or engaged to perform the engagement or audit procedures is not relevant.

As a result, the key questions in relation to whether direct assistance is acceptable under the current Code are: 1. whether the provision of direct assistance causes internal auditors to be members of the audit team, and 2. whether direct assistance conflicts or is inconsistent with the Code because internal auditors are members of the engagement team.

Internal auditors can be

- entity employees;
- engaged by the entity from the external auditor's firm or network; or
- other internal auditors engaged by the entity from other organizations.

Direct Assistance from Entity Employees

Are Entity Employees Providing Direct Assistance on the Engagement Team?

There is no doubt that when internal auditors who are employees of an entity provide direct assistance, that such employees are performing assurance procedures as described in the definition of "engagement team" above. IESBA's explanation in this case is that such employees, nevertheless, do not meet the definition of a member of an engagement team under the current Code because they are not partners or staff of the firm or network firm, nor are they "engaged" by the firm or network firm. We agree that employees of the entity are not partners or staff of the firm or network firm. Furthermore, it is quite right that such employees are not *directly* engaged by the firm or network firm.

However, when the entity agrees to have employees perform assurance procedures by providing direct assistance, the audit firm or network firm *is* engaging the entity to have its employees perform those procedures as part of its audit engagement with that entity. To then suggest that because of the *indirect* engagement, these employees are not members of the engagement team would mean that if a firm or network firm engages another firm to perform assurance procedures, which are then performed by employees of that latter firm, these employees would not be members of the engagement team. We do not believe this is the intention of the Code, which would regard engagement of individuals through another firm (or series of firms through a "chain" of engagements) to be the same as engaging those individuals directly for independence purposes. Furthermore, the word "engagement" does not imply a legally binding contract in all cases, which is why the ISAs use that term rather than "contract". Hence, indirect engagement through the entity of internal auditors who are employees of the entity would not preclude their being members of the engagement team if they perform audit procedures.

We believe that IESBA's explanation is disingenuous at best, and positively dangerous at worst, because the explanation applied generally would tear a massive loophole into the Code (see Section III in our comment letter).

Is Direct Assistance By Employees Prohibited By Current Code?

Employees of the entity are not independent of the entity. We note paragraphs 290.124 to 290.141 of the Code, which forbid even lesser threats to independence than direct employment in this regard. Since there is no difference in terms of independence between internal auditors employed by the entity and any other individual employed by the entity, internal auditors employed by the entity are not independent of the entity.

If external auditors obtain direct assistance from internal auditors employed by the entity, then, as noted above, by definition, internal auditors would be on the engagement team and would therefore need to be independent of the entity, which they cannot be by virtue of being employed by the entity. Consequently, by definition, direct assistance from entity employees is in conflict with the current Code.

Furthermore, having the external auditor directing or taking responsibility for the actions of the entity's internal audit employees (such as through direct assistance) does not increase the independence of those employees. In fact, paragraph 290.197 (second bullet point) of the Code forbids the external auditor, when providing internal audit services, from directing or taking responsibility for the actions of the entity's internal audit employees. It is difficult to see how if the external auditor were not providing internal audit services, but is directing or taking responsibility for actions other than internal audit of internal audit employees (such as direct assistance), that then such direction or responsibility would therefore reduce the risks to external auditor independence – indeed, it would increase that risk. Hence, since such audit procedures would be performed by internal auditors under the direction and supervision of the external auditor, the external auditor would be in violation of paragraph 290.197 of the Code.

Hence, the current Code forbids direct assistance from internal auditors employed by the entity.

Direct Assistance from the External Auditor's Firm or Network

Are Internal Auditors from External Auditor's Firm or Network Firm on Engagement Team When Providing Direct Assistance?

When internal auditors from the external auditor's firm or network provide direct assistance, they are "performing the engagement" or "performing assurance procedures". IESBA's argument is that such individuals are not on the engagement team because they are not partners or staff of the firm or network firm, nor are they "engaged" by the firm or network firm. However, when the external auditor renders internal audit services to the entity and those individuals involved in those internal audit services provide direct assistance, those individuals in fact **are** partners or staff of the firm or network firm, who, by virtue of providing direct assistance are "performing the engagement". It is therefore inconceivable how IESBA can claim that these individuals would not be included on the engagement team under the current Code.

In Section III of our comment letter, we examine the unintended consequences of changing the definition of engagement team in this respect.

Is Direct Assistance By Internal Auditors from External Auditor Inconsistent With the Current Code?

As noted above in Appendix I of our comment letter, as part of the internal audit function, internal auditors design, implement or operate the internal audit function, which, as described above, is a part of internal control – albeit a high level monitoring control segregated from management and governance processes, and from other internal control processes. The current Code forbids the external auditor from taking responsibility for designing, implementing and maintaining internal control, including internal audit services, because this is a management responsibility (paragraphs 290.163 and 290.197 of the Code). Paragraph 290.198 of the Code specifies measures that can be undertaken so that internal audit services can nevertheless be provided by the external auditor. However, paragraph 290.199 recognizes the potential self review threat when the external auditor provides internal audit services, and as an example of a safeguard to reduce or mitigate that threat suggests using professionals who are not on the audit team.

Consequently, obtaining direct assistance from internal auditors of the entity from the external auditor's firm or network would render ineffective the primary potential safeguard (using professionals not on the audit team) that would permit the external auditor to render internal audit services. Consequently, from the perspective of the current Code's independence requirements, permitting direct assistance from internal auditors from the external auditor's firm or network is inconsistent with the requirements and guidance in the current Code.

Direct assistance from internal auditors that are neither employees nor from external auditor's firm or network

Are internal auditors that are neither employees nor from external auditor's firm or network members of the engagement team under the current Code when providing direct assistance?

There is no doubt that when internal auditors who are neither employees nor from external auditor's firm or network members provide direct assistance, that such internal auditors are performing assurance procedures as described in the definition of "engagement team" above. IESBA's explanation in this case appears to be that these individuals, nevertheless, do not meet the definition of a member of an engagement team under the current Code because they are not partners or staff of the firm or network firm, nor are they "engaged" by the firm or network firm. It is entirely correct that such individuals are not partners or staff of the firm or network firm. However, in line with the arguments noted above in relation to employees of the entity, such individuals are being indirectly engaged to perform audit procedures when they provide direct assistance. Therefore, under the current Code, such individuals would be on the engagement team.

Is direct assistance by internal auditors that are neither employees nor from external auditor's firm or network members inconsistent with the current Code?

As noted in this Appendix above, employees of the entity that are internal auditors providing direct assistance are on the engagement team, yet are not independent of the entity, and this would cause a conflict with the Code.

In this respect, the question arises why the situation would be different for internal auditors that are engaged, rather than employed, by the entity, to perform internal audit activities. As noted above in Appendix I of our comment letter, as part of the internal audit function, internal auditors design, implement or operate the internal audit function, which, as described above, is a part of internal control – albeit a high level monitoring control segregated from management and governance processes, and from other internal control processes. Therefore, whether internal auditors are employed or engaged would not cause any differentiation in their function as being “internal” to the entity. On this basis, having internal auditors engaged by the entity provide direct assistance should cause such internal auditors to be on the engagement team, yet not be independent of the entity, and this would cause an inconsistency in principle with the Code.

One of the key arguments used to support direct assistance is based on the fact that the effectiveness of the external auditor’s use of the work of the internal audit function is greatly improved when that work is coordinated with that of the external auditor. The argument then follows that if the external auditor were not only to coordinate the work of the internal audit function, but actually direct and supervise that work, the value of that work to the external auditor would increase significantly.

However, the current Code forbids the external auditor from taking responsibility for designing, implementing and maintaining internal control, including internal audit services, because this is a management responsibility (paragraphs 290.163 in connection with 290.165, and the second bullet point of 290.197 of the Code). Consequently, external auditors coordinating their planning with that of the internal auditors should not cross the line into taking responsibility for any of the work plans or work of the internal audit function by directing or supervising those plans or work, since this would create unacceptable self-review and self-interest threats that cannot be mitigated by safeguards. In this context, direct assistance blurs the distinction between using the work of internal auditors and the performance of audit procedures by the audit team, with all of the concomitant independence problems discussed in the previous sections of this Appendix above.

Overall it seems to us that direct assistance by internal auditors who are neither employees nor from external auditor’s firm or network members is inconsistent with the principles in the current Code.

APPENDIX 3:

Implications of IESBA Explanations on Exclusion from Engagement Team and Impact of Proposed Change of Definition

Implications of IESBA Explanation as to Why Employees not Engaged to Perform Audit Procedures

IESBA claims in the first paragraph of the “Definition of engagement team” section of the Explanatory Memorandum that individuals providing direct assistance cannot be members of the engagement team because they are not partners or staff of the firm or network firm, nor are they engaged by the firm or network firm.

As noted in Appendix 2, there is no doubt that when internal auditors who are employees of an entity provide direct assistance, that such employees are performing assurance procedures. It is quite right that such employees are not *directly* engaged by the firm or network firm. However, when the entity agrees to have employees perform assurance procedures by providing direct assistance, the audit firm or network firm *is* engaging the entity to have its employees perform those procedures as part of its audit engagement with that entity. To then suggest that because of the *indirect* engagement, these employees are not members of the engagement team would have severe consequences for the interpretation of the Code.

Under the current definition of engagement team, individuals engaged by the firm or network firm who perform assurance procedures are members of the engagement team. If, however, a firm or network firm engages another firm to perform assurance procedures, which are then performed by employees of that latter firm, are these employees then members of the engagement team? If not, then firms and network firms can simply circumvent the definition by engaging other firms rather than individuals. This cannot be the intention of the Code.

Consequently, IESBA’s explanation as to why employees of the entity cannot be members of the engagement team would tear a massive loophole into the Code by permitting circumvention of the requirement to include on the engagement team individuals engaged to perform assurance procedures through the indirect engagement of those individuals over an organization or series of organizations.

Implications of Change in Definition of Engagement Team to Exclude Internal Auditors Providing Direct Assistance

IESBA claims in the first paragraph of the “Definition of engagement team” section of the Explanatory Memorandum that individuals providing direct assistance cannot be members of the engagement team because they are not partners or staff of the firm or network firm. However, when the external auditor renders internal audit services to the entity, the individuals providing direct assistance in fact **are** partners or staff of the firm or network firm, who, by virtue of providing direct assistance are “performing the engagement”. Therefore, these individuals would be included in the engagement team under the current Code. ***The consequence of the proposed change in definition to exclude individuals within the entity’s internal audit function from being included in the engagement team would be that partners and staff of the firm or network firm that render internal audit services to the entity and perform the engagement by means of direct assistance (or otherwise) would not be***

included in the engagement team simply because they are providing internal audit services! Hence in future, to avoid partners and staff of the firm or network firm from being subject to the independence requirements applicable to members of the engagement team, the firm or network firm need only ensure that these individuals render internal audit services!

This is a rather strange result, to say the least and represents an unintended loophole created by the proposed change in the definition of engagement team.