

**Meeting:** IESBA CAG  
**Meeting Location:** Teleconference  
**Meeting Date:** January 11, 2017

## Agenda Item

# A

### Long Association

#### Objective of Agenda Item

1. To receive a report-back on the outcome of the IESBA's deliberations regarding the Long Association project in the light of comments raised by the Public Interest Oversight Board (PIOB).

#### Background

2. At the December 7, 2016 CAG teleconference, the Chair of the Long Association Task Force, Richard Fleck, briefed the CAG on developments relating to the project since the September 2016 CAG meeting. In summary, following the IESBA's approval of the Long Association close-off document<sup>1</sup> at its September 2016 meeting, the IESBA Chairman was alerted by senior PIOB representatives around mid-October to the possibility that PIOB approval of the document might not be forthcoming. This was attributed primarily to concern that the provisions were too complex and that the "jurisdictional provision" (dealing with circumstances where jurisdictions have established different legislative or regulatory requirements addressing long association) resulted in only a limited improvement in the cooling-off provisions.
3. In early November, at the request of the IESBA Chairman and Task Force Chair, the PIOB representatives sent a note of the specific issues that the PIOB had identified. A week later, the IESBA Chairman and Task Force Chair submitted a written response to the various matters the PIOB had raised. This [written response](#) (incorporating the comments raised by the PIOB) was included in the agenda material for the December 2016 IESBA meeting.
4. Further discussions between the IESBA and PIOB representatives ensued. As a result of those discussions, the PIOB's concerns were narrowed down to three key areas, namely:
  - (a) The jurisdictional provision;
  - (b) The exception allowing the audit engagement team for a public interest entity (PIE) to consult with a former engagement partner (EP) or engagement quality control reviewer (EQCR) if they have taken on a primary role as a technical specialist in their firms after they have cooled off for two years; and
  - (c) The need for transitional provisions.
5. The discussions led to a tentative agreement with the PIOB representatives on changes to the close-off document that they felt would address the PIOB's key concerns above.

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<sup>1</sup> Provisions approved under the extant structure and drafting conventions of the Code

6. During the discussions, the IESBA and PIOB representatives agreed on the need for closer liaison between the PIOB and IESBA to mitigate or eliminate the risk of a similar situation arising in future. The PIOB representatives acknowledged the importance of the PIOB being clear about its views on substantive issues as a project progresses and the associated transparency needs with respect to reports back to the PIOB after each IESBA meeting.
7. The Task Force met via teleconference in the latter part of November to be briefed on the issues raised by the PIOB and the discussions with the PIOB representatives. The Task Force expressed strong concerns that the matters raised by the PIOB and the timing gave rise to significant issues. However, the Task Force recognized the overarching public interest in ensuring that the provisions secure PIOB approval. The Task Force also accepted that the proposed changes, while not being changes which it would have advocated, do not affect the conceptual structure of the revised provisions. Against that background, the Task Force agreed to recommend the [proposed changes](#) for consideration and approval by the IESBA.
8. At its meeting in early December, the PIOB took note of the substance and formulation of the proposals. The PIOB indicated that it would welcome receiving IESBA approval of these proposals and, subsequently, the IESBA's submission of the revised close-off document for the PIOB's conclusions on due process and in regards to the public interest.

#### **Changes to the September 2016 Close-off Document**

9. At its December meeting, the IESBA deliberated the Task Force's proposals in the light of the comments raised by the PIOB. The nature of the PIOB's concerns on the three matters highlighted above and the outcome of the IESBA's related deliberations are summarized below.

#### **JURISDICTIONAL PROVISION**

10. In the September 2016 close-off document, the IESBA had concluded on the following jurisdictional provision, taking into account comments received from respondents on the February 2016 Long Association re-Exposure Draft (re-ED) and the CAG's support for the revised proposal:

290.163 A legislative body or regulator (or organization authorized by such legislative body or regulator) may have evaluated the familiarity and self-interest threats to independence that arise from long association with an audit client and determined that a different set or combination of requirements to those established in this Section is appropriate to reduce the threats to an acceptable level. In such circumstances, the cooling-off period of five consecutive years specified in paragraphs 290.155, 290.158 and 290.160 may be reduced to three consecutive years if, in relation to the audit of that public interest entity:

- (a) The legislative body or regulator (or organization authorized by such legislative body or regulator) has established requirements for:
  - (i) A time-on period shorter than seven years during which an individual is permitted to be the engagement partner; or
  - (ii) Mandatory firm rotation or mandatory re-tendering of the audit appointment after a predefined period; or
  - (iii) Joint audits where more than one firm has been engaged in the audit engagement and the audit report is signed by each of the firms; and

- (b) An independent regulatory inspection regime operates in the jurisdiction.
11. The PIOB subsequently questioned whether the jurisdictional provision was necessary, in addition to its broader concerns about overall complexity. It noted that by allowing a reduction in the cooling-off period for EPs to three years, the jurisdictional provision would weaken the overall partner rotation regime in the Code. It added that stricter rules in national legislation, such as mandatory firm rotation, would prevail and apply.
  12. In the light of the PIOB concern, the IESBA reconsidered the position regarding the jurisdictional provision. After careful deliberation, the IESBA approved, with some modifications, the Task Force's proposal to replace the jurisdictional provision with a simpler formulation that would achieve the objective of the original provision, i.e., that where an appropriately qualified body has addressed the rotation of an EP in a different way which involves a shorter cooling-off period than five years, that period may be applied as long as it is not shorter than three years:

290.163 Where a legislative body or regulator (or organization authorized or recognized by such legislative body or regulator) has established a cooling-off period for an engagement partner of less than five consecutive years, the higher of that period or three years may be substituted for the cooling-off period of five consecutive years specified in paragraphs 290.155, 290.158 and 290.160(a) provided that the applicable time-on period does not exceed seven years.

(See also final close-off document at **Agenda Item A-1.**)

13. In response to the PIOB comments, the Task Force had also proposed to add a "sunset clause" such that the revised jurisdictional provision would cease to have effect five years after the effective date of December 15, 2018 for the revised long association provisions. The IESBA debated this proposal at length. There were significant concerns that this construct had never been previously used within the body of the Code and would be setting an inappropriate precedent, thus warranting re-exposure.
14. The IESBA ultimately determined instead to establish a transitional period of five years from the effective date during which the jurisdictional provision would remain applicable. By providing a transitional provision as part of the Effective Date section, the IESBA determined that no further consultation would be required. This transitional approach is intended to facilitate an eventual changeover to the cooling-off period of five years for EPs in those jurisdictions where the appropriate national body has currently specified a cooling-off period of less than five years. However, the IESBA has committed as part of its next strategy and work plan to review, during this transitional period, the long association section in the Code to take account *inter alia* of relevant legislative and regulatory developments as well as experience of the application of the section in practice. (See the Effective Date section in **Agenda Item A-1.**)
15. The IESBA believes that this revised formulation achieves the outcome desired under the original provision while being responsive to the public interest concerns raised by the PIOB.

#### ALLOWANCE FOR LIMITED CONSULTATION DURING THE COOLING-OFF PERIOD

16. In December 2015, having considered stakeholders' feedback on the August 2014 ED, the IESBA concluded that the Code should permit an EP or EQCR who has rotated off a PIE audit engagement to provide consultation to the engagement team on a technical or industry-specific issue after two years have elapsed during the cooling-off period if that individual is also, or becomes, a technical specialist within his or her firm. This was on condition that:

- (a) There is no other partner within the firm expressing the audit opinion with the expertise to provide the advice; and
  - (b) Such consultation is in respect of an issue, transaction or event that was not previously considered by that individual in the course of acting as EP or EQCR.
17. Subsequent to the IESBA's September 2016 deliberations, the PIOB questioned this exception to the general principle that consultation with an EP or EQCR is prohibited during his or her cooling-off period. The PIOB wondered whether the provision addressing restrictions on activities during the cooling-off period could be simplified, eliminating the conditions set out above.
18. After careful deliberation in the light of the public interest concerns raised by the PIOB, the IESBA agreed with the Task Force's proposal to withdraw the exception. Consequently, unless it is about work undertaken or conclusions reached in the last year of the individual's time-on period where this remains relevant to the audit (see paragraph 290.164(b) of **Agenda Item A-1**), consultation between the engagement team and the EP or EQCR would be prohibited during his or her cooling-off period. The IESBA acknowledged that while it is unlikely that the withdrawal of this permission would affect the larger firms to any significant extent, smaller firms may face added challenges in auditing PIEs.
19. However, the IESBA noted that under the revised long association provisions (see paragraph 290.168 of **Agenda Item A-1**), firms will have the opportunity to seek relief from partner rotation by reaching out to the relevant regulator in their jurisdictions. In circumstances where such relief is granted, the individual could remain as a KAP (for example, as EP) on the audit engagement.

#### EFFECTIVE DATE AND TRANSITIONAL PROVISIONS

20. In the August 2014 ED, the IESBA had proposed that the revised provisions be effective for audits of financial statements for years beginning on or after December 15, 2017. The issuance of the re-ED in February 2016, however, effectively deferred finalization of the provisions by almost a year. In addition, the IESBA had resolved to restructure the close-off provisions to align with the new structure format before they are released as part of the restructured Code (anticipated by the end of March 2018 or early April 2018, subject to PIOB approval of the restructured Code). This is to avoid the introduction of new provisions (which would need to be translated and adopted through due process) that would then need to be replaced shortly thereafter.
21. Given these circumstances, the IESBA determined that December 2018 would be the earliest possible date when the new provisions could be implemented to allow sufficient time for translation, due process and other implementation activities. Accordingly, subject to the transitional provision pertaining to the revised jurisdictional provision (see Jurisdictional Provision subsection above), the IESBA determined that the effective date of the revised provisions in extant Section 290<sup>2</sup> be for audits of financial statements for periods beginning on or after December 15, 2018.
22. The IESBA discussed the merit of including transitional provisions that would apply for the revised provisions, primarily in support of audit quality as firms may face practical challenges in implementing changes to partner rotation plans, particularly where specialist and EQCR resources are in short supply. However, the PIOB expressed concern about the need to provide such transitional provisions given that the revised provisions would not become effective until two years after the finalization of the close-off document. On balance, recognizing also the importance of the significant enhancements

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<sup>2</sup> Section 290, *Independence – Audit and Review Engagements*

overall becoming effective as early as possible, the IESBA determined not to provide transitional provisions. Firms will therefore have a two-year window to make the necessary arrangements for partner rotation on relevant PIE audit engagements before the revised provisions become effective.

23. While these revised provisions will not be formally released until after they have been restructured under the new Structure format, the restructuring exercise will not change the substance of the provisions.
24. With respect to other assurance engagements (extant Section 291),<sup>3</sup> the revised provisions (also to be issued in the new structure format) would be effective as of December 15, 2018.
25. In both cases, early adoption would be permitted.

### **Way Forward**

26. Subject to PIOB approval of the revised close-off document, the proposed restructured version will be packaged with the Phase 2 Structure of the Code ED planned for issuance on or around January 24, 2017. The restructured provisions are expected to be finalized at the same time as the Phases 1 and 2 Structure texts at the December 2017 IESBA meeting.

### **Material Presented**

Agenda Item A-1      Long Association – Final Close-off Document

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<sup>3</sup> Section 291, *Independence – Other Assurance Engagements*