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Our ref SS/288
Contact Sylvia Smith

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Dear Mr Siong

Proposed Changes to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client

We appreciate the opportunity to comment on the above Exposure Draft issued by the International Ethics Standards Board for Accountants (IESBA or the Board). We have consulted with, and this letter represents the views of, the KPMG network.

Our overarching comments are set out below. The appendix to this letter provides our responses to the specific questions posed in the Exposure Draft.

The purpose of the long association provisions of the Code is to provide a framework, as well as specific requirements, to address the (perceived) familiarity and self-interest threats created by using the same personnel (who have the ability to directly influence the outcome of the audit) over a long period of time. One appropriate response to such threats is to bring a "fresh look" to the audit or assurance engagement by removing certain professionals from the engagement and thereby minimizing their ability to directly influence the outcome of the engagement.

An assessment of whether the provisions are adequate to address the threats cannot be made by assessing the effectiveness of the individual elements of the provisions in isolation. Instead, consideration needs to be given to the interaction of the various aspects (in particular, the amount of time spent on the engagement, the nature of the role(s) performed, the duration of the cooling-off period and the restrictions on activities during the cooling-off period). In respect of audit engagements, the Board has proposed to increase the required cooling-off period for engagement partners on the audit of a PIE from two years to five years. The Board has also proposed to further limit the permissible activities for KAPs during such cooling-off period.

Firstly, and notwithstanding our comments regarding the aspects of the provisions of the Code together rather than as discrete elements, we are supportive of the Board's proposal to extend the two-year cooling-off period for engagement partners on the audit of a PIE as we consider that the current two year timeframe likely does not meet the expected standard for independence in

appearance. However, we are concerned that the proposed extension of the cooling-off period to five years is an excessive response as it may result in the loss of expertise of engagement partners, in particular in respect of highly-specialized industries or sectors and also may have unintended consequences in jurisdictions, or in specific situations, in which the time-on period is less than seven years.

Instead, we recommend that the cooling-off period be extended to three years following a time-on period of seven years, in order to support the aims of the proposals and to maintain audit quality.

Secondly, jurisdictions are already required to have models in place to address the familiarity and self-interest threats created by the long association of engagement partners with audit clients, which have been determined to take into account the particular features of that jurisdiction. While these models may potentially not be fully aligned with each specific element of the provisions proposed by the Board (e.g. differences in length of service on the audit or cooling-off periods), in totality they are likely considered by local regulators to be adequate to safeguard audit quality. Accordingly, if an independent regulator in a relevant jurisdiction has provided such a model for partner rotation that they believe is an appropriate response for that jurisdiction, taking account of other regulatory requirements that may also contribute to a reduction in the identified threats, this should be a key consideration in determining whether auditors in such jurisdictions are in compliance with the principles of the Code.

Please contact Sylvia Smith at +44 20 7694 8871 if you wish to discuss the contents of this letter.

Yours sincerely

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Appendix A: Response to Specific Questions

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? Are there any other safeguards that should be considered?*

Overall we find the enhancements to the general provisions provide more useful guidance for identifying and evaluating familiarity and self-interest threats created by long association.

We highlight that in a number of jurisdictions there is significant ongoing regulatory activity in this arena, for example, recent legislation in the European Union concerning partner rotation and mandatory firm rotation. As a result, we recommend that IESBA evaluate the effects on practice of such recent changes to laws and regulations, in particular those relating to mandatory firm rotation, to determine whether further changes to IESBA requirements are needed to ensure that the key principles underlying the Code are not undermined.

For example, the mandatory rotation of audit firms may lead to a significant increase in movement of personnel between different firms/networks, in particular of senior personnel and those with sector-specific expertise and specialist skills. The General Provisions make reference to the overall length of an individual's relationship with a client and the closeness of their relationships with senior management and TCWG, however, in the main they consider personnel of a particular audit firm who serve a client and do not refer explicitly to any roles prior to their employment with a particular firm.

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)?*

We support the extension of the applicability of the General Provisions to the evaluation of potential threats created by long association of all personnel on the audit team, in addition to senior personnel.

We believe the proposed changes to the Code support the application of a principles-based approach to identifying and evaluating any threats and applying safeguards, since the amendments recognize the nature of the different roles performed, the type of interaction with the audit client, and the extent to which the individual has the ability to influence the outcome of the audit.

This would allow an audit firm to evaluate threats arising from particular relationships based on specific facts and circumstances.

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?

We agree it would be appropriate for the firm to determine both when a threat is so significant that the rotation of an individual is necessary, as opposed to the application of other safeguards, and also an appropriate time-out period as a safeguard based on the specific facts and circumstances, including the nature of the threat identified.

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?

Notwithstanding our overarching comment that the provisions of the Code should be considered in totality, rather than as individual elements, we agree with the proposal that the time-on period remain at seven years as we believe this is optimal to support audit quality overall. We also consider it beneficial that this time period aligns with that required by partner rotation rules in many jurisdictions, including the European Union.

We note that a number of jurisdictions establish a time-on period of less than seven years. We believe that the proposed changes to the Code are premised on the time-on period remaining at seven years, and therefore we suggest elsewhere that it would be beneficial to amend the Code to avoid unintended consequences for such jurisdictions.

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

We acknowledge the intention of the Board to address the perception of a familiarity threat when an engagement partner can serve an audit client for a total of 14 of 16 years under the extant provisions. We consider that the current baseline cooling-off period of two years, following a time-on period of seven years, likely does not meet the expected standard for independence in appearance.

However, we have the following concerns with extending the cooling-off period to five years, in particular, in jurisdictions in which the time-on period is established as less than seven years:

- The extended timeframe may result in the loss of expertise that individuals possess, in particular in relation to highly specialized sectors or industries, for example, in respect of financial services, or natural resources sectors;

- This issue may be exacerbated in jurisdictions in which the time-on period is established as less than seven years. Such jurisdictions may also face resourcing issues as a result of

the combination of a reduced time-on period followed by a disproportionately long cooling-off period, which could impact negatively on audit quality; and

- Audit firms operating in the EU who are already facing the challenges of complying with the new regulations related to partner rotation and mandatory firm rotation will have yet a further complexity added to this equation as a result of such a significant increase in the cooling-off period.

Accordingly, we recommend extending the baseline cooling–off period for the engagement partner on the audit of PIEs to three years, following a seven year time-on period, combined with the proposed strengthening of the restrictions on permitted activities during such period.

As the Board recognizes in the Explanatory Memorandum, this would ensure that the engagement partner is actually away from the audit for at least two full audit cycles (allowing for transitioning activities in the first year of cooling-off) to remove their influence for a sufficiently long period to bring the benefits of an effective fresh look and to address actual or perceived threats to independence, whilst maintaining audit quality.

Notwithstanding the above, we consider that the IESBA approach of premising cooling-off periods on a time-on period of seven years may be overly simplistic, since attempting to establish baseline requirements in respect of individual elements of an overall framework does not take into account the effects of the interaction of these individual aspects when applied in totality, nor does it consider the effects of overlaying these requirements on the stricter rules established in certain jurisdictions.

Instead we consider that the focus of the Code should be on overall audit quality and the timeframes should be considered together in terms of assessing whether the aims of the Code are achieved.

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?*

We believe that the cooling-off period should be the same for the audits of all PIEs.

7. *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?*

We agree that the cooling-off period should remain at two years for the EQCR and other KAPs on the audit of PIEs, given the expected nature of their roles and the reduced level of contact with the client and the ability to influence the outcome of the audit, as compared to the engagement partner.

Furthermore, application of a longer period for all KAPs, and the EQCR in particular, could negatively impact on audit quality as it could reduce the available pool of individuals with appropriate expertise or specialist skills.

We believe that the application of the General Provisions will provide an effective means to analyze and address any threats that may arise in respect of KAPs other than the engagement partner, in response to the specific facts and circumstances, for example, where an individual is interacting with senior management or those charged with governance to a greater extent than might be expected in the role of EQCR.

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?

We support the Board in its proposal to extend the current baseline cooling-off period of two years, which we do consider likely does not meet the expected standard for independence in appearance. Accordingly, we recommend a baseline cooling-off period of three years, following a time-on period of seven years, as we outline in our response to question 5.

As we also set out in that response, we are concerned that the Board's proposed extension to a five-year cooling-off period may be a disproportionate safeguard, in particular in situations when a KAP has served as the engagement partner for less than seven years, for example, in jurisdictions in which the time-on period is established at less than seven years.

We acknowledge the Board's attempt at simplifying the requirements to apply to various scenarios, however, we consider that the benefits of simplicity of the approach do not overcome the view that this may be an excessive time-period, in particular in the circumstances envisaged by this question.

Accordingly, we propose that the Board consider an approach that focuses on overall audit quality, in which time-on and time-off periods are taken together when determining whether the aims of the Code are achieved. Firms should be allowed to exercise professional judgment to determine an appropriate and proportional cooling-off period, based on the facts and circumstances applicable to the situation, which would be fitting for a Code that is principles-based. Such an approach would take into account:

- The length of time that a KAP has served as the engagement partner during the seven-year period;
- How recently the KAP served as the engagement partner; and
- The significance of any familiarity threats or self-interest threats arising in respect of other members of the engagement team (or the absence of these, which may act as a safeguard).

Similar to the requirement in paragraph 290.153, we recommend that such provision takes account of the requirements of the local regulator including any additional or alternative safeguards that such regulator specifies.

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?*

We do not believe that either of these paragraphs is necessary, since they duplicate requirements already set out within the General Provisions. Instead, we recommend that this guidance is included within the General Provisions, for example, the lead-in to paragraph 290.150A could include language to clarify that the following paragraphs apply to audits of PIEs in addition to the General Provisions.

Of the two paragraphs, however, we are more supportive of 290.150C, since this paragraph states that it is to be applied "in accordance with the General Provisions" and considering its placement directly after the preceding paragraphs which set out prescriptive requirements in respect of partner time-on and time-out of PIE audit engagements. It may, therefore, serve to remind auditors that, although specific, these timeframes and are not to be applied by default.

If retained, we suggest that this paragraph could be enhanced by the inclusion of "Notwithstanding the provisions of paragraphs 290.150A…"

We recommend that paragraph 290.150D be removed. We do not consider that this paragraph establishes requirements or provides guidance not already included in the General Provisions, and the inclusion of this paragraph may mislead readers of the Code by appearing to suggest that the section of the Code applicable to PIEs stands alone without the need to apply 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?*

It is a critical aspect of audit quality that, whilst appropriate provisions in respect of engagement partner cooling-off are established to address any threats to independence, such timeframes do not unnecessarily restrict the most appropriate individuals in terms of their technical skills and expertise from being available to consult with engagement teams on particular issues relevant to their area of expertise.

We acknowledge the intention of IESBA to address this matter by proposing that a former engagement partner be permitted to undertake a limited consultation role with the audit team after two years of a five-year cooling-off period. We consider it appropriate to permit an engagement partner who has a role that supports audit quality at a macro level to undertake such a limited consultation role with the audit team and audit client after two years have elapsed. We believe the potential impact to audit quality resulting from restricting access to the special skills and

expertise that such individual possesses would outweigh any residual familiarity or self-interest threat remaining after two years, as such threats would have diminished following limited contact with the engagement team and audit client.

11. *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?*

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

We recommend that further clarification be included that the provisions are not intended to preclude the individual from reasonable social contact or other contact otherwise arising during the normal course of business.

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

We are supportive of the underlying intentions of the provisions in the above paragraphs, and we agree that such provisions should not be effected without discussion with TCWG.

We consider that in any circumstances where it is proposed that a key audit partner continue to serve in that role for more than seven years the reasons for an extension and the need for any safeguards to reduce any threat created be discussed with TCWG.

Accordingly, we suggest that paragraph 290.152 be enhanced to also require such a discussion, in line with the wording used in paragraph 290.151.

Section 291

13. *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"?*

We agree with the corresponding changes to Section 291 as we consider that the same underlying principles apply to any assurance engagement.

Request for General Comments

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?

We agree with the effective date proposed by the IESBA. Audit firms will require some time to consider the effects of the proposed changes and to implement plans.