

**Long Association—Summary of Issues and Options in relation to Jurisdictional Differences and the Cooling-off Period for the EQCR****I. Taking into Account Alternative Approaches at a Jurisdictional Level**

1. At the January 2015 meeting, there was lengthy discussion about the five-year cooling-off period for the engagement partner (EP). Some IESBA members, based on responses to the ED, proposed this should lead to the re-consideration of other approaches, including a three-year cooling-off period instead of five; however, after discussion, the majority of the Board continued to support the Exposure Draft (ED) proposals.
2. Nevertheless, the Task Force (TF) was asked to consider; whether the existence of different regulatory safeguards, or a package of safeguards, set at jurisdictional level might provide an alternative to elements of the PIE rotation requirements in the Code; and whether the Code could allow for such different solutions to address the long association threat.
3. The TF considered the issue at its January meeting and reviewed exposure draft (ED) comment letters relevant to this issue, and subsequently held a conference call with representatives from a respondent,<sup>1</sup> from the EU, who expressed strong concerns regarding the Board proceeding with the current proposals. The concerns expressed by that respondent can be summarized as follows:
  - The Code should not overrule or be more stringent than the requirements set by a regulator or legislature, such as the European Parliament, in good faith and following due process.
  - This proposal is not conducive to convergence and they believe risked EU jurisdictions not adopting the requirements, which would undermine the Code.
  - The application of the requirements to all PIEs is particularly hard to apply in the EU, given the wider definition of a PIE (which is also subject to potential member state additions).
  - It will be complex and difficult to layer these requirements over the top of member state options relating to member firm rotation.
4. The EU requires all KAPs to follow a 7/3 rotation requirement, coupled with member firm rotation after 10 years (subject to possible extension to 20/24 years). The EQCR is not included in the definition of a KAP in the EU. Other jurisdictions have different approaches such as having a shorter time-on period than seven years applicable to all KAPs.
5. The TF also raised this issue at the March CAG meeting but did not receive clear direction. The following limited comments were made on this issue by CAG Representatives due to time constraints:
  - Where local jurisdictions have more stringent standards then that is a valid consideration that the TF ought to address, including how to integrate or deal with mandatory firm rotation.
  - An exemption was not the best solution, and the Board might instead consider applying the requirements only to listed entities and not all PIEs. Another CAG Representative agreed that the provisions could apply to listed companies only.

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<sup>1</sup> Other Professional Organization FEE

- Consideration might be given to a small firm exception like in the USA; however, another CAG Representative did not believe there should be differences for big and small firms.
  - If the Code allows jurisdictions to divert from the principles it requires, then the Board has to carefully consider the criteria that need to be met in order for a jurisdiction to not apply the Code.
6. It should be noted that if the Board proceeds with the 7/5 approach, without allowance for jurisdictional differences, then members of the Forum of Firms will, we understand, be obliged to follow the Code within Europe, which may raise competition issues and compliance issues. The issue is not limited to the EU.

#### Options

- A. Maintain the status quo and do not allow for any such exemptions to compliance with the Code.
- B. Allow for compliance with other approaches in certain circumstances, instead of the requirements in section 290.150A of the Code. The following is a suggested example text for an exemption:

*290.150AA Some national regulatory or legislative bodies have evaluated the familiarity and self-interest threats to independence that arise from long association with an audit client, and have determined that a different set or combination of safeguards other than those required in this Code are appropriate to reduce the threats to an acceptable level. If a national regulatory or legislative body requires a shorter time-on period than seven years in relation to the rotation of key audit partners, or has implemented mandatory firm rotation in addition to rotation of key audit partners, then compliance in a jurisdiction with those requirements instead of those set out in 290.150A will not be considered a breach of this Code.*

- C. Re-consider Board positions on other potential ways to limit the extent of the proposals – e.g. apply only to listed entities and not all PIEs, or even re-consider the 7/3 option.

Table of Pros and Cons

A. <b>No exemption to compliance with Code requirements</b>	B. <b>Exemption to allow compliance with local jurisdiction rules instead of 290.150A</b>	C. <b>Reconsider Board's position on application of its requirements (e.g. listed entities instead of PIEs)</b>
<p>Pros</p> <ul style="list-style-type: none"> <li>Maintains a robust and uniform approach, consistent with the Board's view.</li> </ul> <p>Cons</p> <ul style="list-style-type: none"> <li>Does not give jurisdictions credit for recognizing different but robust</li> </ul>	<p>Pros</p> <ul style="list-style-type: none"> <li>Does not override local laws.</li> <li>Recognizes different but robust requirements established by local regulators.</li> <li>Other PIE provisions would still apply (e.g.</li> </ul>	<p>Pros</p> <ul style="list-style-type: none"> <li>May generate agreement in more jurisdictions and enhance enforcement.</li> <li>Might reduce the hardship of the provisions with regard to SMPs and smaller nations.</li> </ul>

A. <b>No exemption to compliance with Code requirements</b>	B. <b>Exemption to allow compliance with local jurisdiction rules instead of 290.150A</b>	C. <b>Reconsider Board's position on application of its requirements (e.g. listed entities instead of PIEs)</b>
<p>requirements established by local regulators.</p> <ul style="list-style-type: none"> <li>• May lead to a lack of adoption of the provisions and be contrary to the Board's objectives of convergence.</li> <li>• May not be in the public interest to require the overlay of these requirements on top of different local requirements, causing complexity in application and potentially lead to an increase in breaches.</li> </ul>	<p>activities during cooling-off).</p> <ul style="list-style-type: none"> <li>• A principles-based approach allows for the application of the Code to a broad range of scenarios.</li> <li>• Still sets minimum requirements for those jurisdictions that only apply the Code.</li> </ul> <p>Cons</p> <ul style="list-style-type: none"> <li>• Cannot necessarily measure "equivalence" to the Code with a package of measures.</li> <li>• Any particular requirement may appear to be less stringent to the Code when considered in isolation.</li> <li>• Cannot ensure that a jurisdiction that departs from the Code has an equally robust set of measures – e.g. is a shorter time-on sufficient cause for departure? Less stringent cooling-off but also has firm rotation?</li> </ul>	<p>Cons</p> <ul style="list-style-type: none"> <li>• May lead to a re-exposure and delay implementation of the majority of the provisions which is not in the public interest.</li> <li>• Re-opens discussions that the Board has concluded on based on responses to the ED.</li> </ul>

7. The TF also considered the fact that the Code<sup>2</sup> requires that “A member body of IFAC or firm shall not apply less stringent standards than those stated in this Code.” The TF concluded that if the Code allows an appropriate departure from certain provisions of the Code, then a Member Body may apply such a departure and remain in compliance with the Code.

#### **Matters for Consideration**

1. IESBA members are asked for their views on the options set out above.
2. Do IESBA members have any alternative suggestions?

## **II Applying the Same Cooling-Off Period to the EP and the EQCR**

8. Most respondents to the ED supported the cooling-off period remaining at two years for other Key Audit Partners (KAPs), including the EQCR. A few respondents commented that the EQCR should cool-off for a longer period indicating that the role had more significance and justified a longer cooling-off period. The Board discussed the comments from respondents. With regard to the EQCR it did not consider that there was a need to change the proposal based on the rationale expressed in the [Explanatory Memorandum](#).<sup>3</sup> The rationale included consideration of the differences between the EP and EQCR roles, and that the EQCR does not participate in the engagement or meet the client. In January, the Board confirmed its continuing support for the proposals in the ED.
9. At the March 2015 CAG meeting, there was a significant lack of support from CAG members with the position that the Board has taken on the EQCR. The majority of CAG Representatives, including regulatory representatives, made it clear that:
  - The arguments in support of the Board’s position in the EM and IESBA Report Back are not convincing.
  - There was disagreement from some CAG Representatives with the argument that the EQCR is not usually not known to the audit client, has no contact with the client management, nor why, even if this were true, that would be a determinant.
  - The public interest should be taken into account in the sense that the EQCR doesn’t have to have a direct impact on the audit in order to have an impact on objectivity and professional skepticism.
  - The EQCR is involved in major decisions even if they are not the final decision maker. The EQCR is a key role and an important quality control over an audit and the role cannot be underplayed.

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<sup>2</sup> Preface to the Code.

<sup>3</sup> **Extract from the EM** The IESBA also considered some stakeholder feedback that the longer cooling-off period should apply to the EQCR, as the EQCR plays an important role in an audit. While the IESBA agrees that the role of the EQCR is important, it concluded that the nature of the EQCR role gives rise to different threats to independence. The EQCR does not participate in the engagement or make decisions for the engagement team. In practice, the EQCR does not meet the client. The work of the EQCR is akin to an independent internal quality control process. Furthermore, any consultation between the engagement partner and the EQCR (e.g. on matters of judgment) is not intended to be so significant that the EQCR’s objectivity is compromised.

- These views were expressed by CAG Representatives at the September 2014 CAG meeting and it is unclear why the Board continues to support a two-year cooling-off period for the EQCR. The Board needs to pay attention to these views.
- PCAOB<sup>4</sup> and other inspection reports say some of the inspection findings could or should have been found by the EQCR.
- There was very limited support from CAG members for the view that it is appropriate to make a distinction between the roles and an argument that the EP would be seen as the most important individual on the engagement hence meriting a different cooling-off period

10. In addition:

- A CAG Representative for SMPs expressed again their concern about not listening to the majority of stakeholder voices and the impact on PIEs and SMPs. It is noted that the SMPs do not support 7/5 for the EP.
- Some CAG Representatives encouraged the Board to limit application to listed companies only.
- Some CAG Representatives commented that the cooling-off period for both roles should be three years.
- CAG Representatives noted that the EU does not regulate the EQCR as the EQCR is not considered a KAP and is not therefore subject to rotation.
- A CAG Representative commented that the Board should come to a conclusion. The Representative noted that the further delay was not advisable.

*Options:*

- D Maintain the status quo and have a five year cooling-off period as proposed only for the EP
- E Apply the five year cooling off to both the EP and the EQCR
- F Apply the same cooling-off period to both the EP and the EQCR but reconsider five years

**Table of Pros and Cons**

D. Status quo – 5 year cooling-off period only for EP	E. 5 year cooling-off period for both EP and EQCR	F. Same cooling-off period for EP and EQCR but reconsider the five years
<p>Pros</p> <ul style="list-style-type: none"> <li>• As exposed – no persuasive argument for requiring a longer cooling off for the EQCR.</li> </ul>	<p>Pros</p> <ul style="list-style-type: none"> <li>• Receptive to the views of key audit regulators and investor stakeholders.</li> </ul>	<p>Pros</p> <ul style="list-style-type: none"> <li>• May address concerns in the EU about the 7/5.</li> <li>• A 7/3 for all KAPs, for example, would be a</li> </ul>

<sup>4</sup> Public Company Accounting Oversight Board

D. Status quo – 5 year cooling-off period only for EP	E. 5 year cooling-off period for both EP and EQCR	F. Same cooling-off period for EP and EQCR but reconsider the five years
<ul style="list-style-type: none"> <li>Consistent with our analysis in the EM.</li> <li>Focuses on the partner who has the most influence on the outcome of the audit (the decision maker).</li> <li>Safeguards audit quality (see E).</li> </ul> <p>Cons</p> <ul style="list-style-type: none"> <li>Would require re-exposure.</li> </ul>	<p>Cons</p> <ul style="list-style-type: none"> <li>Potentially detrimental to audit quality – the pool of partners at a firm who are able to fulfill this role (given necessary experience, seniority and stature) is limited. There would be risks to audit quality.</li> <li>Objections from the SMP committee would be even stronger.</li> <li>Would require re-exposure.</li> </ul>	<p>simpler approach, avoiding complexities.</p> <p>Cons</p> <ul style="list-style-type: none"> <li>Would require re-exposure.</li> <li>Re-opens discussions the Board has debated – e.g. may not be seen as a meaningful change.</li> </ul>

#### Matters for Consideration

- IESBA members are asked for views on the proposed options for the length of the cooling-off period for the EP and the EQCR.
- Do IESBA members have any alternative suggestions?