

Long Association—Issues Paper

How the Project Serves the Public Interest

The project serves the public interest as long association of personnel on an audit engagement with an audit client can impact objectivity and professional skepticism, which in turn are important contributors to audit quality. The independent auditor constitutes the principal external check on the integrity of financial statements. Hence, the length of the auditor's relationship with the audit client becomes a very visible factor when evaluating the auditor's independence of mind and in appearance. It is acknowledged that a perception issue exists with respect to long association, particularly as the length of time an individual may serve an audit client that is a Public Interest Entity (PIE) in a Key Audit Partner (KAP) role may be 14 out of a total of 16 years. It is therefore important, and in the public interest, for the Board to consider whether the provisions remain appropriate for addressing the threats arising from long association.

The issues involved are complex and interwoven. The factors that give rise to threats to independence may also be factors that contribute to audit quality. These could include knowledge of the audit client and knowledge of the audit client's operations and continuity of personnel. In addition, while some stakeholders call for mandatory requirements to be strengthened, it is also recognized that arbitrary requirements can create unintended hardship on companies when rotations are forced to occur at times of change or transition.

I. Background

1. Since the initiation of the long association project, the Task Force (TF) has presented proposals to the Board at its September and December 2013 and April 2014 meetings. As a result of these meetings, the Board reached tentative agreement on the following:
 - Mandatory tendering and firm rotation developments should be closely monitored as any provisions developed by the TF should provide a reasonable and robust alternative to those proposals.
 - The overall framework and general principles currently contained in paragraph 290.150¹ that apply to all audit engagements should be strengthened.
 - The time-on period of seven years remains appropriate for all key audit partners (KAPs).
 - The cooling-off period should be extended to five years for the engagement partner on the audit of a public interest entity (PIE) after any time served as engagement partner, with a two-year cooling-off period for other KAPs.
 - Mandatory rotation requirements under the Code should not be extended to individuals on the engagement teams for audits of entities that are not PIEs.
 - Concurrence should be sought from those charged with governance (TCWG) with respect to the application of certain provisions.
 - A former KAP should be prohibited from undertaking specific activities related to the audit client during the cooling-off period. However, an engagement partner who is cooling-off for a five-year

¹ Section 290, *Independence – Audit and Review Engagements*

period could, after two of those five years have been completed, be consulted on issues, transactions or events that were not previously considered by that individual in the course of acting as engagement partner.

2. At the April 2014 Board meeting in Toronto, the IESBA asked the TF to further reflect on:
 - The proposed minimum cooling-off period set out in the general principles applicable to all audits; and
 - Whether a KAP may participate in the provision of other services to the audit client during cooling-off.
3. The TF has proposed corresponding changes to Section 291² of the Code which addresses independence for other assurance engagements.

II. **Significant Issues**

A. COOLING-OFF PERIOD FOR KAPS ON AUDITS OF PIES

April 2014 Board meeting

4. As summarized above, at the meeting in April the Board reached tentative conclusions on several of the issues on which it has been deliberating in relation to the duration of the cooling-off period.
5. The majority of the Board also agreed with the TF's proposal that after a seven-year period of service, the cooling-off period be extended to five years for the engagement partner on the audit engagement rather three years. The TF also proposed that the longer cooling-off period only apply to engagement partners on the audits of listed companies. However, the view of the majority of the Board was that there was little or no justification for distinguishing listed companies from all other PIEs, and the longer cooling-off period should apply to engagement partners on the audits of all PIEs. The TF has considered these comments and made further amendments to the proposals attached in Agenda Item 2-B so that the five-year cooling-off period applies to the engagement partner for the audit of a PIE.
6. Comments have also been received from several stakeholders concerning the Board's proposals which are outlined below.

IFAC Small and Medium Practices (SMP) Committee (SMPC)

7. In commenting on the IESBA's April 2014 agenda material, the SMPC indicated that it did not support any changes to the cooling-off period. It added that if it had to make a choice, then it would prefer the initial proposal of extending the cooling-off period to three years for all KAPs (as discussed at the IESBA meeting in April 2014). Amongst other things, the reasons for the SMPC's lack of support included:
 - Revision of the cooling-off period should be based on robust evidence in support of change and there is no concrete evidence to suggest that the current provisions for audit partner rotation have not worked satisfactorily.

² Section 291, *Independence – Other Assurance Engagements*

- There are other equally effective alternatives to the proposals which are in place as safeguards, for example, requirements in International Standard on Quality Control (ISQC) 1.³
- The proposals would place unreasonable constraints on and present practical challenges to specialist partner resources which are required for PIE audits and could have a disproportionate impact on SMPs.
- The proposals could further exacerbate market dominance of the largest accountancy firms and lead to a further erosion of choice in the PIE audit market.
- The complexity of the bifurcated approach may prove detrimental to the Code's acceptance and adoption in certain jurisdictions and could have a disproportionate impact on SMPs.

National Standard Setters (NSS)

8. At the May 2014 IESBA-NSS meeting, NSS participants were asked if they supported the Board's proposal that the current maximum time-on period of seven years for KAPs on the audits of PIEs remains appropriate and should not be changed. They were also asked if they supported the Board's proposal that the cooling-off period of two years should be extended to five years for the engagement partner on the audit of a PIE, after any time served as the engagement partner, with the two-year cooling-off period being maintained for other KAPs.
9. Participants who expressed a view were generally supportive of the increase in the cooling-off period to five years for the engagement partner on the audit of a PIE. However, participants considered that the longer cooling-off period should also apply to engagement quality control reviewers (EQCRs) in view of the importance of their role. Several participants expressed the view that there should be adequate justification of the change to the five-year period because of the effect on firm resources.
10. The issues raised by these stakeholders fall broadly into five categories:
 - The justification for extending the cooling-off period.
 - The impact on SMPs of the proposed change to the cooling-off period.
 - Adoption and implementation impacts.
 - Whether the EQCR should be subject to the same cooling-off period as the engagement partner.
 - Other reasons for opposing the proposed changes.

The TF discussed these comments at its meetings in May and June.

TF Deliberations in May and June 2014

The Justification for Extending the Cooling-Off Period

11. At the beginning of the project, the TF first considered the rationale for increasing the cooling-off period from the current two years. The research conducted indicated that there was no specific concern with the current two-year cooling-off period and there was little fact-based evidence to support a need for change. However, the TF recognizes that a perception concern has been raised by Board members

³ ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

and several stakeholders to which consideration should be given. The perception issue primarily concerns a seven-year time-on period in conjunction with a two-year cooling-off period as it allows the possibility of a KAP to serve for 14 out of 16 years on an engagement, assuming the KAP returned to the audit once the cooling-off period has been completed. The response from some stakeholders and Board members was that the seven-year period of service was appropriate but that the two-year cooling-off period seemed too short.

12. The TF recognizes that the issues are finely balanced and that any change must be seen by stakeholders as being substantive and made on a sound and defensible basis, while balanced against the cost and complexity of implementation and the likely benefits. However, the TF also recognizes that the perception of independence and the public interest are key elements in determining the cooling-off period, taking into account the feedback from stakeholders that the cooling-off period is too short. The TF therefore does not propose a change to the current proposal that the cooling-off period should be extended for the engagement partner on the audit of a PIE.

The Impact on SMPs of the Proposed Change to the Cooling-Off Period

13. The TF and the Board have considered the impact of the proposals on stakeholder groups including its SMP stakeholders. Whilst the Board acknowledges that the proposals potentially pose constraints on, and present practical challenges to the availability of specialist partner resources, the Board is required to take into account and act in the public interest. For the reasons noted previously, the TF considers the proposal to extend the cooling-off period for the engagement partner strikes the right balance for addressing the perception concerns outlined above and ensuring there is a “fresh look” with respect to the PIE audit client and its financial reporting. In addition, the majority of the Board has concluded that two and three-year cooling-off periods would be too short. The TF has taken the comments into account; however, it does not propose a change to the proposed five-year cooling-off period for the engagement partner.

Adoption and Implementation Challenges

14. The TF and Board have given careful consideration to adoption and implementation challenges throughout the course of the project. The TF also considered some stakeholder views that indicated a preference for a uniform cooling-off period for all KAPs, noting that a bifurcation would create unnecessary complexity. However, the majority of the TF continues to recommend the bifurcated model that applies a five-year cooling-off period for the engagement partner, leaving the cooling-off period for other KAPs at the current two years. On balance, the TF feels that the perception issues are most effectively addressed by focusing on the cooling-off period for the engagement partner given that individual’s unique role on the audit. The TF accordingly does not recommend a change to the proposed five-year cooling-off period for the engagement partner.

Should the EQCR be Subject to the Same Cooling-Off Period as the Engagement Partner?

15. With respect to the comments regarding applying the same five-year cooling-off period to the EQCR, the TF noted that it and the Board have considered this matter previously. The majority of the Board recommended leaving the cooling-off period for other KAPs, including the EQCR, at the current two years. This was based on the view that the engagement partner and the EQCR are distinctly different roles, the engagement partner having much more familiarity with the client than the EQCR who provides an objective evaluation of the significant judgments that the engagement team has made and

the conclusions it reached on formulating the audit report. Having reviewed the Board's earlier reasoning for its decisions, the TF does not propose to extend the five-year cooling-off period to the EQCR.

Other Reasons for Opposing the Proposed Change

16. The SMPC advances two other propositions against the Board's proposals: that there are equally effective safeguards to the Board's proposals and these are included in ISQC 1, and that the Board's proposals exacerbate market dominance of the largest accountancy firms and lead to a further erosion of choice in the PIE audit market.
17. The TF considers that it has received sufficient feedback that existing safeguards, either in the Code or as a result of the application of ISQC 1, do not go far enough to address the perception issues that continue to be raised by certain stakeholders.
18. The TF is aware of the concerns raised in relation to the PIE audit market and acknowledges the additional resource issues that may be created for smaller firms. However, the TF also recognizes that the perception issues described above are greatest with respect to the audits of PIEs given the large number and wide range of stakeholders. In light of the various factors considered, the TF considers that it has struck the right balance with the proposal that the cooling-off period only be extended with respect to the engagement partner.

CAG Representatives' Comments

19. The CAG has a teleconference at the end of June 2014 which is after this issues paper has been finalized. The CAG is being asked whether it supports the TF's proposals with respect to the five-year cooling-off period applying to the engagement partner for the audit of a PIE. Significant issues arising from the CAG discussion will be summarized for the Board in time for its July 2014 meeting.

Matter for Consideration

1. Does the Board support the amendments made to reflect the view of the majority of the Board at the April meeting that the five-year cooling-off period should apply to engagement partners on the audits of all PIEs?
2. Board members are invited to consider the comments from the SMPC and NSS participants on the TF's proposal with respect to the five-year cooling-off period.

B. PERMISSIBLE ACTIVITIES DURING THE COOLING-OFF PERIOD

Board Comments at its April 2014 Teleconference

20. The TF presented revised proposals to the Board during the April teleconference. The majority of IESBA members supported the TF's revised proposal that there not be an overall prohibition on the provision of non-assurance services but rather a principle that such activities that should be restricted only if they impact the audit. Some IESBA members also made the following comments and suggestions for the TF's further deliberations:
 - Whether the wording of the provision in relation to exerting influence on the audit could be adjusted so that it could not be construed as prohibiting a KAP from becoming the managing partner of the firm during the cooling-off period. In response, the TF proposes an amendment to

clarify that the provisions are not intended to prevent an individual from assuming certain leadership roles during the cooling-off period, such as becoming the senior or managing partner of the firm.

- Whether the wording of the provisions allowing consultation during the cooling-off period could appear to be inconsistent with the proposed principle, given that by being permitted to consult after a two-year period has elapsed, the former engagement partner would be in a role where that individual could influence the audit. In response, the TF is proposing an amendment to clarify that the principle applies to other roles or activities not already referred to previously in the paragraph. The TF has also proposed amendments to restrict the applicability of the provision that allows the former engagement partner to provide technical consultation after two years has elapsed.
 - Whether in the proposals the term “lead audit engagement partner” might be used instead of engagement partner. The TF does not propose a change to the use of the term “engagement partner” which is a defined term in the Code, and is the partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm.
 - Whether the term “other services” was intended to include non-audit services. The TF is proposing an amendment to clarify that the term includes non-audit services.
21. Mr. Koltvedgaard commented that the proposals were a simpler solution but questioned whether the right balance had been struck. He indicated a continuing concern about the engagement partner having any involvement with the audit team during the cooling-off period. The TF has given consideration to this issue over the course of the project and has concluded that a complete ban on contact between a former KAP and the audit client and/or audit team is impractical. The TF believes it has struck the right balance by taking a principles-based approach with respect to activities such as the provision of non-audit services.
22. The proposed amendments are attached in Agenda Item 2-B. The TF has also received feedback from the SMPC and the NSS on its proposals as described below.

SMPC Comments

23. In commenting on the IESBA's April 2014 agenda material, the SMPC indicated that:
- It did not agree that prescribing further restrictions would enhance audit quality.
 - It considered that a complete ban on certain activities seemed inappropriate, in certain areas, especially where it might be possible to introduce other safeguards.
 - It considered that the proposals to limit discussions with the engagement team and the restrictions on interaction “with senior management or those charged with governance other than in a limited and social context” were not only impractical but also could lead to the cost of implementing the proposals likely outweighing the benefit.
 - It considered that the rationale behind the proposal of relaxing certain non-permissible activities that the engagement partner may undertake after two years is unclear and counter-intuitive.

NSS comments

24. NSS participants were asked whether they supported the proposals for restricting roles and activities related to the audit client during the cooling-off period. Some participants expressed the view that there should be no permissible activities or interaction between KAPs and the audit client at all during the cooling-off period. As noted above, the TF considers that a complete ban on interaction between the former KAP and the audit client is not the right approach.
25. The very different comments and views of the IFAC SMPC and the NSS participants illustrate the wide and sometimes opposing range of stakeholder views on this issue.

CAG Representatives' Comments

26. The CAG is meeting by way of teleconference at the end of June 2014 after this issues paper has been finalized. The CAG is being asked whether it supports the TF proposals describing the roles and activities that can and cannot be undertaken by a former KAP during the cooling-off period. Significant issues arising from the CAG discussion will be summarized for the Board in time for the July 2014 meeting.

Matter for Consideration

3. Do Board members agree with the revised proposal for the activities that a KAP may and may not undertake during the cooling-off period?

C. STRENGTHENING OF OVERALL FRAMEWORK AND GENERAL PRINCIPLES FOR ALL AUDITS

April 2014 Board Meeting

27. In situations where there are no mandatory rotation requirements, but where rotation was considered to be an appropriate safeguard, the TF had proposed that there should be a minimum cooling-off period of at least one year.
28. In generally supporting the proposed enhancements to the general principles addressing long association, IESBA members suggested that the TF consider whether specifying a one-year cooling-off period might be too prescriptive or may result in a shorter cooling-off period than if the principles were applied.
29. At its teleconferences in May and June 2014, the TF deliberated on the Board's suggestion and proposes to replace the suggested one year period with a requirement that the firm determine an appropriate period, of sufficient duration to allow the familiarity and self-interest threats to be eliminated or reduced to an acceptable level. The TF's further proposals are include in Agenda Item 2-B.

Matter for Consideration

4. Do Board members agree with the revised proposal to replace the suggested one year rotation period with a proposal that the firm determines an appropriate period as described in paragraph 29?

D. INVOLVEMENT OF TCWG

April 2014 Board Meeting

30. The TF recommended that the concurrence of TCWG be obtained with regard to the application of exception provisions which permit the continuation of service by the KAP beyond the rotation requirements in certain circumstances. In generally supporting the proposals, IESBA members suggested that the TF consider whether the term “concurrence” in relation to TCWG was the right word to use and whether it gave a clear indication of what was expected, for example, whether such concurrence should be obtained in writing or orally, so as to aid translation issues in certain countries.

TF Deliberations

31. The TF proposes no changes to the use of the word “concurrence” as its meaning includes agreement, whether obtained orally or in writing, and is consistent with the wording used in the breaches provision. The TF considers that judgment can be used regarding the manner in which the concurrence of TCWG is obtained.

Matter for Consideration

5. Do Board members agree that there should be no change to the word “concurrence?”

E. CORRESPONDING CHANGES TO SECTION 291

32. During the IESBA’s April 2014 teleconference, the Board discussed the differences between audit and other assurance engagements. The Board made a distinction between the intrinsic nature of audit and review engagements as opposed to other assurance engagements. The Board noted that familiarity threats in relation to audit engagements tend to arise from the length of the engagements and their recurring nature, whereas other non-audit assurance engagements tend to be of a shorter duration and often not recurring. The TF has proposed changes to paragraph 291.139 to reflect this discussion. In response to the comments mentioned above, the TF has recommended adding wording to limit the application of the provisions to assurance engagements of a recurring nature. It has also made other general corresponding changes following the discussion at the April Board teleconference to emphasize the nature of the assurance engagement rather than the nature of the person performing the engagement. The proposed wording is included in Agenda Item 2-D.

Matter for Consideration

6. IESBA members are asked to provide feedback concerning the proposed changes to Section 291 as noted in Agenda Item 2-D.

F. EXPLANATORY MEMORANDUM

33. The TF is preparing a draft explanatory memorandum to accompany the exposure draft that will also include draft transitional provisions for the implementation of the new rotation requirements. Time permitting, the TF intends to provide the draft explanatory memorandum to IESBA members at the Board meeting.