

Agenda Item 3



International
Ethics Standards
Board for Accountants

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Meeting Location: Teleconference

Meeting Date: October 15, 2012. 07:00-09:00 Eastern Time

Definition of Engagement Team

Objective

1. To receive a brief update on significant comments received on the exposure draft (ED) of the proposed change to the definition of the term “engagement team” in the IESBA *Code of Ethics for Professional Accountants* (Code).

Background

2. During the development by the IAASB of its revised ISA 610,¹ the IESBA considered whether individuals in the internal audit function providing direct assistance (Direct Assistance) would be included within the definition of engagement team, and therefore be required to be independent of the audit client. The IESBA concluded that these individuals do not meet the definition because they are not partners or members of the professional staff of the firm or network firm, nor are they engaged by the firm or network firm. Comments from several respondents to the IAASB exposure draft of the proposed revised ISA 610, however, indicated that there was uncertainty as to whether the extant definition in the Code would capture these individuals as part of the engagement team.
3. The IESBA therefore proposed to change the definition of engagement team as follows to make it clear that internal auditors providing direct assistance to the external auditor are not considered to be part of the engagement team under the Code, thereby eliminating the perception that the Code and the revised ISA 610 are in conflict:

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

4. The IESBA issued the ED in February 2012. It was expected that, subject to any comments received on the ED, the IAASB would make a similar amendment to the definition of engagement team in the ISAs and ISQC 1 for purposes of alignment with the Code.

¹ ISA 610 (Revised), *Using the Work of Internal Auditors*

Overview of Responses

5. The comment period for the ED closed on May 31, 2012. Forty six responses were received. The table below highlights broadly the balance of support for the proposed change to the definition. The Appendix provides a detailed listing of the respondents and an indication of whether they support the proposal.

Category of Respondent	Supportive	Some Concerns	Not supportive
Member Bodies	24	2	2
Firms	6	0	0
Regulators and Public Authorities	1	1	2
Individuals & Others	1	0	1
Other Professional organizations	5	1	0
Total	37	4	5

6. Clearly, the overwhelming majority of the respondents are supportive of the proposed change. However, a minority have indicated that they do not support it. In addition, while accepting the proposal in principle, a few other respondents have raised some concerns.
7. The following is a high level staff summary of the significant concerns that have been expressed, mainly by those opposing the proposed change. This summary has not yet been considered by the Task Force.

Significant Comments

Conflict with Independence

8. Four respondents² did not support the proposal as they are of the view that Direct Assistance fundamentally conflicts with the principle of independence because internal auditors providing direct assistance to the external auditor are not independent of the audit client. One of the respondents,³ in particular, argued that the competence and objectivity of these internal auditors are not subject to the same level of regulation that applies to external auditors. Further, the respondent expressed the view that the audit client could put undue pressure on the external auditor to use DA to reduce the audit fee. It also believes that it is conceptually inappropriate to exclude internal auditors from the engagement team definition when their work would be expected to be subject to the same direction, supervision and review as work performed by ordinary engagement team members.
9. Another respondent⁴ believes that Direct Assistance creates a conflict of interest with the external auditor's objectives which is difficult or impossible to eliminate.

² IDW, ICAC, WpK, and a group of 11 European audit regulators (the latter representing Czech Republic, France, Luxembourg, Malta, The Netherlands, Norway, Portugal, Romania, Slovenia, Spain and Switzerland)

³ The group of 11 European audit regulators

⁴ ICAC

Definition of Internal Audit Function

10. One respondent⁵ believes that the definition used by the IAASB⁶ is flawed for several reasons:

- It does not adequately distinguish the nature of an internal audit function from other internal controls in that 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 amended definition, even though they are not a part of an “internal audit function” properly defined.
- 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. Consequently, individuals in internal audit functions without consulting activities performing direct assistance would not be exempted from the engagement team under the proposed amended definition, even though they are a part of an “internal audit function” properly defined.
- 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 would not be an internal audit function as defined. Consequently, individuals in these internal audit functions performing direct assistance would not be exempted from inclusion in the proposed amended definition of engagement team, even though they are a part of an “internal audit function” properly defined.

Accordingly, the respondent believes that the IESBA should submit the definition of “internal audit function” to the IAASB for reconsideration.

11. The respondent also highlighted what it believes are two issues with the proposed amended engagement team definition:

- The Board’s explanation as to why employees of the entity are not “engaged” to provide direct assistance could have severe consequences for the interpretation of 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. The respondent believes that it is not the Board’s intention to exclude from the engagement team individuals performing audit procedures that are indirectly engaged by the firm or network firm.

⁵ IDW

⁶ The revised ISA 610 defines an internal audit function 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.”

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- The proposed change would open up a loophole in the Code by excluding from the engagement team partners and staff of the firm or network firm who 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.
12. Another respondent⁷ questioned whether, in reaching its conclusion on the proposed amended definition, the IESBA had 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.
13. A few other respondents also commented on the proposed change to the engagement team definition as follows:
- One respondent⁸ felt that the proposed amended definition was unclear as to whether individuals providing direct assistance who fall outside the definition of the internal audit function would be considered part of the engagement team. It noted that the revised ISA 610 expressly states that activities similar to those performed by an internal audit function may be conducted by functions with other titles within an entity. Accordingly, the respondent suggested that the definition be amended to state that the engagement team “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.”
 - Three other respondents⁹ suggested deletion of the reference to the revised ISA 610 in the proposed amended definition as they believe internal auditors should be excluded from the engagement team regardless of whether or not they are providing direct assistance on the audit engagement.

Action Requested

IESBA members are asked to note the significant comments received on the ED in advance of discussion at the December 2012 IESBA meeting.

⁷ IOSCO

⁸ ACCA

⁹ FEE, FSR and ICJCE

Appendix

LIST OF RESPONDENTS <i>Proposed Change to the Definition of "Engagement Team"</i>				
ABBR.	ORG.	Support	Concern	Not Support
MEMBER BODY				
ACCA	The Association of Chartered Certified Accountants		1	
AICPA	American Institute of CPA	1		
CGA	Certified General Accountants Association of Canada	1		
CICA	The Canadian Institute of Chartered Accountants	1		
CICPA	Chinese Institute of Certified Public Accountants	1		
CNCC-CSOEC	Compagnie Nationale des Commissaires aux Comptes + Conseil Supérieur de l'Ordre des Experts-Comptables	1		
CND-CEC	Consiglio Nazionale dei Dottori Commercialisti + E Degli Esperti Contabili	1		
CPA Au	CPA Australia		1	
FAR	FAR	1		
FSR	Foreningen af Statsautoriserede Revisorer	1		
HKICPA	Hong Kong Institute of Certified Public Accountants	1		
IBR-IRE	Institut des Réviseurs d'Entreprises/ Instituut der Bedrijfsrevisoren	1		
ICAA	The Institute of Chartered Accountants in Australia	1		
ICAB	The Institute of Chartered Accountants of Bangladesh	1		
ICAEW	The Institute of Chartered Accountants in England and Wales	1		
ICAS	The Institute of Chartered Accountants of Scotland	1		
ICJCE	Instituto de Censores Jurados de Cuentas de España	1		
ICPAK	Institute of Certified Public Accountants of Kenya	1		
ICPAS	Institute of Certified Public Accountants of Singapore	1		
IDW	Institut der Wirtschaftsprüfer			1
JICPA	The Japanese Institute of Certified Public Accountants	1		
KICPA	Korean Institute of Certified Public Accountants	1		
MIA	Malaysian Institute of Accountants	1		
NAAAU	National Association of Accountants and Auditors of Uzbekistan	1		
NBA	Nederlandse Beroepsorganisatie van Accountants	1		
SAICA	The South African Institute of Chartered Accountants	1		
WPK	Wirtschaftsprüferkammer			1
ZICA	Zambia Institute of Chartered Accountants	1		
FIRMS				
BDO	BDO Global Coordination B.V.	1		
DTT	Deloitte Touche Tohmatsu	1		

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ABBR.	ORG.	Support	Concern	Not Support
EYG	Ernst & Young Global	1		
GT	Grant Thornton International	1		
KPMG	KPMG	1		
PwC	PricewaterhouseCoopers	1		
REGULATORS & PUBLIC AUTHORITIES				
ICAC	Accounting and Auditing Institute (Spain)			1
CARB	Chartered Accountants Regulatory Board	1		
IOSCO	International Organization of Securities Commissions		1	
EAIG	11 European Audit Regulators			1
INDIVIDUALS & OTHERS				
Denise Juvenal	Denise Silva Ferreira Juvenal	1		
Anon	Anonymous			1
OTHER PROFESSIONAL ORGANIZATIONS				
APESB	Accounting Professional & Ethical Standards Board Limited-Australia		1	
FEE	Fédération des Experts Comptables Européens	1		
GAO	United States Government Accountability Office	1		
IIA	The Institute of Internal Auditors	1		
UKNAO	United Kingdom National Audit Office	1		
NZAuASB	New Zealand Auditing and Assurance Standards Board	1		
TOTAL RESPONSES		37	4	5