

**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 or audit team 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 the long association, particularly as the length of time an individual may serve an audit client 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. At its April 2014 meeting, the Board considered the Task Force's (TF) proposals with respect to the revised Long Association provisions. Amongst other matters, the TF asked the Board to consider proposals related to the nature of the roles that are acceptable for a rotated individual to undertake during the cooling-off period. In particular, the TF's proposals attempted to strike the right balance between the proposed restrictions and the nature and extent of permissible roles if the cooling-off period for an engagement partner (LAEP) was extended to five years. The extension of the cooling-off period for LAEPs to five years has been assumed in this paper following the majority views of the Board at the April meeting.
2. The Board debated the proposals and the views were not unanimous. However, the majority of the Board agreed that a LAEP who has been rotated off for five years could be consulted on issues, transactions or events that were not previously considered by that individual in the course of acting as engagement partner after two of the five years have been completed.
3. The Board, however, did not reach a conclusion concerning whether a KAP may participate in the provision of other services to the audit client during cooling-off. In addition, the Board did not reach a conclusion whether a LAEP could be allowed, after a period of two years has elapsed, to provide other services so long as the individual does not directly influence the outcome of the audit engagement.
4. The Board asked the TF to further reflect on the provisions and revert to it with a clearer proposal. This paper is limited in scope to considering the areas on which the Board has not yet reached a consensus.
5. At its meeting, the TF also:
  - a) Drafted proposed conforming wording for the corresponding position in Section 291.139 and
  - b) Read comments on the issues paper submitted by the IFAC SMP Committee.

These items are included for the information and consideration of the Board and Board members are welcome to provide comments to the TF on these agenda items, if possible, in time to be considered by the TF at its next meeting on May 6, 2014. These items however will not be discussed during this meeting.

## **II. Permissible Activities during the Cooling Off Period**

### **A. PARTICIPATION IN THE PROVISION OF OTHER SERVICES**

#### *Board Comments*

6. The Board discussed whether restrictions on all non-audit services should be imposed during cooling-off, whether the restrictions should apply to services provided to all related entities of the audit client, and what types of services could be permitted, if any. The Board also discussed whether, if a restriction on non-audit services during cooling-off was imposed for all KAPs, there should be a relaxation of the prohibition after a period of two years for the LAEP. There was no consensus reached on these provisions as a whole:
  - a) Some Board Members expressed support for there being no relaxation to the restrictions on activities during the five year cooling-off period. They believed that it would be difficult to justify proposing the five year cooling-off provision on the one hand and then allowing exceptions after two years of cooling-off.
  - b) Other Board members agreed with the proposal for the provision of certain services being acceptable after a two-year period because they felt that the two-year period was sufficient to provide an appropriate balance with the need to not unnecessarily restrict access to resources for the remainder of the cooling-off period. During the discussion, some Board Members expressed the view that the two-year period could be acceptable in relation to non-client specific services.
  - c) One Board member supported a restriction on activities without exception for the five-year cooling-off period only if the LAEP was returning to the audit engagement after the expiry of that period, but supported some work being undertaken after two years if the LAEP was not going to return to the audit engagement.
7. After confirming that the proposed restriction on non-audit services during cooling-off was a stricter provision than currently exists in any jurisdiction, the Board agreed that time should be taken to consider the matter further.

#### *TF Deliberations*

8. The TF took into consideration the Board's comments including comments from one Board member that the provisions taken as a whole could still allow an individual to influence the audit even if that individual's interaction with management was in a "limited and social context" as outlined in the draft proposals. The TF evaluated three options:
  - i. Removing the restriction altogether in relation to other services;
  - ii. Leaving the provisions as proposed and/or removing the ability for the engagement partner to provide services after two years; or
  - iii. Seeking some middle ground and reconsidering the approach more generally.

9. The TF reconsidered the objective of the provisions and also discussed the feedback from the IESBA Consultative Advisory Group. The TF did not believe removing the provision altogether was the correct response. It did, however, recognize that the restriction as proposed could be seen as excessive if the objective was to ensure the rotated individual could not be in a position to influence the outcome of the audit engagement or continue to interact closely and frequently with senior management or those charged with governance.
10. Whilst the TF considered that allowing a two-year cooling-off period for a LAEP who was not going to return to the engagement had merit, it believed that this would add further complexity to the position.
11. The TF noted the Board's concern on the complexity of the provisions and felt that it could add more clarity to the existing provisions by going back to the principles that the provisions are trying to address. The TF felt that the essence of the issue hinges on whether an individual exerts influence on the outcome of the audit engagement or has significant on-going contact with client management.
12. The TF proposes for all KAPs that an individual be restricted from undertaking any roles or activities with respect to the audit client which would result in the individual having ongoing or frequent interaction with senior management or those charged with governance, or being able to exert influence, including through the provision of other services, on the outcome of the audit engagement. The TF considers this proposal addresses the concerns of the Board and the comments of the CAG.

**Matter for Consideration**

1. Do Board members agree with the revised proposal for restricting roles and activities related to the audit client during the cooling-off period?

**B. FOR THE INFORMATION AND CONSIDERATION OF THE BOARD**

**Proposed wording for section 291.139**

13. At its TF meeting, the TF considered the changes that would be necessary to conform Section 291 to Section 290. A draft of the proposed changes to Section 291 is included in Agenda Item 1-D.

**Matter for Consideration**

2. Board members are asked to submit any comments on the proposed wording for Section 291 in writing to the TF.

*Memorandum from the IFAC SMP Committee*

14. Immediately before the last Board meeting, and too late for inclusion in the last issues paper, comments were received from the SMP Committee which were briefly mentioned during the Board discussion (Agenda Item 1-F). In summary the SMP Committee is opposed to changing the extant cooling-off period. The Committee believes that it is too early to determine whether the recently introduced two year period is inappropriate and so does not support either the proposed three year cooling-off period or the five year cooling-off period. It considers that the proposals place unreasonable constraints on and present practical challenges to SMPs. The Board will not be invited to discuss the SMP comments during the conference call because of the limited time available but they will be included in the next issues paper.

**Matter for Consideration**

3. The Board is asked to note the objections of the IFAC SMP Committee.