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the next solution

29 October 2014

International Ethics Standards Board for Accountants
6th Floor
529 Fifth Avenue
NEW YORK NY 10017
UNITED STATES OF AMERICA
Attn: Mr Ken Siong, Technical Director

By email: kensiong@ethicsboard.org

Dear Sirs & Madams,

Submission on Exposure Draft *Proposed Changes to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client*

We welcome the opportunity to provide the International Ethics Standards Board for Accountants with our comments on the IESBA's Exposure Draft (ED) *Proposed Changes to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client*.

Nexia Australia represents the Nexia firms of the Australia and New Zealand network comprising seven independent Chartered Accountancy firms located in Sydney, Melbourne, Canberra, Adelaide, Perth, Auckland and Christchurch with 75 partners and 600 staff.

Nexia Australia firms service clients from small to medium enterprises, large private company groups, not-for-profit entities, publicly listed entities and other public interest entities and includes market leaders in many sectors of business.

All firms are members of Nexia International, a global accounting and consulting network ranking 10th in size in terms of annual turnover and employing over 20,000 people in over 100 countries.

Executive Summary

Nexia Australia is opposed to the proposal to extend the cooling-off period for Audit Engagement Partners to five years for the following reasons:

i) The IESBA itself acknowledges on page 14 of the ED that "It [the proposals] may well, however, have a negative impact on audit firms, particularly smaller audit firms which have fewer audit personnel available to them. The change in the cooling-off period for engagement partners is recognized by IESBA as being the change which overall will have the greatest impact. No other jurisdictions currently apply a seven/five year approach solely for the engagement partner and only three jurisdictions that participated in the benchmarking survey have a five-year cooling-off period."

   We agree with the Board's assessment of the impacts of the proposal. In our view, the proposal places an unreasonable burden on smaller and mid-tier firms that have less than five audit partners in an individual office, and also those firms that audit entities in specialised industries (eg, financial services, resources) where specialist audit expertise is required.

   Furthermore, the proposal will result in the mandatory adoption by all jurisdictions of the most onerous cooling-off provisions currently applied in only three jurisdictions without providing any

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empirical data to support that audit quality is enhanced in those jurisdictions compared to other jurisdictions with less onerous cooling-off periods.

ii) In respect of listed entities, Australia's *Corporations Act 2001* requires a cooling off period of two years for the Engagement Partner (EP) and the Review Partner (RP), once they have completed a five year term as an EP or RP.

Similarly, in respect of New Zealand, NZX Listing Rules require that the external auditor or lead audit partner is changed at least every five years for listed Issuers.

The IESBA's extension of the cooling off period to five years for Engagement Partners will impose a burden greater than that considered necessary by local regulators and legislators. We also note that the IESBA believes that the seven years time-on period remains appropriate (page 9 of the ED) and that this was a consideration in extending the cooling-off period to five years.

In the Australian and New Zealand contexts, we believe that adoption of a five year cooling-off period (ie, five years time-on followed by five years cooling-off) is excessive and not justified by objective data that such an approach would enhance audit quality.

iii) We are concerned that the proposals will result in the concentration of audits of PIEs to the Big 4 audit firms and have a detrimental impact on competition in the Australian and New Zealand audit services market. Adopting a five-year cooling-off period will amount to audit firm rotation as those smaller and medium practices struggle to adequately resource those engagements.

iv) We are aware of a published survey in the US that purports to illustrate that audit quality is enhanced by auditor rotation, by reference to the number of audit adjustments recorded by entities in the year immediately preceding and subsequent to auditor rotation compared to other periods. However, we suggest that reference to the number of audit adjustments recorded in any particular year cannot be attributed solely to changes in audit quality in those periods.

v) We support the objective of exploring ways to improve audit quality. However, in our opinion, extending the cooling-off period to five years is not the right solution and the proposal lacks clear evidence to support that assertion. Instead, we believe that the IPESB should consider other means that would more directly improve audit quality such as through improving auditor competency, consultation requirements, and education.

Consequently, in our view, a reasoned, rational and supportable case for imposing an additional burden on smaller and mid-tier firms has not been made.

Our comments on the relevant Request for Comments are included in the attached Appendix.

Should you wish to discuss any aspects of our submission, please contact me at molde@nexiaaustralia.com.au or +61 2 9251 4600.

Yours sincerely

Nexia Australia

Martin Olde
Technical Director - Australia & New Zealand

Appendix
IESBA Request for Specific Comments

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?*

   Yes. However, we believe that the proposal should acknowledge that potential threats caused by long association may be mitigated by the size of the fees generated from the client, both in nominal terms and as a percentage of the firm's total revenue. For example, paragraph 290.148A states that "a self-interest threat may be created as a result of an individual's concern about losing a longstanding client of the firm". However, a self-interest threat may be insignificant if the revenue generated by that client is not significant to either the engagement partner's portfolio or the audit firm as a whole.

   Therefore, we suggest that the factors identified in paragraph 290.148B make reference to the size of the fees generated by the client as a factor to consider in assessing the significance of the self-review threat.

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)?*

   No. In our opinion, the potential self-interest threats posed by junior members of an audit team are not significant and the proposed General Provisions should not be extended to all members of the audit team.

   The practical reality is that all audit firms face significant staff turnover at the intermediate and senior staff levels. Audit clients consider stability of client teams as enhancing audit quality and efficiency as those audit staff develop their knowledge and understanding of the client's business.

   Any potential threats caused by long association of audit staff is reduced through the planning, monitoring and review processes undertaken by more senior audit personnel, including the engagement partner and review partner.

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?*

   As indicated at Q2, we do not agree with the proposal to extend cooling-off to all individuals on the audit team.

   However, if the IESBA proceeds with the proposals, we recommend that the firm should determine an appropriate time-out period rather than a period being mandated by the IESBA.

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?*

   Yes.

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?*

   No. For the reason set out in pages 1 and 2 of this submission, we do not support a five year cooling-off period for Engagement Partners. Furthermore, in many cases a five year cooling-off period would amount to mandatory audit firm rotation as firms are unable to adequately manage the cost and logistics of assigning a suitable replacement engagement partner for that period of time.

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 do not agree with the extension of the cooling off period for all PIEs to five years. If the Board is intent on adopting a five year cooling-off period, in our opinion, this should extend only to audits of listed entities.

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?*

   Yes. In our opinion, a two year cooling-off period appropriately balances the need to bring 'fresh eyes' to an audit with the costs associated with doing so.

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. Refer detailed comments above.

   Furthermore, the proposal is unworkable in the cases of engagement partners that may have only been appointed for a short time and depart due to illness, secondment, transfer or for personal reasons. The proposals means that a partner retuning from maternity leave after only 1 or 2 years as the engagement partner would still have to serve a five year cooling-off period even though they had not served a full term as engagement partner.

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?*

   Yes. We concur with the inclusion of additional application guidance.

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?*

    Yes, subject to our response at Q5.

    It is generally recognised that smaller and mid-tier audit firms do not have the depth of expertise in comparison to large multinational audit firms. Restricting the ability of audit teams to discuss

technical or industry matters with the previous engagement partner during the cooling-off period has the potential to reduce audit quality for little or no demonstrable benefit.

Furthermore, due to the proposed prohibition, SMPs could be required to obtain external technical or specialist advice that would otherwise be available to it internally, thereby increasing the costs of performing an audit, making those firms less competitive and will lead to the further concentration of the Large Firms in the audit services market.

We believe that an engagement partner should be permitted to undertake a limited consultation role during the cooling-off period where that individual possesses specialist technical or industry knowledge. For example, we believe that it would be inappropriate and counter-productive to enhancing audit quality if a partner with demonstrable technical or industry expertise (eg, a member or former member of a national accounting or auditing standard setting body, or a key advisor to a peak industry body or professional association, etc) was prohibited from being consulted on matters relevant to that expertise.

Nexia partners pride themselves on being accessible and trusted advisors to our clients. Clients expect that they should be able to consult with a partner that possesses experiences, insights, knowledge and expertise notwithstanding that those "issues, transactions and events" may be similar to those that were considered during the period the partner was the engagement partner. In our opinion, it would harm, more than enhance, audit quality if those partners with key experiences, knowledge and insights were precluded from sharing their knowledge because a transaction or event was too similar to an issue or transaction that had occurred previously

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?*

    No. For the reasons identified above, we do not agree with the imposition of additional restrictions on the activities that can be performed during the cooling-off period.

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

    For the reasons identified above, we do not agree with the proposals.

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 disagree with the proposal. If a change to the cooling-off period is to be adopted, it should only apply to audit engagements [of financial reports] of a recurring nature, not all assurance engagements.

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?*

    In our opinion, consideration of the potential impacts of the proposals has been understated by the IESBA.

Large audit firms will often have more than 10 audit partners in a single office and can easily adopt and apply the IESBA's proposals without undue cost or effort. However, some smaller and mid-tier audit practices already have to deal with the additional cost and administrative burden of seconding the assistance of audit partners from other offices in order to comply with the current auditor rotation rules.

Adding to this cost and complexity will be a significant burden to those firms and, in some cases, may effectively lead to audit firm rotation.

In our opinion, such an outcome would be myopic and not in the best interest of the audit profession or the clients we serve.

In our opinion, the IESBA should carefully consider the impact of the proposed changes on audit firms outside the six global networks of Large Firms and the potential consequences on competition in local markets.

Request for General Comments

In addition to the request for specific comments above, the IESBA is also seeking comments on the following general questions:

(a) ***Small and Medium Practices (SMPs)*** *–The IESBA invites comments regarding the impact of the proposed changes for SMPs.*

As discussed above, the impact of the proposed changes on SMPs are significant and has the potential to:

- effectively introduce mandatory audit firm rotation for practices with less than four audit partners;
- force SMPs out of the audit market for PIEs, thereby concentrating the audit of PIEs to the Big 4 audit firms and reducing competition in the audit services market. In our opinion, reducing the choice of audit firms for PIEs has the potential to reduce, rather than enhance, audit quality;
- potentially reduce audit quality in the SMP sector by imposing overly stringent prohibitions on consultations with internal experts during the cooling-off period.