

Long Association—Draft IESBA CAG Minutes March 2015

Ms. Orbea introduced the topic, providing background information regarding the responses received on the August 2012 exposure draft (ED), *Proposed Changes to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client*. She briefed the CAG on the general themes from the responses and the Board's consideration of, and tentative views on, the significant comments on the main issues at its January 2015 meeting. She then led Representatives through the Task Force's analysis and proposals on the main issues.

LENGTH OF TIME-ON PERIOD FOR ALL KEY AUDIT PARTNERS (KAPs)

Ms. Orbea reported that most respondents were supportive of the time-on period remaining at seven years for all KAPs for audits of public interest entities (PIEs). The Board therefore proposed that the time-on period remain at seven years.

CAG Representatives made no comments on this proposal.

LENGTH OF COOLING-OFF FOR ENGAGEMENT PARTNER (EP)

Ms. Orbea reported that the majority of respondents did not support extending the cooling-off period for the EP to five years. She noted the lengthy Board discussion on respondents' comments, noting that the majority of the Board believed that the five-year cooling-off proposal for the EP remained appropriate. She explained that the Board had requested that the Task Force consider whether the existence of different regulatory safeguards, or a package of safeguards, set at a jurisdictional level might provide an alternative to the partner rotation requirements for PIE audits in the Code.

The following matters were raised:

- Mr. Hansen supported the proposed five-year cooling-off period for the EP.
- Ms. McGeachy expressed concern about the direction of the proposal given that the majority of respondents did not support a five-year cooling-off period. She believed that whilst the profession might be accused of self-interest, when such a large proportion of respondents have the same view, that view should not be discounted. She commented that the provisions had only recently been introduced and that she was not aware of any research indicating that the two-year cooling-off period was inadequate. She was of the view that mandatory firm rotation should be factored into the Board's assessment of the long association provisions. She added that global convergence is in the public interest and that the closer the world can reach the same provisions, the better it would be for the market.
- Ms. de Beer noted that given that mandatory firm rotation was already in place in a number of jurisdictions around the world, this was a signal for the Board to strengthen the Code's provisions.
- Ms. Robert supported Ms. McGeachy's comments on global convergence, noting that the Board should not undermine provisions that are already in place at the jurisdictional level to address long association. She highlighted, for example, the debate over many years in the EU that led to the recent mandatory firm rotation legislation. Given this context, she expressed a concern that in Europe the proposals in the ED would be very complex to implement and monitor. Accordingly, she was of the view that convergence would not be achievable with the current proposals.

LENGTH OF COOLING-OFF FOR OTHER KAPs, INCLUDING THE ENGAGEMENT QUALITY CONTROL REVIEW PARTNER (EQCR)

Ms. Orbea explained that most respondents to the ED supported the cooling-off period for other KAPs, including the EQCR, remaining at two years. She noted, however, that a few respondents had commented that the EQCR should cool off for a longer period because the role had more significance and therefore justified a longer cooling-off period. She added that the Board did not consider that there was a need to change the ED proposal based on the rationale that had been set out in the explanatory memorandum.

The following matters were raised:

- Mr. Hansen indicated that he did not support the view that the EQCR should cool off for only two years because he regarded the EQCR as being involved in key decisions on an audit. He disagreed with the comments in the report-back, in particular that the EQCR is usually not known to, and has no contact with, the client, and that it would not be necessary to have another control on top of the EQCR's control role. He noted that in his experience the EQCR is usually known to the client and is involved in major decisions. He added that whilst the EQCR might not be the decision maker, the EQCR's involvement comes right at the end of an audit and he or she plays a key role at that time.
- Ms. Orbea indicated that the views of CAG Representatives on the June 2014 conference call had been quite evenly split on the cooling-off period for the EQCR. She explained that the same theme had come through from the comment letters. She emphasized that the Board was not viewing the roles of the EQCR and other KAPs as unimportant, because the Board acknowledged that these are roles that make significant judgments. She explained, however, that the Board was targeting the individual who was at the greatest risk of familiarity, i.e., the EP.
- Mr. Waldron agreed with Mr. Hansen. He indicated that the CFA Institute regarded the EP and EQCR as so close and integral to the audit process that they should be treated the same. He noted that inspection reports from the PCAOB had flagged issues on audits that should have been identified by the EQCR, thus highlighting the importance of the EQCR role. He noted that IOSCO had expressed support for the EQCR being treated the same as the EP with respect to cooling off. He urged the Board to carefully consider the advice from the CAG and to have regard to the public who relies on audited financial statements.
- Ms. de Beer agreed with Messrs. Hansen and Waldron, noting the need for care in considering who was raising comments on the ED. With respect to the ED proposal allowing for the rotated EP to undertake a limited consulting role with the engagement team or client after two of the five years in the cooling-off period have elapsed, she was of the view that this would dilute the provision. She felt that a better approach would be to impose a strict cooling-off with no involvement with the engagement team or client. Mr. Greene agreed with Mr. Hansen and Ms. de Beer on the EQCR issue.
- Mr. Thompson agreed that the EQCR plays a very important role in the audit process. He noted that he had himself served in that role on a number of listed audits and that the clients never knew him. He considered that in Europe the client usually neither knows the identity of nor meets the EQCR. He noted that practices may differ in other jurisdictions. He was of the view that only the EP should be the key contact with the client. He suggested the need to distinguish among the roles of the various KAPs on an audit engagement and to address those roles separately, i.e., the EP who plays the most important role, the EQCR who provides a second set of eyes, other KAPs, and other partners.

- Mr. Hansen commented that he knew of situations where clients had expressly requested that certain individuals not be appointed EQCR for their audits. He suggested that the Board might perhaps consider the merit of prohibiting contact between the EQCR and the audit client.
- Ms. Orbea noted that the Board is very much aware of the source of comments on the ED. She explained that the Board had listened to concerns expressed by stakeholders about an individual being able to serve on an audit of a PIE for 14 out of 16 years. She noted that the Board had always come back to consider the perception of a lack of independence and considered that such a perception was at its greatest with the role of the EP. Ms. Orbea confirmed that the CAG's views on this issue had been presented to Board.
- Mr. James agreed with Messrs. Hansen and Waldron, and Ms. de Beer. He noted that IOSCO saw the EQCR issue as an independence-in-appearance issue and that it viewed the EQCR at a similar level of influence as the EP. He noted that it would be disappointing if the Board decided that the EQCR should not have the same five-year cooling-off period as the EP. Mr. Fukushima concurred with Mr. James.
- Ms. Robert noted that the EQCR is not regulated in the EU. Accordingly, she had no view on this issue.
- Mr. Thompson noted that in the UK, the current provisions are 7+5 for the EQCR and 5+5 for the EP. Nevertheless, he noted that it would be more important to consider the roles of the individuals.
- Mr. Arteagoitia noted the length of time that the Board had been debating these provisions. He urged the Board to make a decision because it was difficult to justify the continuing debate. He was of the view that a cooling-off period of two or three years was reasonable. He clarified that the EU legislation addresses only the EP, not the EQCR.
- Mr. Michel was of the view that a three-year cooling-off period was reasonable. He also urged the Board to make a decision promptly. Ms. Lang agreed with Mr. Arteagoitia that the Board should come to a conclusion on the issue and that further delay would not be advisable.
- Ms. Elliott had no comments on this issue.
- Ms. Lopez expressed support for having the same cooling-off period for the EQCR as for the EP to address the perception issue. Mr. Bradbury shared the same view. He noted that he found the Task Force's rationale for having a different treatment for the EQCR unconvincing. He highlighted his own experience in previous audit tenders where the individuals proposed as EQCR were identified to him.
- Ms. Borgerth noted that Brazil has instituted strict provisions to address long association, including mandatory firm rotation. While these provisions are suitable for the Brazilian context, she was not certain that they would work for the IESBA Code.
- Ms. Miller noted her perception that the EQCR would have less direct interaction with the client. Accordingly, she was comfortable with a different cooling-off treatment. However, she indicated that she did not feel strongly about any particular position on this issue.
- Mr. Muis expressed support for having the same cooling-off treatment for both the EQCR and the EP. He noted that the PIOB had previously expressed regret about the scope of the project in that it did not address the issue of mandatory firm rotation. He acknowledged that coming to a decision on the EQCR issue was more a matter of art than science. However, he noted that the checks and balances were at work in the CAG discussion. Ms. Orbea noted that this is an area where there is wide divergence of views. Accordingly, she agreed that developing a solution was not a science.

APPLICABILITY OF LONGER COOLING-OFF PERIOD TO AUDITS OF LISTED COMPANIES OR ALL PIEs

Ms. Orbea noted that at its meeting in January 2015, the Board had supported retaining the proposal for the provisions to apply to all PIEs. She explained that the definition of a PIE in the Code allows jurisdictions flexibility to determine which types of entity should be considered to be PIEs. The Board was of the view that once a local jurisdiction had established this, the independence provisions relating to PIEs should be applied consistently across that jurisdiction.

The following matters were raised:

- Ms. McGeachy commented that a large number of PIEs are currently audited by SMPs worldwide. She was of the view that layering the proposals over current regulatory provisions at the jurisdictional level would complicate implementation and have detrimental consequences. For these reasons, she encouraged the Board to limit the proposed provisions to audits of listed entities only.
- Mr. Hansen supported Ms. McGeachy's view and considered that it might be particularly important to the Board's desire for convergence across jurisdictions. He commented that there was so much disparity across jurisdictions that it might be best to concentrate on listed entities. He expressed the view that it was with listed entities that the public interest is at greatest stake and where the most damage could be caused if an individual were to lose his or her independence.

OTHER COMMENTS

- Mr. Greene asked that the Code's long association provisions be clarified in relation to time-on and time-off engagements. In particular, he suggested that an individual's time on the audit should be cumulative and that the time-off period should be calculated consecutively. He also suggested that the provisions should expressly apply to the individual and not to the firm so as to prevent a move of an individual from one firm to another bypassing the provisions.
- Ms. Orbea indicated that the word "consecutive" had been added to the relevant paragraph¹ in the draft provisions to address the first situation raised by Mr. Greene. She also explained that an additional clause had been included in the revised proposals to address an individual's length of service as a KAP at a prior firm.
- Mr. Dalkin noted that in public sector audits, it is quite common that an individual serves on the audit of a particular governmental entity for more than seven years as EP. He wondered whether the proposals addressed this situation. He felt that there would need to be practical considerations regarding partner rotation in public sector audits.
- Mr. Hansen was of the view that the Task Force should address situations where jurisdictions have more stringent legislation or regulation addressing the topic of long association. On the issue of mandatory firm rotation, he wondered how this could be integrated into the proposals. Finally, he wondered whether there was any research regarding the extent to which SMPs perform audits of PIEs and listed entities. He noted that in the US, there are certain exceptions for firms that have less than a predetermined number of partners. He suggested that reflecting on a similar approach for the Code might assist in achieving a better balance. Ms. McGeachy was of the view that making the split between listed entities and PIEs might be a better and fairer approach than drawing a line in terms of a specific number of partners in a firm.

¹ Agenda Item E-3, paragraph 290.150A

GENERAL OBSERVATIONS ON PROCESS

- Mr. Waldron noted that it would be helpful to see in the summary of respondents' comments who was supporting the particular proposals. He emphasized that it should not be a numbers game.
- Mr. James noted that he had raised a suggestion during the IAASB CAG meeting earlier in the week regarding how the standard-setting process might be improved. In particular, he had suggested that consideration be given to using an independent body to summarize comments on EDs. He suggested that the Board reflect on this further. He added that the PIOB had staff who might be able to prepare such summaries. Mr. Waldron agreed with Mr. James.
- Mr. Siong cautioned that delegating the task of summarizing responses to EDs to an external organization would have adverse implications for the timeline of projects. He emphasized that staff and Task Forces go to great lengths to ensure that comments in response letters are faithfully and transparently represented. In particular, the extensive footnoting in the agenda material would enable anyone to trace back the source of a particular comment. He also emphasized that respondents' comments are weighed on the basis of their merits and that comments from respondents representing the public interest are given first prominence in the Board's papers.
- Dr. Thomadakis expressed significant concern about the suggestion from Mr. James, noting that there would be major problems from a management and co-ordination perspective if it were implemented, and that the Board would lose control of the standard-setting process.
- Mr. Muis noted that the PIOB cannot be involved in the working process of setting the standards as doing so would compromise its independence. However, he acknowledged that Mr. James had raised a relevant question regarding the qualitative analysis of respondents' comments.
- Ms. Lang was of the view that it would be helpful for there to be consideration of the cost-benefit impact of the proposals, both pre- and post-implementation.
- Mr. Koktvedgaard acknowledged that there are quality controls in place with regard to summarizing comments from respondents. He expressed the view that comments should be brought forward from all respondents. He noted that the substance of comments was an important factor and that a single participant or small investor might bring up a significant point. He expressed a concern that if the Board immediately gave more weight to certain comment letters, it might send the wrong signal to respondents. He noted that such a signal might make respondents reluctant to comment on future Board publications. He expressed the view that it was important to have a diversity of respondents.

WAY FORWARD

Ms. Orbea thanked the Representatives for their comments, noting that the Task Force would take into account their input in preparing the agenda material for the April 2015 Board meeting.