



Partnership beyond numbers



IPA INSTITUTE OF PUBLIC
ACCOUNTANTS

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Mr Ken Siong
Technical Director
International Ethics Standards Board for Accountants
International Federation of Accountants
529 5th Avenue, New York
USA

Via email: kensiong@ethicsboard.org

Dear Mr Siong

**Re: Exposure Draft, August 2014, issued by the International Ethics Standards Board
for Accountants (IESBA)
“Proposed Changes to Certain Provisions of the Code Addressing the Long Association of
Personnel with an Audit or Assurance Client”**

Introduction

We thank you for the opportunity to provide comment on the IESBA Exposure Draft (ED) “*Proposed Changes to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client*”. In general, we *do not support* the premise that mandatory audit partner rotation for specified arbitrary periods of time is an effective, nor reasonable, solution to the issue of improving audit quality.

It is our view that through increased professional development, improved quality control policies and procedures, and a wider, more thorough engagement quality control review (EQCR) mandate, that audit quality can be increased much more effectively than by some of the arbitrary changes proposed in the ED.

The Institute of Public Accountants in Australia (IPA) is a professional organisation for accountants recognised for their practical, hands-on skills and a broad understanding of the total business environment. Representing more than 24,000 members nationally, the IPA represents members and students working in industry, commerce, government, academia and private practice. Through representation on special interest groups, the IPA ensures views of its members are voiced with government and key industry sectors and makes representations to Government including the Australian Tax Office, Australian Securities and Investment Commission and the Australian Prudential Regulatory Authority on issues affecting the profession and industry.

Summary of general comments on the proposals within the ED

We make the following general comments on the proposals within the ED.

1. *Principles not Rules* – the Code of Ethics should be a principles-based standard and not be overly reliant on rules such as arbitrary time periods on auditor rotation.
2. *Rotation is not the only answer* – we do not subscribe to the proposition that an increase in audit partner rotation is the only effective method by which a “fresh look” can be brought to an audit

engagement. The “fresh look” suggestion fails to recognise the importance of an EQCR, and the firm’s other monitoring and inspection procedures.

3. *Do ‘appearances’ actually reduce audit quality?* – we question the validity of the argument advanced by some stakeholders who raise concerns about the ‘appearance of independence’ being an important rationale for supporting the changes as proposed in the ED. We do not see the perceived familiarity with an audit client i.e. the entity itself, as being a major factor in the determination of audit quality.
4. *Small and Medium Practices (SMP) unfairly disadvantaged* – ‘cooling-off’ periods adversely affect the SMP’s by virtue of audit partner rotation becoming quasi firm rotation. This is due to the limited number of audit partners within the typical SMP firm.
5. *Better ways to address audit quality* – we believe there are much greater factors affecting audit quality than the ‘appearance of independence’ issue. We do not see the correlation between audit quality and rotation of audit partner based on an arbitrary time period.
6. *Lack of evidence* – we are concerned that there is lack of empirical evidence of “*the concern is that over a period of time a member of the audit team may become too familiar with the audit client, its personnel and their interests, including accounting and reporting issues, resulting in a loss of independence either of mind or in appearance*”. Perceptions appear to be drivers for some of the changes proposed.
7. *Influence of jurisdictional rules* – we do not believe it is appropriate for the IESBA as an international board to propose changes to its ethical requirements based on rules of individual jurisdictions as this becomes a race to the bottom. Rather it is the IESBA principles, if appropriately determined, that should set the benchmark.

Responses to the specific questions raised in the Explanatory Memorandum (we have not responded to any questions deemed not applicable)

General Provisions

1. *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?*

Yes. These proposed amendments are helpful as they give more emphasis to the importance of familiarity and self-interest threats.

Are there any other safeguards that should be considered?

Yes. We support the inclusion of additional safeguards within paragraph 290.149A such as:

- Appropriate training for members of the engagement team on the identification and reduction of familiarity threats that may occur on an engagement. Training might include the demonstration of professional scepticism and, in particular, ways in which to audit for potential management bias.

2. *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)?*

Yes. We have no objection to the general provisions being extended to all members of the engagement team.

3. *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?*

Yes. We believe this safeguard is in fact the most appropriate method by which familiarity should be dealt with under the Code. Rather than the Code prescribing arbitrary time-on and cooling-off periods based upon set numbers of years, we believe that a firm with the necessary principles in the Code can determine an appropriate cooling-off period, if in fact that is deemed necessary.

Rotation of KAPs on PIEs

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

No.

We do not support the concept that the Code of Ethics contain 'rules' which specify time limits for either 'time-on' or 'cooling-off' an audit engagement. We believe the principles within the Code should be able to provide members with the necessary guidance and safeguards to determine for themselves when a key audit partner (or any other personnel) should be rotated from an engagement.

We are of the opinion that there should be a principle rather than a rule and that any time period should be purely indicative. This indicative time period should remain at seven years and not be influenced by local jurisdictional rules.

If specific time based rules are to be imposed upon the auditor then we believe the local regulator is best placed to make those decisions. Local based regulators are in a better position to weigh up all of the arguments for and against a rotation period and can also accommodate some of the unique practical difficulties faced by local practitioners and the industry.

We object to the default proposition that an audit practitioner cannot remain independent even after a long association with a client subject to appropriate safeguards (other than forced rotation) being in place.

5. *Do respondents agree with the proposal to extend the cooling-off period to five years for the engagement partner on the audit of PIEs?*

No. As described above in question 4, we are of the opinion that there should be a principle rather than a rule and that a time period should be purely indicative. This indicative time period should remain at two years and not be influenced by local jurisdictional rules.

We question the basis on which a five year cooling-off period has been arrived at without any evidence that the current two year period is inappropriate or that any other time periods would not achieve the desired result?

We also have concerns with the IESBA approach toward determining an appropriate time period by attempting to match international jurisdictions such as the U.S., UK and European Union. We believe that the IESBA should be providing principles-based standards and that regulators in international jurisdictions can, if they wish, impose time limits in accordance with local laws.

If not, why not, and what alternatives, if any, could be considered?

Why Not?

'Principles not Rules'

Consistent with our responses above, we do not believe the Code is the place for rules based restrictions at an international level.

'Fresh Look'

The explanatory memorandum states at page 9; “...*in addition to reducing or eliminating the familiarity threat, an objective of the partner rotation requirements is to ensure a fresh look on the audit engagement*”.

We question the fundamental assumption that a long association with an audit client necessarily creates a stale look that requires an audit partner to step away from the engagement. In our opinion, the ‘fresh look’ argument fails to acknowledge the very real input that other members of the engagement team contribute to the engagement. To suggest that changing the audit partner will “ensure” a fresh look, is both a blinkered and reactionary response to what we believe is a flawed argument.

Members of the engagement team, other than the audit partner, will in practice change from year to year. Be they the EQCR, manager or any other member of the team, these individuals bring a fresh look to the engagement each time they start on a new client.

We believe the ‘fresh look’ argument is a fundamentally flawed one.

'Where is the evidence?'

We do not believe there is any compelling evidence provided in the explanatory memorandum that there is a problem to fix, other than a perception problem by some stakeholders.

'Significance of threats depend on factors'

Paragraph 290.148B lists a number of pertinent factors that may affect the familiarity threat. All of these factors will vary and may change significantly over time. The arbitrary time limits for time-on and cooling-off do not take into account the factors. It is noted that paragraph 290.148C concedes that factors may reduce the significance of threats, but no allowance is made for altering the proposed time-on or cooling-off periods.

We suggest that the imposition of time limits is therefore contrary to the underlying conceptual approach in the Code which identifies threats and safeguards through principles rather than rules.

'Rotation is more likely to reduce rather than increase audit quality'

We believe that the constant changing of audit partners reduces audit quality in *practice* while only increases independence in *theory*. The lost knowledge of an audit partner rotated off an engagement cannot be underestimated particularly if that partner has specialist industry experience that the replacement partner does not.

This is particularly important for the SMPs in Australia who, given their geographical spread amongst cities, rural and regional areas, often find it very difficult to maintain an adequate number of suitably qualified staff capable of serving as engagement partner.

6. 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?

Not applicable, as we object to the cooling off period being extended.

7. Do respondents agree with the cooling-off period remaining at two years for the EQCR and other KAPs on the audit of PIEs?

Yes. In fact we believe that a suggested rotation of the EQCR and other KAPs is an alternative measure by which audit quality can be maintained if one was to subscribe to the 'fresh look' concept.

If the IESBA are committed to mandatory rotation then we suggest the EQCR and other KAPs could be the individuals who are able to provide the so called 'fresh look'. We do not believe it necessary to force the engagement partner to rotate away from the engagement if other safeguards are in place.

In our opinion, for an EQCR to provide an effective safeguard against familiarity threats then the EQCR responsibilities should be increased under the auditing standards. For example, the EQCR could be expected to evaluate any familiarity threat of long association by the engagement partner and be required to conclude themselves on auditor independence and the EQCR could increase their involvement in the audit engagement, such as attending key client meetings between the engagement partner and the audit client.

8. 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?

No. We see this as an overly restrictive and unnecessary proposal that will be severely handicap the SMP's within Australia who do not have the number of engagement partners available to cover such rotations.

9. 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?

These new paragraphs do not add any significant help to the principles already established within the general provisions.

10. 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?

Not applicable, as we objective to the rule based cooling-off period for the engagement partner.

11. Do respondents agree with the additional restrictions placed on activities that can be performed by a KAP during the cooling-off period?

Not applicable, as we objective to the rule based cooling-off period for the engagement partner.

Impact Analysis

14. Do respondents agree with the analysis of the impact of the proposed changes?

In the light of the analysis, are there any other operational or implementation costs that the IESBA should consider?

We believe that the IESBA might not appreciate the difficulties that mandatory engagement partner rotation will have on SMP's within counties like Australia. The operational costs of quasi-firm rotation for both audit practitioners and clients alike will be substantial.

Within Australia there are many mid-tier firms as well as SMP's in large cities that also struggle to maintain more than one experienced audit partner and the changes to the long association rules as proposed will severely impact upon these firms.

If you would like to discuss our comments, please contact me or our technical advisers Justin Reid GAAP Consulting, (+61 400 200 009, or jrconsulting@live.com.au) or Colin Parker (+ 61 421 088 611 or colin@gaap.com.au).

Yours faithfully



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