PROPOSED CHANGES TO CERTAIN PROVISIONS OF THE CODE ADDRESSING THE LONG ASSOCIATION OF PERSONNEL WITH AN AUDIT OR ASSURANCE CLIENT

ICAEW welcomes the opportunity to comment on the exposure draft *Proposed Changes to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client* published by IESBA on 14 August 2014, a copy of which is available from this link

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MAJOR POINTS

1. While we refer in our detailed responses to the questions, to some specific issues, we support the proposed amendments overall, as an enhancement to the existing Code. We do believe that implementation should be aligned with other changes to the Code, perhaps the pending code restructuring that IESBA is discussing.

RESPONSES TO SPECIFIC QUESTIONS

Q1. Do the proposed enhancements to the general provisions in paragraph 290.148 provide more useful guidance for identifying and evaluating familiarity and self-interest threats created by long association? Are there any other safeguards that should be considered?

2. We agree that the proposed enhancements are a useful addition, though we do not believe that they merit an amendment to the Code by themselves – see comments below on effective date.

Q2. Should the General Provisions apply to the evaluation of potential threats created by the long association of all individuals on the audit team (not just senior personnel)?

3. In principle, familiarity threats could arise from any member of staff so the general provisions should apply to all individuals on the audit team. That said, it should be recognised that the more junior the member of staff, the less likely there is a significant threat

Q3. If a firm decides that rotation of an individual is a necessary safeguard, do respondents agree that the firm should be required to determine an appropriate time-out period?

4. We agree, though we would hope that this is the codification of current good practice.

Q4. Do respondents agree with the time-on period remaining at seven years for KAPs on the audit of PIEs?

5. We agree. The principal familiarity threat will arise with the engagement partner, by the nature of the audit process, so it seems reasonable to have a longer rotation period for other key audit partners. Indeed the proposal reflects the approach adopted by the APB Ethical Standards on auditor independence for some years. Any specified limit is arbitrary but we are not aware of any evidence to suggest that there has been a particular problem with seven year maximum rotation periods.

Q5. Do respondents agree with the proposal to extend the cooling-off period to five years for the engagement partner on the audit of PIEs? If not, why not, and what alternatives, if any, could be considered?

6. The rationale for the existing two year cooling off period was clear in that it is important that at least one complete audit cycle needs to be scoped out. That said, we understand that there is a perception that this is too short and on those grounds we accept that an increase for the engagement partner (the key threat), on a PIE audit, should be made. As noted before, any specified limit is arbitrary but under the circumstances, five years does not seem unreasonable. Again, the proposal in this respect reflects the approach adopted by the APB Ethical Standards on auditor independence for some years.

Q6. If the cooling-off period is extended to five years for the engagement partner, do respondents agree that the requirement should apply to the audits of all PIEs?

7. We agree. As the extension is addressing a perception threat, and perception threats are particularly important in respect of PIE audits by their nature, the proposals should apply to the audits of all PIEs.

Q7. Do respondents agree with the cooling-off period remaining at two years for the EQCR and other KAPs on the audit of PIEs? If not, do respondents consider that the longer cooling-off period (or a different cooling-off period) should also apply to the EQCR and/or other KAPs?

8. We agree. As noted above, we understand the rationale for the current two year period and believe this continues to be appropriate for those partners where there is a lesser potential impact of the familiarity threat. We note that in the European Union, the new European regulation on Statutory Audit will set a minimum cooling – off period for key audit partners of three years from 2016.

Q8. Do respondents agree with the proposal that the engagement partner be required to cool-off for five years if he or she has served any time as the engagement partner during the seven year period as a KAP?

9. We agree. As the extension is addressing a perception threat with PIE audits, prior service as the engagement partner should count, even where this occurred before the entity became a PIE. That said, there may be circumstances where a short additional period of continuity is particular important where an entity has just, for example, become listed on a stock exchange. We note that the existing limited extensions continue to be available in key audit partner roles in 290.151 and 152. The example in 290.151 seems to indicate that this paragraph does address engagement partners as well as other key audit partners, but it is unclear whether 290.152 applies to engagement partners (with the periods duly amended) or not.

Q9. Are the new provisions contained in 290.150C and 290.150D helpful for reminding the firm that the principles in the General Provisions must always be applied, in addition to the specific requirements for KAPs on the audits of PIEs?

10. While not sure that the new provisions in 290.150C and 150D are necessary – they are merely reminders of general requirements, we doubt that it hurts to restate these obligations.

Q10. After two years of the five-year cooling-off period has elapsed, should an engagement partner be permitted to undertake a limited consultation role with the audit team and audit client?

11. The 'limited consultation role after two years' provisions could be considered to be an unnecessary complication: if the audit firm has managed without the partner being involved in a consultation role on the relevant entity for two years, as required, then an additional three years would not seem to cause undue further hardship. That said, we note that a similar provision is included in the APB Ethical Standards on auditor independence (which specify a five year cooling – off period for the engagement partner) and we are not aware that it has caused problems.

Q11. Do respondents agree with the additional restrictions placed on activities that can be performed by a KAP during the cooling-off period? If not, what interaction between the former KAP and the audit team or audit client should be permitted and why?

12. The fundamental requirement must be that the partner cooling-off, not be involved in any role or activity that would exert influence on the audit. We think it reasonable to specify that being responsible for leading the firm's professional services to the audited entity is not an acceptable activity during that period. This can, for example, have an adverse impact on the audited entity's attitude to the new engagement partner, and would certainly be perceived as being an influential role.

13. We do not believe that a complete prohibition is necessary on providing non-audit services where this could involve 'significant or frequent interaction with senior management or those charged with governance'. We do not believe that this would always result in the exertion of influence on the current engagement partner. Where such influence might arise, this would be addressed by the requirement not to engage in activities that would influence the audit that is in the proposed 290.150B.

14. We note that 290.150B proposes referring to 'direct' influence on the audit: this seems to be too narrow as the key issue is the significance of the influence, not how it arises.

15. In view of the inclusion of paragraph 290.149B (to which we do not object), the requirements of 290.150 could be interpreted to apply to the audits of non-PIEs, where there has been rotation. It is therefore particularly important to ensure that the requirements in this area are not set in more detail than they need to be to preserve independence and the perception thereof, as there could be quite a significant effect on the ability to provide good service to SMEs..

Q12. Do respondents agree that the firm should not apply the provisions in paragraphs 290.151 and 290.152 without the concurrence of TCWG?

16. While informing those charged with governance is not of itself a safeguard, we agree that concurrence should be obtained, as the use of exception overrides could have an impact on perception, which is a matter of importance to the PIE as well as the audit firm.

Q13. Do respondents agree with the corresponding changes to Section 291? In particular, do respondents agree that given the differences between audit and other assurance engagements, the provisions should be limited to assurance engagements "of a recurring nature"?

17. We agree: the approach seems the most appropriate in view of the diverse nature of engagements dealt with by section 291.

Other matters

Effective date – Recognizing that the proposed changes are substantive, would the proposal require firms to make significant changes to their systems or processes to enable them to properly implement the requirements? If so, do the proposed effective date and transitional provisions provide sufficient time to make such changes?

18. The proposed changes could impact significantly on smaller firms, smaller offices of large firms and firms carrying out specialised audits. It is right that a significant lead-in period be envisaged. However, while an enhancement to the existing provisions, we do not believe that there is evidence of a need for urgent change, and the proposed changes do not merit a change to the Code by themselves. They should be incorporated with other changes, perhaps the pending code restructuring that IESBA is discussing. An extended, publicised implementation period would mean that no transitional provisions are necessary.