



**TO: CHAIR, LONG ASSOCIATION TASK FORCE**

**FROM: SMP COMMITTEE**

**DATE: APRIL 10, 2015**

**RE: LONG ASSOCIATION**

The SMP Committee would like to thank the Long Association Task Force (TF) for giving us the opportunity to consider key issues relating to the Long Association project in advance of the papers to be presented at the April 2015 IESBA meeting. The Ethics Task Force of the SMP Committee has prepared this response. These comments have been circulated and approved by the entire SMP Committee (SMPC). Members and Technical Advisers serving the SMPC are drawn from IFAC member bodies representing 22 countries from all regions of the world<sup>1</sup>.

#### **GENERAL COMMENTS**

The SMPC has closely followed the Long Association project and provided consistent input in respect of our concerns with some of the proposals through comments letters such as this, our response to the Exposure Draft<sup>2</sup> (the ED) and through discussion with IESBA Staff and Board Member at our November 2014 SMPC meeting.

In many jurisdictions around the world SMEs and SMPs account for a very significant part of the economy in the private sector. Indeed, in some countries there are relatively few larger entities, and these are serviced mainly by SMP accountancy firms. The operating environment and resource capacities of SMEs and SMPs often differ significantly from those applicable to larger entities and practices. This is one of the reasons that the international standard setters do not generally receive many comment letters from individual SMPs or SMEs (a direct contrast to the larger firms / businesses) and therefore the SMPC's input deserves to be afforded due regard.

We have previously welcomed the inclusion of the SMP Committee concerns in the IESBA Agenda Items (Agenda Item 2-A, July 2014) and the acknowledgement of specific SMPC comments in the previous papers (Agenda Item 8-A, January 2015). We were therefore concerned to see limited reference to the SMPC comments included in the remaining analysis of the ED responses in Agenda Item 3-A. For example, one of the key issues raised by the SMPC for which we had expected to see a reference relates to our disagreement with the proposal that the general provisions should apply to all individuals on the audit team (previously only senior personnel) in paragraph 65 of Agenda Item 3-A (footnote 51). In addition, we do not agree with the additional restrictions placed on activities that can be performed by a KAP during the cooling-off period and also advocated for a risk-based approach. The SMPC could

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<sup>1</sup> Australia, Belgium, Brazil, Canada, China, France, Germany, Hong Kong, India, Italy, Kenya, Malawi, Malta, Nigeria, South Africa, Spain, Sweden, Turkey, Tunisia, Uganda, United Kingdom, United States.

<sup>2</sup> <http://www.ifac.org/publications-resources/ifac-smp-committee-response-iesba-exposure-draft-proposed-changes-certain-pro>

therefore have been added to footnote 19, paragraph 40. We appreciate that the TF will have considered these points, but believe it is important to highlight these, so the Board can have an informed discussion at the April meeting.

We have outlined below our detailed comments in response to the questions raised in Agenda Item 3-A. Some of the key points include:

- We agree that there should be an exemption to allow compliance with local jurisdiction rules instead of 290.150A and support the TF proposal of Option C that the Board should reconsider its position on application of its requirements e.g. to apply only to listed entities and not all PIEs or even re-consider the 7/3 option.
- The practical application of the first bullet point of Section 290.150A may not be straightforward. In particular we question why an Engagement Partner (EP) who has served as EP for at least two of the last three years should have to cool off at all.
- We do not agree with the additional restrictions placed on activities that can be performed by a Key Audit Partner (KAP) during the cooling-off period, but support the EP being permitted to provide limited consultation to the audit team after a period of two years. We continue to believe that a risk based approach should be applied in this area.
- The time plan for considering the input received (and CAG to discuss the issues) is perhaps overly tight. Accordingly, we agree with the TF that it would not be appropriate from a due process perspective for this project to be finalized in July as previously intended.

## **SPECIFIC COMMENTS**

Our specific comments below are in response to the questions (*in italics*) raised in Agenda Item 3-A.

### **Length of cooling-off period for the EP and alternative approaches at jurisdictional level**

1. *SMPC members are asked to consider the issues raised in Section I of Agenda Item 3-B and for views on the options presented by the TF.*

The SMPC has previously expressed significant concern regarding the Board's original proposals. We note with interest that the majority of respondents to the ED did not support extending the cooling off period (para 12, Agenda Item 3A) and other respondents also suggested the Board explore a more risk based approach (para 40, Agenda Item 3A). We welcome the change in TF considerations explained in Agenda Item 3-A regarding two specific situations – if the time-on period for a KAP serving a PIE is shorter than 7 years, or the jurisdiction has also implemented firm rotation. The SMPC supports these proposals as well as the TF proposals in Agenda item 3-B, whereby the Board is asked to address further situations including those frequently facing SMPs.

The SMPC response to the ED had sought to sensitize the IESBA to the significant global variation in national definitions of the term PIE and the practical difficulties that SMPs may experience in complying with the overall “package” comprising provisions of the Code, together with national requirements (which the Code does not recognize). In this context, our letter referred to the recent survey undertaken in the EU by FEE. Our letter also encouraged the IESBA to consider the number of PIEs which are currently audited by SMPs worldwide so as to obtain an understanding of the number of firms that would potentially have issues with some of the current proposals. The SMPC finds it most encouraging to see from Agenda Item 3-B that the EU's concerns detailed in the paper also raise this issue.

We fully support the Code being sufficiently flexible as to recognize that more than one type of/ design of safeguard may be capable of addressing a particular threat and that certain alternatives to specific safeguards prescribed by the Code will be deemed equally effective and acceptable. We therefore support the TF proposing the Board deliberate further.

In our opinion, of the three options identified by the TF, Option A (no exemption to compliance with Code requirements) should be rejected. However, Option B (exemption to allow compliance with local jurisdiction rules instead of 290.150A) and Option C (reconsider Board's position on application of its requirements) are not mutually exclusive. Option B is essential to gaining general acceptance of the Code, since where, in a particular jurisdiction, alternative safeguards can be expected to be sufficiently effective it makes no sense not to "allow" these as a substitute for specific provisions of the Code. However, we believe that Option B is needed in conjunction with Option C, as the latter addresses different issues.

The advantages listed for Option C are highly persuasive whereas the disadvantages (timetable delay and re-opening discussions) are much less convincing. We are aware that several IESBA members suggested the Board adopt a flexible approach, (e.g., minimum cooling off period of three years which could be higher in certain circumstances) at the IESBA meeting in January 2015. We also note that views were expressed at the CAG that these provisions might be applicable to listed entities rather than PIEs in the Code. The SMPC supports both of these proposals as the Board seeks a solution to this issue.

#### **Length of cooling-off period for the EQCR**

2. *SMPC members are asked to consider the issues raised in Section II of agenda item 3-B and for their views on the options presented by the TF.*

We maintain our support for the Board's view that the independence and familiarity threats created by long association of the EQCR is less than the KAP and support the original distinction proposed by the Board. However, we do not agree with Option D (5 year cooling-off period only for EP), Option E (5 year cooling off period for both EP and EQCR), or Option F (same cooling-off period for EP and EQCR but reconsider the five years) as currently outlined in Agenda Item 3-B.

#### **EP for only part of the seven-year time-on period**

3. *SMPC members are asked for views on the TF's proposal concerning the application of the five year cooling-off period to a KAP who is an EP for only part of the seven-year time-on period.*

In our opinion, the practical application of the first bullet point of Section 290.150A may not be straightforward, in particular the distinction between EP and KAP, which is not made in the extant Code (para. 290.149). For example, it is generally confusing why an EP who has served as EP for at least two of the last three years should have to cool off at all (i.e., why not allow the full 7 years even with breaks in between?). The requirement to cool-off for five years also seems disproportionate in many of these circumstances. We believe that a risk-based approach would be more appropriate.

We support the issue of a KAP moving directly from a KAP role into an EQCR role (including any cooling off) being dealt with in the IAASB's work on ISQC 1<sup>3</sup>. This issue concerns audit quality as opposed to just auditor objectivity and so is more appropriately dealt with by the IAASB than the IESBA.

#### **Limited Consultation by the EP and restriction on activities**

4. *SMPC members are asked for views on the TF proposals concerning: (a) limited consultation by the EP; and (b) additional restrictions on the EP's activities.*

As stated in our response to the ED, we do not agree with the additional restrictions placed on activities that can be performed by a KAP during the cooling-off period. We also believe that if the proposals for a five-year cooling-off period are not re-considered, then we would strongly support the EP being permitted to provide limited consultation to the audit team after a period of two years.

We are not convinced that the proposed additional wording in para. 290.150B "and there is no other equivalent expertise available" is sufficiently clear. From an SMP perspective it is particularly important that the Board clarify that it is the availability of such equivalent expertise within the firm that should be considered rather than externally, since in comparison with larger firms many SMPs will have a fewer number of partners with specialist technical expertise in industry-specific areas. External consultation should not be forced, as the related costs would put many SMPs at a competitive disadvantage; although this could be an option depending on the nature of the issue and severity of the situation.

We therefore continue to believe that a risk based approach should be applied. For example, no consultation at all is excessive in practical terms, especially for matters of relatively low risk and it could also impact audit quality.

#### **New provisions 290.150C and 290.150D**

5. *SMPC members are asked whether they agree that no changes are necessary to proposed provisions 290.150C and 290.150D.*
6. *SMPC members are also asked whether the proposals could be enhanced by the deletion of 290.150D to avoid repetition.*

The phrase in paragraph 290.150D "significance of any threat created by the long association of a member of the audit team who is not a key audit partner with an audit client" seems too severe a definition given the relative impact and influence of non-key audit partners to e.g. junior staff, and especially since proper safeguards (and quality control) will be undertaken by the firm. We also do not believe the proposed addition in paragraph 290.148A is helpful. Our concern is that, in practice, this will lead to annual evaluations of KAP and members of the audit team that does not contribute to audit quality. It would be preferable for the provision to be worded on the basis "if anything comes to the firm's attention" instead or failing that we would support deleting paragraph 290.150D.

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<sup>3</sup> International Standard on Quality Control (ISQC 1), *Quality Control for Firms that Perform Audits and Reviews of Financial Statements and Other Assurance and Related Services Engagements*

### **Concurrence of TCWG**

7. *SMPC members are asked for their views on whether any changes should be considered to the proposals requiring concurrence with TCWG?*

We agree that the firm should apply the provisions in paragraphs 290.151 and 290.152 only if they have concurrence of TCWG. We therefore support the TF not making any change to the proposal in the ED.

### **Strengthening General Provisions**

8. *SMPC members are asked whether they agree with the amendments to the General Provisions proposed by the TF in response to the comments from respondents to the ED?*
9. *SMPC members are also asked whether there are other changes that the TF should consider?*

As stated in our response to the ED we disagree with the proposal that the general provisions should apply to all individuals on the audit team. In our opinion, there is a lack of evidence in support of the need to extend the application of these sections and it is unnecessary to have general provisions beyond senior personnel.

On the assumption that the deletion of the term “senior” is, however, to remain, we agree with the TF proposal to add to the factors in 290.148B.

### **Corresponding changes to Section 291**

10. *SMPC members are asked for views on the corresponding changes to Section 291.*

We have the same views as outlined to the other questions in respect of the corresponding changes to Section 291. We agree that the provisions should be limited to assurance engagements of a recurring nature.

### **Effective date**

11. *SMPC members are asked for views on the effective date.*

We refer to our previous comments on the effective date where we highlighted the importance of SMPs having sufficient time to understand the changes, assess how they are affected and take measures to enable them to comply.

On the basis that a number of issues are still to be resolved, we agree with the TF that the originally proposed effective date may need to be deferred.