PART 5 – SECTION 540

LONG ASSOCIATION OF PERSONNEL (INCLUDING PARTNER-ENGAGEMENT LEADER ROTATION) WITH AN AUDIT SUSTAINABILITY ASSURANCE CLIENT

Introduction

540.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

540.2 When an individual is involved in an audit sustainability assurance engagement over a long period of time, familiarity and self-interest threats might be created. This section sets out requirements and application material relevant to applying the conceptual framework in such circumstances.

Requirements and Application Material

All Audit Sustainability Assurance Clients

540.3 A1 Although an understanding of an audit sustainability assurance client and its environment is fundamental to audit assurance quality, a familiarity threat might be created as a result of an individual’s long association as an audit sustainability assurance team member with:

(a) The audit sustainability assurance client and its operations;
(b) The audit sustainability assurance client’s senior management; or
(c) The financial statements on which the firm will express an opinion or the financial information which forms the basis of the financial statements
(c) The sustainability information on which the firm will express an opinion or the financial or non-financial information which forms the basis of the sustainability information.

540.3 A2 A self-interest threat might be created as a result of an individual’s concern about losing a longstanding client or an interest in maintaining a close personal relationship with a member of senior management or those charged with governance. Such a threat might influence the individual’s judgment inappropriately.

540.3 A3 Factors that are relevant to evaluating the level of such familiarity or self-interest threats include:

(a) In relation to the individual:

- The overall length of the individual’s relationship with the client, including if such relationship existed while the individual was at a prior firm.
- How long the individual has been an engagement team member, and the nature of the roles performed.
- The extent to which the work of the individual is directed, reviewed and supervised by more senior personnel.
- The extent to which the individual, due to the individual’s seniority, has the ability to influence the outcome of the audit sustainability assurance engagement, for example, by making key decisions or directing the work of other engagement
team members.

- The closeness of the individual’s personal relationship with senior management or those charged with governance.
- The nature, frequency and extent of the interaction between the individual and senior management or those charged with governance.

(b) In relation to the audit sustainability assurance client:

- The nature or complexity of the client’s accounting and financial reporting issues and whether they have changed. The nature or complexity of the client’s sustainability reporting issues and whether they have changed.
- Whether there have been any recent changes in senior management or those charged with governance.
- Whether there have been any structural changes in the client’s organization which impact the nature, frequency and extent of interactions the individual might have with senior management or those charged with governance.

540.3 A4 The combination of two or more factors might increase or reduce the level of the threats. For example, familiarity threats created over time by the increasingly close relationship between an individual and a member of the client’s senior management would be reduced by the departure of that member of the client’s senior management.

540.3 A5 An example of an action that might eliminate the familiarity and self-interest threats created by an individual being involved in an audit sustainability assurance engagement over a long period of time would be rotating the individual off the audit sustainability assurance team.

540.3 A6 Examples of actions that might be safeguards to address such familiarity or self-interest threats include:

- Changing the role of the individual on the audit sustainability assurance team or the nature and extent of the tasks the individual performs.
- Having an appropriate reviewer who was not an audit sustainability assurance team member review the work of the individual.
- Performing regular independent internal or external quality reviews of the engagement.

R540.4 If a firm decides that the level of the threats created can only be addressed by rotating the individual off the audit sustainability assurance team, the firm shall determine an appropriate period during which the individual shall not:

(a) Be a member of the engagement team for the audit sustainability assurance engagement;
(b) Perform an engagement quality review, or a review consistent with the objective of an engagement quality review, for the engagement; or
(c) Exert direct influence on the outcome of the audit sustainability assurance engagement.

The period shall be of sufficient duration to allow the familiarity and self-interest threats to be addressed. In the case of a public interest entity, paragraphs R540.5 to R540.20 also apply.
Audit Sustainability Assurance Clients that are Public Interest Entities

R540.5 Subject to paragraphs R540.7 to R540.9, in respect of an audit sustainability assurance engagement of a public interest entity, an individual shall not act in any of the following roles, or a combination of such roles, for a period of more than seven cumulative years (the "time-on" period):

(a) The engagement leader partner;
(b) The individual appointed as responsible for performing the engagement quality review; or
(c) Any other key audit sustainability assurance partner leader role; or
(d) A key audit partner.

After the time-on period, the individual shall serve a "cooling-off" period in accordance with the provisions in paragraphs R540.11 to R540.19.

Matters for IESBA’s Consideration

Rotation of Engagement Leaders

In the case of a sustainability assurance engagement, the Task Force believes that threats might also be created if the individual serves in the combination of key sustainability assurance leader and key audit partner roles for more than seven years. For example, if the individual has already served as a key audit partner, that period should be considered when calculating the "time-on period" as an engagement leader for a sustainability assurance client. (See paragraph R540.5 (d).)

(A corresponding change would be made to paragraph R540.5 to include “A key sustainability assurance leader” as an additional role that would be relevant to consider with respect to determining the time-on period in the context of an audit engagement.)

Do IESBA members agree with the proposed requirements regarding the rotation of the engagement leaders in paragraphs R540.5, and R540.14 to R540.18?

R540.6 In calculating the time-on period, the count of years shall not be restarted unless the individual ceases to act in any one of the roles in paragraph R540.5(a) to (ed) for a minimum period. This minimum period is a consecutive period equal to at least the cooling-off period determined in accordance with paragraphs R540.11 to R540.13 as applicable to the role in which the individual served in the year immediately before ceasing such involvement.

540.6 A1 For example, an individual who served as engagement partner leader for four years followed by three years off can only act thereafter as a key audit sustainability assurance partner leader on the same audit sustainability assurance engagement for three further years (making a total of seven cumulative years). Thereafter, that individual is required to cool off in accordance with paragraph R540.14.

R540.7 As an exception to paragraph R540.5, key audit sustainability assurance partners–leaders whose continuity is especially important to audit assurance quality may, in rare cases due to unforeseen circumstances outside the firm’s control, and with the concurrence of those charged with governance, be permitted to serve an additional year as a key audit sustainability assurance partner–leader as long as the threat to independence can be
eliminated or reduced to an acceptable level.

540.7 A1 For example, a key sustainability assurance audit partner leader may remain in that role on the audit sustainability assurance team for up to one additional year in circumstances where, due to unforeseen events, a required rotation was not possible, as might be the case due to serious illness of the intended engagement partner leader. In such circumstances, this will involve the firm discussing with those charged with governance the reasons why the planned rotation cannot take place and the need for any safeguards to reduce any threat created.

R540.8 If an audit sustainability assurance client becomes a public interest entity, a firm shall take into account the length of time an individual has served the audit sustainability assurance client as a key sustainability assurance audit partner leader or key audit partner before the client becomes a public interest entity in determining the timing of the rotation. If the individual has served the audit sustainability assurance client as a key sustainability assurance audit partner leader or key audit partner for a period of five cumulative years or less when the client becomes a public interest entity, the number of years the individual may continue to serve the client in that capacity as a key sustainability assurance leader before rotating off the engagement is seven years less the number of years already served. As an exception to paragraph R540.5, if the individual has served the audit sustainability assurance client as a key sustainability assurance audit partner leader or key audit partner for a period of six or more cumulative years when the client becomes a public interest entity, the individual may continue to serve in that capacity as a key sustainability assurance leader with the concurrence of those charged with governance for a maximum of two additional years before rotating off the engagement.

R540.9 When a firm has only a few people with the necessary knowledge and experience to serve as a key sustainability assurance audit partner leader on the audit sustainability assurance engagement of a public interest entity, rotation of key sustainability assurance audit partners leaders might not be possible. As an exception to paragraph R540.5, if an independent regulatory body in the relevant jurisdiction has provided an exemption from partner key sustainability assurance leader rotation in such circumstances, an individual may remain a key sustainability assurance audit partner leader for more than seven years, in accordance with such exemption. This is provided that the independent regulatory body has specified other requirements which are to be applied, such as the length of time that the key sustainability assurance audit partner leader may be exempted from rotation or a regular independent external review.

Other Considerations Relating to the Time-on Period

R540.10 In evaluating the threats created by an individual’s long association with an audit sustainability assurance engagement, a firm shall give particular consideration to the roles undertaken and the length of an individual’s association with the audit sustainability assurance engagement prior to the individual becoming a key sustainability assurance audit partner leader.

540.10 A1 There might be situations where the firm, in applying the conceptual framework, concludes that it is not appropriate for an individual who is a key sustainability assurance audit partner leader to continue in that role even though the length of time served as a key sustainability assurance audit partner leader is less than seven years.
Cooling-off Period

**R540.11** If the individual acted as the engagement partner leader for seven cumulative years, the cooling-off period shall be five consecutive years.

**R540.12** Where the individual has been appointed as responsible for the engagement quality review and has acted in that capacity for seven cumulative years, the cooling-off period shall be three consecutive years.

**R540.13** If the individual has acted as a key sustainability assurance leader other than in the capacities set out in paragraphs R540.11 and R540.12 for seven cumulative years, the cooling-off period shall be two consecutive years.

**540.13 A1** The key sustainability assurance leader rotation requirements in this section are distinct from, and do not modify, the cooling-off period required by ISQM 2 as a condition for eligibility before the engagement partner leader can assume the role of engagement quality reviewer (see paragraph 325.8 A4).

Service in a combination of key audit partner or key sustainability assurance audit partner leader roles

**R540.14** If the individual acted in a combination of key audit partner or key sustainability assurance audit partner leader roles and served as the engagement partner or leader for four or more cumulative years, the cooling-off period shall be five consecutive years.

**R540.15** Subject to paragraph R540.16(a), if the individual acted in a combination of key audit partner or key sustainability assurance audit partner leader roles and served as the key audit partner or key sustainability assurance audit partner leader responsible for the engagement quality review for four or more cumulative years, the cooling-off period shall be three consecutive years.

**R540.16** If an individual has acted in a combination of engagement partner or engagement leader and engagement quality reviewer roles for four or more cumulative years during the time-on period, the cooling-off period shall:

(a) As an exception to paragraph R540.15, be five consecutive years where the individual has been the engagement partner or engagement leader for three or more years; or

(b) Be three consecutive years in the case of any other combination.

**R540.17** If the individual acted in any combination of key audit partner or key sustainability assurance audit partner leader roles other than those addressed in paragraphs R540.14 to R540.16, the cooling-off period shall be two consecutive years.

Service at a Prior Firm

**R540.18** In determining the number of years that an individual has been a key sustainability assurance audit partner leader as set out in paragraph R540.5, the length of the relationship shall, where relevant, include time while the individual was a key audit partner or key sustainability assurance partner leader on that engagement at a prior firm.

Restrictions on Activities During the Cooling-off Period

**R540.19** For the duration of the relevant cooling-off period, the individual shall not:

(a) Be an engagement team member or perform an engagement quality review, or a review consistent with the objective of an engagement quality review, for the audit
sustainability assurance engagement;

(b) Consult with the engagement team or the client regarding technical or industry-specific issues, transactions or events affecting the audit-sustainability assurance engagement (other than discussions with the engagement team limited to work undertaken or conclusions reached in the last year of the individual’s time-on period where this remains relevant to the audit sustainability assurance engagement);

(c) Be responsible for leading or coordinating the professional services provided by the firm or a network firm to the audit-sustainability assurance client, or overseeing the relationship of the firm or a network firm with the audit-sustainability assurance client; or

(d) Undertake any other role or activity not referred to above with respect to the audit sustainability assurance client, including the provision of non-assurance services, that would result in the individual:

(i) Having significant or frequent interaction with senior management or those charged with governance; or

(ii) Exerting direct influence on the outcome of the audit sustainability assurance engagement.

540.19 A1 The provisions of paragraph R540.19 are not intended to prevent the individual from assuming a leadership role in the firm or a network firm, such as that of the Senior or Managing Partner (Chief Executive or equivalent).