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Dear Mr Siong

**Exposure draft: *Long Association of Personnel with an Audit Client***

Thank you for the opportunity to provide comment on the *Exposure draft: Proposed changes to certain provision of the Code Addressing the Long Association of Personnel with an Audit Client*, released by the International Ethics Standards Board for Accountants (IESBA).

By way of general comment, we recognise the importance of auditor rotation and its objective to promote auditor independence. We agree that the length of tenure of key audit personnel is important, but length of tenure needs to be considered in the context of a focus on quality of audit, including the role of the board and audit committee in overseeing the external audit.

We do not support the proposed increase in a mandatory cooling-off period from 2 years to 5 years and discuss the reasons in our submission.

**About the Institute of Directors**

The Institute of Directors in New Zealand (IoD) is a non-partisan voluntary membership organisation committed to raising governance standards in New Zealand. We aim to help businesses understand governance and concurrently assist skilled and experienced directors with vision and independence of thought to work with management to achieve better business performance.

We represent a diverse membership of over 6,600 members drawn from NZX-listed corporations, unlisted companies, private, closely held companies, small to medium enterprises, public sector organisations, not-for-profits and charities.

***Comment on proposal for a longer cooling off period***

The IESBA proposes increasing the mandatory 'cooling off' period from 2 years to 5 years for engagement partners auditing public interest entities (PIEs). This will apply to all entities using New Zealand's External Reporting Board (XRB) Tier 1 accounting standards. It will mean a rotation cycle for *audit engagement partners* of:

- 5 years on, 5 year off for listed entities when combined with NZX rules, and;
- 7 years on, 5 years off for other Tier 1 entities, including large registered charities.

This is a significant increase in the length of the cooling off period. In our view such a long cooling off period is not necessary to maintain auditor independence and it could also have a detrimental effect on auditor quality.

As a small country, New Zealand has a relatively small pool of industry and experienced audit partners. A longer cooling off period reduces the amount of time available by suitably experienced audit partners.

International proposals such as those of the IESBA need to be considered in context. New Zealand cannot sustain a system which becomes impractical and onerous due to the relative size of auditor pool. The IoD strongly supports good practice in auditor cooling off but those standards must be workable for directors and boards.

The IoD is not convinced that a case has been made by IEBSA for extending the cooling off period as it relates to the specific New Zealand context.

#### *NZX 5 year mandatory rotation for listed companies*

The effect on listed companies of a cooling off period of 5 years is even greater given the New Zealand Stock Exchange (NZX) Listing Rule 3.6.3(f), which requires the Audit Committee of an issuer to ensure that *'the external auditor or lead audit partner is changed at least every five years'*. This will mean 5 years on, 5 years off, for listed companies.

We do not support mandatory rotation after 5 years for larger and more complex firms, as it can result in the loss of audit and industry specific knowledge in the leadership of the audit team potentially eroding the quality of the audit. This is because:

- an auditor is often required to understand the industry and international context of a company before developing the specialist knowledge necessary to undertake the audit; and
- the audit term generally includes a period of transition (e.g. a year at the beginning and at the end of the engagement term), which comprises a significant portion of the 5 years.

NZX has a policy<sup>1</sup> for considering waivers to the rule if:

- a) the extension of the auditor's or lead partner's term is necessary to safeguard the quality of the audit; and
- b) notwithstanding the extension, the auditor's or lead partner's ability to exercise objective and impartial judgment in relation to the audit is not impaired.

Although we support this policy which allows exceptions, as noted above we consider that the norm of a 5 year maximum can potentially erode audit quality, which will be exacerbated by a longer cooling off period.

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<sup>1</sup> Which is similar to the Australian Securities and Investments Commission (ASIC) approach under Regulatory Guide 187 to providing relief from the Australian requirement for 5 year rotation.

### *Auditor-General's 2 year stand-down period*

In March 2014 the New Zealand Auditor-General revised its statement<sup>2</sup> on the Code of Ethics for Assurance Practitioners, which outlines the Auditor-General's specific requirements relating to rotation of key audit partners on audits of public entities (Appendix 2(I) *Long association of senior personnel involved in annual audits with public entities*). The statement:

- Sets a maximum of 6 consecutive years (usually 2 terms of 3 years) on the same audit for Appointed Auditors and senior audit personnel.
- Allows for re-appointment after a 2 year stand-down period (as long as there were no professional or consulting engagements with the entity during the 2 years).
- For public entities that are listed on the NZX – the more restrictive rules will apply.

We agree with the Auditor-General that a 2 year stand-down/cooling off period is sufficient time off an audit to support auditor independence and objectivity.

### *Role of the Audit Committee*

In our view directors are now more focused and concerned about audit quality. The audit committee plays a key role in helping ensure the external audit is effective and we support a focus on increasing the influence and responsibilities of audit committees.

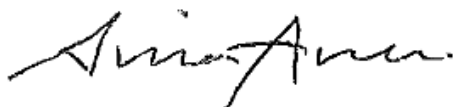
### **Conclusion**

We recognise the importance of auditor rotation and its objective to promote auditor independence. But length of tenure needs to be considered in the context of a focus on audit quality and the need for specialist audit knowledge and expertise. We do not think that a 5 year cooling off period for the audit engagement partner is necessary to maintain auditor independence and objectivity.

Moreover the impact of increasing a two year cooling off period to five years in New Zealand, which has a relatively smaller pool of industry and experienced audit partners, could compromise audit quality. Accordingly, we support maintaining the current 2-year stand down period, which we note is consistent with the new Zealand Auditor-General's standards.

We also support a focus on the role of directors and audit committees in maintaining audit quality.

Yours sincerely,



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Manager, Governance Leadership Centre  
Institute of Directors in New Zealand

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<sup>2</sup> [AG PES 1 \(Revised\)](#): *The Auditor-General's Statement on Professional and Ethical Standard 1 (Revised) Code of Ethics for Assurance Practitioners* (issued March 2014).