

**Basis for Conclusions**  
**Prepared by the Staff of the IESBA**  
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*International Ethics Standards Board for  
Accountants*

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# Change to the Definition of “Engagement Team” in the Code of Ethics for Professional Accountants

**IESBA**

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This document was prepared by the Staff of the International Ethics Standards Board for Accountants (IESBA).

The IESBA is an independent standard-setting board that develops and issues high-quality ethical standards and other pronouncements for professional accountants worldwide. Through its activities, the IESBA develops the *Code of Ethics for Professional Accountants*, which establishes ethical requirements for professional accountants.

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

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## **BASIS FOR CONCLUSIONS: CHANGE TO THE DEFINITION OF “ENGAGEMENT TEAM”**

This Basis for Conclusions has been prepared by staff of the International Ethics Standards Board for Accountants (IESBA). It relates to, but does not form part of, the change to the definition of “engagement team” in the *Code of Ethics for Professional Accountants* (the Code). The change to the definition was approved by the IESBA in January 2013 with the affirmative votes of 16 out of 16 IESBA members present.

### **Background**

1. The International Auditing and Assurance Standards Board (IAASB) initiated its project to revise ISA 610<sup>1</sup> in March 2009 to reflect developments in the internal audit environment and changes in practice regarding the interactions between external and internal auditors. At the same time, there was a strong need to address the ambiguity in the scope of the extant ISA 610 regarding whether or not external auditors are permitted to use internal auditors to provide direct assistance on the external audit (DA).
2. The IAASB issued its exposure draft of the proposed revised ISA 610<sup>2</sup> (ED-610) in July 2010. In addition to addressing the use of the work of the internal audit function, ED-610 set out clearly the external auditor’s responsibilities where DA is used, and included requirements and guidance to ensure that DA is used only in appropriate circumstances.
3. Recognizing that DA is established practice in some jurisdictions, many of the respondents agreed that the proposed ISA should address it so that appropriate limitations and safeguards can be put in place regarding its use. Those respondents who accepted the use of DA generally felt that such a practice should be restricted to more limited circumstances than the use of the work of the internal audit function. Among the reasons cited, respondents were concerned that DA appeared to be in conflict with the Code. In particular, it was felt that internal auditors performing external audit procedures at the direction of the external auditor would, in effect, be part of the engagement team (ET) and the Code requires that the ET be independent of the audit client.
4. In the light of these comments, the IESBA established a Task Force to consider the relationship between DA and the definition of ET in the Code. After consideration of its Task Force’s analysis of the issues and the IAASB’s related responses, the IESBA recommended a number of changes to the proposed ISA. The IESBA also concluded that a change to the ET definition was needed to explicitly scope out internal auditors providing direct assistance.
5. At its December 2011 meeting, the IAASB finalized the wording of the proposed ISA 610 (Revised), including the DA provisions. However, in March 2012, the IAASB released only the provisions of the standard addressing the external auditor’s use of the work of the internal audit function. This recognized the importance of timely release of strengthened requirements relating to using the work of the internal audit function, while also allowing the IESBA the time it needed to expose the proposed change to the ET definition.

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<sup>1</sup> ISA 610, *Using the Work of Internal Auditors*

<sup>2</sup> Proposed ISA 610 (Revised), *Using the Work of Internal Auditors*

6. At its February 2012 meeting, having satisfied itself that the changes made by the IAASB to the proposed ISA with respect to DA were consistent with what it had proposed, the IESBA approved an amended definition of ET for exposure (ED-ET).
7. The comment period for ED-ET closed on May 31, 2012. Forty six responses were received from various respondents, including regulators and public authorities, national standard setters, IFAC member bodies, other professional organizations, and Firms. While the overwhelming majority of the respondents were supportive of the IESBA's proposal, a minority had concerns with certain aspects of the proposal.
8. The IESBA liaised closely with the IAASB on the significant issues raised by respondents to ED-ET. As part of their consideration of comments on exposure, the leaderships of the IESBA and IAASB Task Forces jointly held discussions with representatives of a regulatory respondent to fully understand the concerns the respondent had expressed, and to explain more clearly the respective proposals of the Boards and their further proposed changes.
9. The IESBA also discussed the ET and ISA 610 projects with the IESBA Consultative Advisory Group on three occasions.
10. As a result of the IESBA's approval of the revised ET definition, the IAASB approved in February 2013 the final provisions of ISA 610 (Revised 2013)<sup>3</sup> addressing DA, as well as necessary conforming amendments to the ET definition in the ISAs and ISQC 1<sup>4</sup> for purposes of alignment with the Code.

### Conflict Between Direct Assistance and Independence

11. ED-ET proposed the following change to the ET definition:

*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.

12. Some respondents did not support the proposed change to the definition, believing that DA fundamentally conflicts with the principle of independence<sup>3</sup> because internal auditors providing DA are not independent of the audit client. A respondent, 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. The respondent also felt it conceptually inappropriate to exclude internal auditors from the ET definition when their work would be expected to be subject to the same direction, supervision and review as work performed by ordinary ET members.
13. A similar concern was expressed by another respondent who questioned whether the IESBA had considered that from a functional perspective internal auditors providing DA, as defined, are performing procedures under the direction, supervision and review of the external auditor. The

<sup>3</sup> ISA 610 (Revised 2013) can be accessed at: <https://www.ifac.org/publications-resources/isa-610-revised-2013-using-work-internal-auditors>

<sup>4</sup> ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

same respondent, however, also noted that where DA is permitted, it should be subject to specific objectivity requirements and the application of appropriate safeguards and professional skepticism to mitigate independence concerns. The respondent suggested that the IESBA more explicitly state that its guidance is provided to assist an external auditor conduct its work in situations in which DA from internal auditors is allowed, as opposed to being provided to establish or imply whether such assistance is appropriate.

14. Two respondents commented that both IESBA and IAASB projects could have benefited from both Boards jointly discussing the broader notion of objectivity.
15. A few other respondents objected to the proposal on the following grounds:
  - (a) DA creates a conflict of interest with the external auditor's objectives which is difficult or impossible to eliminate.
  - (b) There is a lack of public interest justification for explicitly permitting DA.
16. Most respondents, however, expressed support for the proposal. In particular, it was noted that the revised ISA 610 recognizes the need to ensure that the objectivity of the external auditor is not impaired by the use of DA and that the revised ISA consequently establishes significant additional requirements for such situations. It was also noted that the safeguards provided by these new requirements are sufficiently robust to ensure that the objectivity of the external auditor is not undermined when internal auditors are used in a DA capacity.
17. A respondent, while supporting the proposal, expressed concern regarding the potential for external auditors to use internal auditors more frequently to complete their audit work.

### **IESBA Decisions**

18. The IESBA noted that in undertaking the project to revise ISA 610, the IAASB had observed that in some jurisdictions internal auditors are not prohibited from providing DA under the direction, supervision, and review of the external auditor. Because the extant ISA 610 explicitly states that it does not deal with such instances,<sup>5</sup> the IAASB had recognized the ambiguity that exists regarding whether this meant that the IAASB does not support the use of DA, or whether DA is simply not addressed in the scope of the ISA. The IAASB had, however, noted that national auditing standards of a number of jurisdictions allow for DA, and it is common practice in many, although in others it is not allowed. The IAASB had therefore concluded that it would not be in the public interest to allow continued ambiguity about its intent.
19. The IESBA also noted that the IAASB had acknowledged the concerns of some stakeholders about threats to the independence of the ET (in fact or perceived) when internal auditors provide DA. The IESBA had concurred with the IAASB that safeguards can be put in place, through adequate direction, supervision, and review, to ensure that DA is used only in appropriate areas, and that the external auditor can address possible risks to audit quality arising from the fact that internal auditors are not independent of the audit client. The IESBA noted that in ED-610, the IAASB had therefore proposed to establish requirements and guidance to ensure that DA is obtained only in appropriate circumstances and to clearly set out the external auditor's responsibilities in such cases, including the required involvement of the external auditor.

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<sup>5</sup> ISA 610, paragraph 2

20. In addition, the IESBA noted that the IAASB had also carefully considered the fact that in some jurisdictions DA is explicitly prohibited by law or regulation. ED-610 therefore acknowledged this fact. It also explained that prohibitions or restrictions regarding the use of the work of internal auditors will not prevent the external auditor from complying with the ISA because the proposed requirements do *not* require or encourage the external auditor to use, or to consider using, DA.
21. The IESBA was consulted by the IAASB with respect to, and fully supported, the actions the IAASB took when the IAASB concluded its deliberations on the final wording of the revised ISA 610 with respect to DA, including the IAASB's further actions in response to respondents' comments noted above (see the Basis for Conclusions for ISA 610 (Revised 2013)).<sup>6</sup>
22. With respect to the comment that both IESBA and IAASB projects could have benefited from both Boards jointly discussing the broader notion of objectivity, the IESBA noted that this had already happened at the Board and Task Force levels since the initiation of the IAASB's project. Further, the two Boards had indeed fully considered in their deliberations the issue of the internal auditors' objectivity, with the IESBA reaching satisfaction that the safeguards built into the final ISA wording were adequate.
23. Nevertheless, the IESBA accepted the suggestion that it more explicitly state that its guidance is provided to assist an external auditor conduct its work in situations in which DA is permitted so as to avoid the suggestion that such assistance is appropriate. The IESBA therefore determined that the definition should be further amended to read:

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.

The term “engagement team” also excludes individuals within the client’s internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013), *Using the Work of Internal Auditors*. (Footnote)

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

## Proposed Revised Definition of Engagement Team

24. A respondent expressed the following two concerns regarding the proposed revised definition:
- The IESBA’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 ET 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 felt that it was not the IESBA’s intention to exclude from the ET individuals performing audit procedures that are indirectly engaged by the firm or network firm.

<sup>6</sup> The Basis for Conclusions for ISA 610 (Revised 2013) can be accessed at: <http://www.ifac.org/publications-resources/basis-conclusions-isa-610-revised-2013-using-work-internal-auditors>

- The proposed change would open up a loophole in the Code by excluding from the ET 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.
25. A few other respondents also commented on the proposed change to the definition as follows:
- A respondent 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 ET. The respondent 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 ET “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.”
  - A few respondents suggested deletion of the reference to the revised ISA 610 in the proposed amended definition as they were of the view that internal auditors should be excluded from the ET regardless of whether or not they are providing DA on the audit engagement. A few others highlighted the fact that specific references (including ISA numbers) are not generally made within the Code and that the IESBA should consistently maintain this approach with respect to the ET definition.
26. A respondent argued that the ET definition in the Code should be made consistent with that in the IAASB’s literature, which does not limit the concept of “engagement team” to assurance engagements only (the definition in ISQC 1 refers to “any individuals engaged by the firm or a network firm who perform *procedures* on the engagement”).
27. A further respondent noted that the IESBA’s use of the term “individuals” in the definition conflicts with the IAASB’s use of the term “internal auditors.” The respondent argued that the same terms should be used to avoid unintended consequences.

### **IESBA Decisions**

28. With respect to the comments in paragraph 24 above:
- The IESBA disagreed with the respondent’s literal interpretation of the term “engaged,” as this was not what the IESBA had intended. Members of the ET are engaged by the firm under an employment contract or other contractual arrangement and the IESBA did not believe it was necessary to be any more specific, particularly as no other respondents had taken a similar view as the respondent.
  - The IESBA noted that under the Code, firm personnel who provide only internal audit services to a client are treated as providing non-audit services and are not treated as part of the audit engagement team, unless they are also undertaking supporting assurance services specifically for the external audit. The IESBA believed that the latter circumstance would unlikely arise in practice because, in reality, firm personnel who provide internal audit services to a client would generally not be expected to be part of the audit engagement team due to the self-review threat (see paragraph 290.199 of the Code).
29. With respect to the comments in paragraph 25 above:
- The IESBA, in consultation with the IAASB, rejected the suggestion that the ET definition be

broadened as indicated because the critical aspect of individuals working in the internal audit function is that these individuals are subject to a systematic and disciplined approach to their work, as explained in the ISA 610 (Revised 2013) wording:

There may be individuals in an entity that perform procedures similar to those performed by an internal audit function. However, 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 and obtaining evidence regarding the effectiveness of such controls would be part of the auditor's responses to assessed risks in accordance with ISA 330.<sup>7</sup>

- The IESBA, in consultation with the IAASB, also disagreed with the suggestion to delete the reference to ISA 610 (Revised) in the ET definition because the critical function served by this reference is to point to the conditions and safeguards incorporated in the revised ISA around the use of DA.
30. With respect to the comment in paragraph 26 above, the IESBA noted that the respondent's suggestion fell outside the scope of this project. Nevertheless, the IESBA agreed to ask its planning committee to consider the matter separately.
31. Finally, the IESBA did not agree that the term "internal auditors" should be used in the revised definition as that term is not explicitly defined in the revised ISA.

### **Threats and Safeguards**

32. Some respondents cited the need for the IESBA to consider, improve or modify safeguards to address objectivity considerations if DA is used, as well as guidance related to potential threats when DA is used. The following specific comments were made:
- (a) It is important to consider safeguards to address the external auditor's objectivity when internal auditors provide direct assistance to external auditors.
  - (b) The Code should directly address ethical considerations which the external auditor and the internal auditor should consider when DA is used. This should include potential threats that the external auditor and internal auditor should identify and appropriate safeguards that may mitigate those threats. Further, as the Code has higher independence requirements for PIEs, the IESBA should consider whether DA 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, a consideration may be to have the internal audit function reporting directly to the audit committee of the PIE.
  - (c) The revision of the ET definition is insufficient and parts B and C of the Code should address the use of DA and include guidance to professional accountants in practice and in business about the potential threats and possible safeguards. Further, it is important that the Code addresses the independence issues involved, including the nature of threats and safeguards.
  - (d) To ensure the application of appropriate safeguards and professional skepticism to mitigate independence concerns, one possible way under ISA 610 would be to go further in the IAASB's recent deliberations on it and specifically modify the safeguarding requirements as follows:

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<sup>7</sup> ISA 610 (Revised 2013), paragraph 10



- (i) For the work of internal auditors providing DA 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.
- (ii) The totality of procedures performed by internal auditors providing DA and by the internal audit function and relied upon by the external auditor should not form a significant portion of the total audit work.
- (iii) 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.
- (iv) 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.

This respondent also suggested that to emphasize the importance of these provisions to the position taken in the Code regarding the role of internal auditors, it would be appropriate to make reference in the Code to the fact that ISA 610 contains them.

- (e) Even in countries where independence regulation may not prohibit DA, the revised ISA 610 provides insufficient guidance concerning threats that would be considered unacceptable vs. threats that could be overcome by appropriate safeguards.
- (f) If the external auditor uses the reports or other work of the internal audit function as audit evidence but not in a DA capacity, then this would have a similar effect on the external auditor's work. As such, the safeguards applied in both scenarios may not be consistent. Accordingly, the IAASB should consider expanding the definition of DA to include the external auditors' use of reports and other work performed by the internal audit function as audit evidence in performing compliance and substantive testing. As an alternative, the IAASB could provide the same safeguards for this use of the internal audit function's work.

33. A respondent recommended that the IESBA make reference in Section 280 of the Code (Objectivity—All Services) to the impact that the use of DA would have on independence if such use were not in accordance with ISA 610 (Revised). The respondent suggested that the following cross reference would be sufficient as the revised ISA 610 addresses the threats to independence of using DA and the related safeguards to reduce such threats to an acceptable level:

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.

### **IESBA Decisions**

34. With respect to the comments regarding the need for the IESBA to address objectivity considerations if DA is used, the IESBA noted that in finalizing the wording of ISA 610 (Revised), the IAASB had proactively consulted with the IESBA in relation to further strengthening of the threats and safeguards framework in the proposed ISA to respond to comments on exposure. The IESBA had agreed with the IAASB that the threats and safeguards framework is best built into the revised ISA not only because the Code does not apply to internal auditors (and therefore the suggestions for guidance on threats and safeguards applicable to internal auditors are not

appropriate), but also because auditors would need to directly apply that framework during the actual performance of their audits. Importantly, the IESBA had agreed with the IAASB that it would be undesirable to have safeguards in two separate places. In addition, the IESBA believed that including detailed guidance in the Code addressing DA would inappropriately suggest that use of such DA is a core aspect of the external audit.

35. The IESBA did not agree with the comment that the revised ET definition is insufficient and additional guidance should be provided in parts B and C of the Code to address the use of DA. The IESBA noted that Part C of the Code deals only with the typical roles and responsibilities of professional accountants in business. The additional guidance is for the benefit of external auditors when using internal auditors for DA and not for the internal auditors themselves.
36. Regarding the suggestions in paragraph 32(d)-(f) above, the IESBA was consulted by the IAASB with respect to, and fully supported, the actions and views of the IAASB on these matters (see the Basis for Conclusions for ISA 610 (Revised 2013)).
37. The IESBA did not agree that it would be appropriate for the Code to make reference to the fact that the revised ISA contains the provisions mentioned in paragraph 32(d)(i)-(iv) above. Instead, the reference should be to all the requirements and guidance in the revised ISA addressing DA. Accordingly, the IESBA added a footnote to this effect in the revised ET definition.
38. Finally, the IESBA did not believe that the suggested addition to Section 280 of the Code would be appropriate, as Section 280 deals specifically with objectivity as opposed to broader independence considerations relevant to the use of DA.

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