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Impact Analysis - Partner Rotation

The partner rotation changes from the Code (July 2006) to the Code (July 2009) were as follows;

- Extending partner rotation requirements from listed entities to all public interest entities;
- Extending the partner rotation requirements to all key audit partners (that is requiring rotation of "other audit partners, if any, on the engagement team who make key decisions or judgments on significant matters with respect to the audit.");
- Replacing the provision to permit no partner rotation if the firm has only a few people with the necessary knowledge to act as engagement partner or quality control reviewer with the provision that partner rotation is not necessary if a firm has only a few people with the necessary knowledge and experience, and an independent regulator in the jurisdiction has provided an exemption from partner rotation provided safeguards are in place;
- Stating that during the "time-out" period the individual shall not participate in the audit of the entity, provide QC for the engagement, consult with the engagement team or the client regarding technical or industry-specific issues, transaction or events or otherwise directly influence the outcome of the engagement; and
- Replacing the provision that some degree of flexibility over the timing of rotation may be necessary in certain circumstances, with the provision that when continuity is especially important one additional year is allowed in rare circumstances that were unforeseen and outside the firms control as long as the threat to independence can be eliminated or reduced to an acceptable level by applying safeguards.

The actual text of the old Code and the revised Code are provided in the Appendix to this document.

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Subject: Partner Rotation – extending rotation requirements to all key audit partners and to all public interest entities			
Audit Quality	**Direction and Magnitude of Impact**	**Application**	**Duration of Impact**
Audit quality increases because: All those who make key decisions or judgments on the audit of the consolidated or group financial statements will be subject to rotation. Rotation addresses the familiarity threat and provides a "fresh-look" at the audit. Extending the partner rotation requirements to all public interest entities increases the audit quality for those entities	Moderate increase	Larger audits of public interest entities where there are several key audit partners.	Continuing
Audit Firm Choice	**Direction and Magnitude of Impact**	**Application**	**Duration of Impact**
Audit firm choice may decrease Audit firms with a limited number of people with the appropriate knowledge and experience to serve as key audit partner on a public interest entity may be unable to undertake such audits. This would reduce choice.	Small decrease	All audits of public interest entities, but particularly those in jurisdictions where there are many small audit firms performing audits of public interest entities	Continuing
Audit Firm Concentration	**Direction and Magnitude of Impact**	**Application**	**Duration of Impact**
Audit firm concentration may increase Small audit firms auditing public interest entities may decide to merge or combine with other audit firms to obtain the necessary depth to be able to develop effective partner rotation. For some entities this could result in greater audit choice (for example a larger number of firms who are able to service large clients). For other entities the reduced number of firms could reduce auditor choice.	Variable	All audits of public interest entities, but particularly those in jurisdictions where there are many small audit firms performing audits of public interest entities	Continuing

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Subject: Partner Rotation – extending rotation requirements to all key audit partners and to all public interest entities			
Compliance effort	**Direction and Magnitude of Impact**	**Application**	**Duration of Impact**
Auditors			
Compliance effort increase because: Audit firms will have to maintain more extensive partner rotation plans to ensure appropriate succession planning.	Small increase	All audits of public interest entities	Significant initial impact because of need to track number of years partners have served in relevant roles and to establish a rotation plan. Continuing small increase for ongoing impact
Other stakeholders (such as audit oversight bodies)			
Compliance effort increases because: Oversight bodies will have an additional requirement for which compliance will be assessed.	Small increase	All audits of public interest entities	Continuing small increase
Convergence	**Direction and Magnitude of Impact**	**Application**	**Duration of Impact**
Convergence may increase because investors and oversight bodies support increased rotation which will enhance convergence globally	Small increase	All audits of public interest entities	Continuing small increase

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Subject: Partner Rotation – replacing limited resource exemption with independent regulator exemption			
Audit Quality	**Direction and Magnitude of Impact**	**Application**	**Duration of Impact**
Audit quality increases: Replacing the "limited resources" exemption with an exemption if an independent regulator in the jurisdiction has provided an exemption will increase consistency of application of the exemption and thus increase audit quality.	Small increase	All audits of public interest entities, but particularly those in jurisdictions where there are many small audit firms performing audits of public interest entities	Continuing
Convergence	**Direction and Magnitude of Impact**	**Application**	**Duration of Impact**
Convergence may increase because investors and oversight bodies support exemption based on independent regulator exemption which will enhance convergence globally	Small increase	All audits of public interest entities	Continuing small increase

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Subject: Partner Rotation – Flexibility on timing of rotation			
Audit Quality	**Direction and Magnitude of Impact**	**Application**	**Duration of Impact**
Audit quality increases: Replacing the provision that some degree of flexibility over the timing of rotation may be necessary with the provision that one additional year is allowed when continuity is especially important and it is in rare circumstances that were unforeseen and outside the firm's control increases consistency of application of the exemption and this increase audit quality.	Small increase	All audits of public interest entities.	Continuing
Convergence more acceptability	**Direction and Magnitude of Impact**	**Application**	**Duration of Impact**
Convergence may increase because investors and oversight bodies support exemption which will enhance convergence globally	Small increase	All audits of public interest entities	Continuing small increase

Partner Rotation

Old Code

290.154 Using the same engagement partner or the same individual responsible for the **engagement quality control review**[*] on a financial statement audit over a prolonged period may create a familiarity threat. This threat is particularly relevant in the context of the financial statement audit of a listed entity and safeguards should be applied in such situations to reduce such threat to an acceptable level. Accordingly in respect of the financial statement audit of listed entities:

(a) The engagement partner and the individual responsible for the engagement quality control review should be rotated after serving in either capacity, or a combination thereof, for a pre-defined period, normally no more than seven years; and

(b) Such an individual rotating after a pre-defined period should not participate in the audit engagement until a further period of time, normally two years, has elapsed.

290.155 When a financial statement audit client becomes a listed entity the length of time the engagement partner or the individual responsible for the engagement quality control review has served the audit client in that capacity should be considered in determining when the individual should be rotated. However, the person may continue to serve as the engagement partner or as the individual responsible for the engagement quality control review for two additional years before rotating off the engagement.

290.156 While the engagement partner and the individual responsible for the engagement quality control review should be rotated after such a pre-defined period, some degree of flexibility over timing of rotation may be necessary in certain circumstances. Examples of such circumstances include:

- Situations when the person's continuity is especially important to the financial statement audit client, for example, when there will be major changes to the audit client's structure that would otherwise coincide with the rotation of the person's; and
- Situations when, due to the size of the firm, rotation is not possible or does not constitute an appropriate safeguard.

In all such circumstances when the person is not rotated after such a pre-defined period equivalent safeguards should be applied to reduce any threats to an acceptable level.

290.157 When a firm has only a few people with the necessary knowledge and experience to serve as engagement partner or individual responsible for the engagement quality control review on a financial statement audit client that is a listed entity, rotation may not be an appropriate safeguard. In these circumstances the firm should apply other safeguards to reduce the threat to an acceptable level. Such safeguards would include involving an additional professional accountant who was not otherwise associated with the assurance team to review the work done or otherwise advise as necessary. This individual could be someone from outside the firm or someone within the firm who was not otherwise associated with the assurance team.

Revised Code

Audit Clients that are Public Interest Entities

290.150 In respect of an audit of a public interest entity, an individual shall not be a key audit partner for more than seven years. After such time, the individual shall not be a member of the engagement team or be a key audit partner for the client for two years. During that period, the individual shall not participate in the audit of the entity, provide quality control for the engagement, consult with the engagement team or the client regarding technical or industry-specific issues, transactions or events or otherwise directly influence the outcome of the engagement.

290.151 Despite paragraph 290.151, key audit partners whose continuity is especially important to audit quality may, in rare cases due to unforeseen circumstances outside the firm's control, be permitted an additional year on the audit team as long as the threat to independence can be eliminated or reduced to an acceptable level by applying safeguards. For example, a key audit partner may remain on the audit 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.

290.152 The long association of other partners with an audit client that is a public interest entity creates familiarity and self-interest threats. The significance of the threats will depend on factors such as:

- How long any such partner has been associated with the audit client;
- The role, if any, of the individual on the audit team; and
- The nature, frequency and extent of the individual's interactions with the client's management or those charged with governance.

The significance of the threats shall be evaluated and safeguards applied when necessary to eliminate the threats or reduce them to an acceptable level. Examples of such safeguards include:

- Rotating the partner off the audit team or otherwise ending the partner's association with the audit client; or
- Regular independent internal or external quality reviews of the engagement.

290.153 When an audit client becomes a public interest entity, the length of time the individual has served the audit client as a key audit partner before the client becomes a public interest entity shall be taken into account in determining the timing of the rotation. If the individual has served the audit client as a key audit partner for five 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 before rotating off the engagement is seven years less the number of years already served. If the individual has served the audit client as a key audit partner for six or more years when the client becomes a public interest entity, the partner may continue to serve in that capacity for a maximum of two additional years before rotating off the engagement.

290.154 When a firm has only a few people with the necessary knowledge and experience to serve as a key audit partner on the audit of a public interest entity, rotation of key audit partners may not be an available safeguard. If an independent regulator in the relevant jurisdiction has provided an exemption from partner rotation in such circumstances, an individual may remain a key audit partner for more than seven years, in accordance with such regulation, provided that the independent regulator has specified alternative safeguards which are applied, such as a regular independent external review.