Technical Director
International Ethics Standards Board for Accountants
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York 10017

November 12, 2014

**Re: IESBA Exposure Draft – Proposed Changes to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client**

Dear Mr Siong

## Introduction

We[1] appreciate and thank you for the opportunity to comment on the IESBA's Exposure Draft "Proposed Changes to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client".

We have responded to the Board's request to submit our views on each specific question included in the Exposure Draft but also felt it would be relevant to highlight the key principles that underpin each of our specific responses.

## Principal comments

### *Independence and audit quality*

Independence – the objectivity, scepticism and integrity of auditors – is fundamental to audit quality and is at the heart of who we are and what we do. Audit quality is also driven by the cumulative knowledge and experience the audit engagement team develops over time spent with a particular

[1] This response is being filed on behalf of PricewaterhouseCoopers International Limited (PwCIL). References to "PwC", "we" and "our" refer to PwCIL and its global network of member firms, each of which is a separate and independent legal entity.

*PricewaterhouseCoopers International Limited*
*1 Embankment Place*
*London WC2N 6RH*
*T: +44 (0)20 7583 5000 / F: +44 (0)20 7822 4652*

client and industry. An auditor's familiarity with the business and the environment in which the audit client operates as well as the need to remain objective and apply professional scepticism are both essential to performing a quality audit, and need to be appropriately balanced. In our view, any consideration of auditor rotation requirements needs to be considered within the broader context of audit quality, with the relative risks of long association weighed carefully against the benefits to audit quality of cumulative knowledge and experience.

***The current Code***

We believe that the safeguards in the current Code are robust, extensive and adequate and provide a solid foundation for managing threats to independence. Many of the current provisions in the Code, particularly those relating to Key Audit Partners, have only been in effect from January 1, 2011, and are yet to be fully implemented in terms of a rotation cycle. We support consideration of ways to enhance audit quality, including how the Code may be revised to enhance independence. However, given that the current provisions have not yet run their course, we question making significant changes to the current provisions so soon in the absence of evidence that change is needed to improve their effectiveness. The proposed changes appear to us to be responding to perceptions about the adequacy of the current requirements rather than to evidence that they are not achieving their objectives. If there were examples of circumstances where the current provisions have given rise to a demonstrable threat to the independence of the auditor to the detriment of audit quality, it would elevate the debate beyond the theoretical.

Certain jurisdictions have supplemented the Code with additional requirements - shorter "on" periods and/or longer "off" periods. For example, the US (for SEC registrants) and UK (for listed entities) require rotation of audit engagement partners after 5 years, and each of these, plus Canada, have an "off" period of five years as opposed to two years in the Code. More recently several local regulators have reversed these reduced rotation periods; for example, Canada recently extended the rotation period for audit engagement partners and engagement quality control reviewers, and the UK increased the "on" period for engagement quality control reviewers, from 5 years to 7 years. This indicates there is still diversity in views and at the very least suggests there is not conclusive evidence that stricter rotation requirements are more effective in practice.

***Focusing safeguards on areas with the greatest potential for threats to arise***

As independence is a state of mind, it is wrong to presume that any individual on the audit engagement team will lack objectivity and scepticism simply due to long association with a client. However, the audit engagement partner is most at risk from familiarity threats because of the nature of their role as the key ultimate decision-maker in the audit. Therefore, if there are to be any changes to the Code, we believe that the Board's attention should focus on the audit engagement partner.

***The bigger picture of regulatory change***

Finally, as the Board is aware, the landscape of auditor regulation is currently subject to widespread review and recent decisions on matters such as mandatory firm rotation, retendering and audit reform, particularly in the European Union, will lead to profound structural change of the profession. These areas are interrelated with the questions raised here and we believe that making changes to the

Code in isolation, without a clear picture of how these structural changes will be implemented or the full impact they will have, runs the risk of unintended and negative consequences.

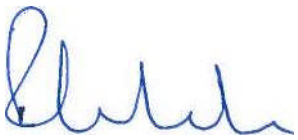
Long association and rotation considerations for personnel on an engagement team should, as they do currently, reinforce and work alongside other safeguards. Different jurisdictions have adopted different mixes of safeguards, which collectively may be equally effective, despite the fact that any particular requirement may appear to be less stringent when considered in isolation. Members of the Forum of Firms face a particular challenge as we voluntarily comply with the Code of Ethics in relation to transnational audits as well as with local regulatory and standards requirements. A principles-based approach allows for the application of the Code to a broad range of scenarios. While there may be jurisdictions that apply only the Code and so having the Code to set minimum requirements is necessary, there may be different but robust requirements established by local regulators that achieve the same aim. Where requirements are being set, we believe that the Board needs to take into account the possible interplay and that the Code should allow for compliance with these other alternative approaches instead of the minimum requirements set out in the Code.

With these key principles in mind, our more detailed comments on the specific questions the Board has asked are set out in Appendix 1.

**Contact**

We would be happy to discuss our views further with you. If you have any questions regarding this letter, please contact Aya Larsen (at aya.j.larsen@us.pwc.com), or me, at richard.g.sexton@uk.pwc.com.

Yours sincerely



Richard G. Sexton
Vice Chairman, Global Assurance

**Appendix 1**

**Detailed 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?**

   The proposed enhancements to the general provisions provide useful guidance for identifying and evaluating familiarity and self-interest threats that may be created by long association. In particular, we are supportive of the explicit statement in 290.148A that an understanding of an audit client and its environment is fundamental to audit quality, as this highlights the fact that the length of time spent on a client engagement can enhance audit quality. However, there are some areas that could be further clarified, as follows:

   - 290.148A includes the following statement: "…a familiarity threat may be created as a result of an individual's long association with… *the financial statements on which the firm will express an opinion or the financial information which forms the basis of the financial statements*". We question how an individual's long association or familiarity with financial statements would be defined or measured as this statement could have wide application, especially given the public nature of PIE financial statements. As such, we suggest that this specific bullet point be removed or amended to read "*the* ***audit of the*** *financial statements on which the firm will express…*"
   - 290.148A includes the following statement: "*A self-interest threat may be created as a result of an individual's concern about losing a longstanding client of the firm or a desire to maintain a close personal relationship with a member of senior management or those charged with governance*". It is wrong to presume that individuals on the engagement team will lack the objectivity and scepticism to make independent decisions with respect to the client or engagement. To highlight this point and better communicate the fact that the evaluation of threats needs to be balanced with consideration of safeguards, we would suggest that a discussion of safeguards follow this introduction of the threats in this paragraph as follows: *"These threats arising from long association can be eliminated or reduced through the application of safeguards, which may include internal or external safeguards."*

   In terms of other safeguards that should be considered, we note that the examples of safeguards listed in 290.149A are all examples of safeguards that would be implemented after a threat is identified rather than including examples of safeguards that can be put in place proactively to help manage the creation of these threats on an ongoing basis, such as review and supervision of engagement team members. These types of safeguards are even more significant to highlight if

the General Provisions are extended to all "individuals" rather than only "senior personnel" and given their effectiveness in protecting against threats on a continual basis.

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)?**

   While we agree that every individual on an engagement team needs to be independent and objective and that potential threats can apply to any individual, there are numerous other highly effective safeguards applicable to individuals other than senior personnel associated with the audit engagement, that are available to manage actual or perceived threats that may arise from long association. As indicated in our response to Question 1, we believe the General Provisions do not currently give an appropriately balanced recognition of safeguards as compared to potential threats and giving more prominence to other available safeguards becomes even more critical if the General Provisions apply to all "individuals" rather than "senior personnel".

   While examples of external safeguards are included in the Code, there are numerous examples of internal safeguards which are not explicitly mentioned, including:

   - Professional standards requiring that the work of managers and junior staff is directed, reviewed and supervised
   - The fact that key audit decisions are ultimately the responsibility of the audit engagement partner, who is subject to rotation
   - Engagement quality control review by an independent, objective partner who casts an impartial eye over the team's work and the engagement leader's decision, with this partner also subject to rotation
   - Audit firm requirements to have robust quality management systems in place to monitor independence

   Any evaluation of potential threats for individuals other than senior personnel should include consideration of all of these safeguards, and we recommend that the General Provisions recognise these additional safeguards.

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 that this is a reasonable expectation in cases where firms use rotation as a safeguard when a threat has been identified. However, the use of the phrase "*shall not participate in the audit engagement*" in 290.149B is unclear. We would suggest replacing this with the wording already included in paragraph 290.150A: *"shall not be a member of the engagement team or provide quality control for the audit engagement"*.

**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?**

We agree that the time-on period should not be reduced. We believe the current Code provides robust and appropriate safeguards against familiarity and self-interest threats and we do not believe there is a convincing supported case for changing the Code. The variation and recent changes in various local regulatory requirements indicates there is still diversity in views and at the very least suggests there is not conclusive evidence that more stringent rotation requirements are more effective in practice.

We noted that even in jurisdictions with large practices where local regulators have imposed stricter rotation requirements, the change from seven years to five years on was very challenging to implement and continues to impact career progression of practitioners and by extension, the profession and audit quality, and any shortening of the time-on period would have an even greater impact on smaller or medium practices, including those smaller or medium-sized practices that are part of a larger network.

As such, we are very much in support of there being no change made to the time-on period for KAPs on the audit of PIEs.

**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?**

As indicated in our response to question 4 and in our cover letter, we believe the current Code provides robust and appropriate safeguards against familiarity and self-interest threats and that we do not believe there is a convincing supported case for changing the Code. The overall construct of safeguards and requirements related to long association and rotation, including recent changes such as mandatory firm rotation in some jurisdictions, is complex. Smaller firms struggle with extended cooling-off periods given a smaller pool of resources, and larger networks face challenges complying with global requirements layered on top of national requirements that all vary. As noted in our cover letter, there is no consensus on cooling-off periods and the interaction of the differing global and local requirements is complicated to implement and manage.

The challenge is, of course, setting the cooling-off period in a way that appropriately balances the need for objectivity and the importance of understanding the client to performing a quality audit. The current baseline in the Code is 7 years on and 2 years off. There is no evidence to suggest that, for example, a rotation schedule of 7 years on and 5 years off is more or less effective than 5 years on and 3 years off, or the 7 and 2, particularly when each of these may be one part of a broader package of safeguards in a particular jurisdiction. As noted in our covering letter, different jurisdictions have adopted different mixes of safeguards, which collectively may be

equally effective, despite the fact that any particular requirement may appear to be less stringent when considered in isolation.

Given all of the complexity in this arena and the fact that the current provisions have only been in place since 2011, and the lack of evidence supporting a five year cooling-off period, we believe that the current rules should be allowed to be fully implemented before there is further consideration of whether any changes are needed to improve their effectiveness.

**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?**

Please see our response to question 5 where we argue that it would add further disruption to already substantive changes being made to the audit market to make a change in the cooling-off period in the absence of demonstrable evidence that such change is warranted.

Should the Board decide nevertheless to extend the cooling-off period from two to five years, clearly, making that change would present an implementation and administrative challenge even for large practices, and without a doubt for small and medium-sized practices.

What we have learned from practices in jurisdictions that have adopted a five year cooling-off requirement is that some of these implementation challenges include the availability of specialist expertise, mobility challenges which impact career development prospects, the need to plan for transferring licenses and qualifications between jurisdictions. These challenges are exacerbated for smaller practices and smaller countries.

Specifically, one of the challenges of using “PIE” as part of the scope of this provision is that each jurisdiction can interpret this differently. In certain cases, the application of this definition can be very broad. For example, the EU explicitly scopes in credit institutions and insurance undertakings to their definition of PIE, in addition to listed entities. Proposing application to PIEs of an already more restrictive new provision compounds the impact of the change.

Providing some flexibility in the Code is one way to alleviate some of this burden and also allow local regulators to tailor the model to best suit their local market demands and conditions. For example, if the Board decides to proceed with an extension of the cooling-off requirement to five years for the audit engagement partner we recommend that this be limited to the audit of listed entities. This would align the provisions in the Code more closely with other national regulations on long association and rotation (e.g. UK and US SEC) and maintains focus on those entities of greatest public interest.

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 there should be no change for other KAPs and that the cooling-off period should remain at two years for the EQCR and other KAPs on the audit of PIEs. The audit engagement partner is most at risk from the threat of over-familiarity because of the nature of their role as the key ultimate decision-maker in the audit and there is no other KAP that shares this role. As indicated in our responses above, we believe the current system of safeguards to address these threats, even relating to the audit engagement partner is robust, extensive and adequate. We recognize that there is a heightened risk and perceived risk of these threats for audit engagement partners, and as such, if there are any changes made, they should be focused on that role. As such, we support the Board's proposal, as explained in the Explanatory Memorandum, to not extend the longer cooling-off period to other KAPs including EQCRs.

   There are other practical considerations that support the cooling-off period remaining at two years for EQCR and other KAPs in the interest of maintaining audit quality, balanced with managing threats to independence and objectivity. Some of these considerations are:

   - KAPs other than the audit engagement partner are subject to an additional safeguard, which is the fact that there is an audit engagement partner on the audit engagement who is the ultimate decision maker, and so any decisions made by other KAPs would be scrutinized by, and be the responsibility of, the audit engagement partner.
   - Managing any change to an extended cooling-off period for audit engagement partners would be a significant burden given the implementation challenges, some of which are listed in our response to question 6. Extending this requirement to also include EQCR and other KAPs would further compound the challenge and put further strain on experienced resources which will harm audit quality. EQCR resources are often already constrained as many practices mandate stringent requirements on those partners able to fill these roles, in the interest of quality.
   - As the Code acknowledges, these provisions must be balanced with the benefit to audit quality that comes from understanding the audit client and its environment, and having the option to retain KAPs other than the audit engagement partner on the client engagement while the audit engagement partner rotates off can help to preserve a certain amount of this knowledge and help mitigate the potential risk to audit quality.
   - One way in which practices currently manage succession, in the interest of maintaining audit quality, is that individuals act as KAPs for a certain period of time on an audit engagement to familiarize themselves with the client's business and build up an appropriate amount of industry expertise. If the practice is planning for that KAP to eventually take on the audit engagement partner role, in the interest of ensuring they can look at the audit with "fresh eyes" when they take on the role, the KAP will cool-off for a period of two years before coming onto the engagement as the audit engagement partner. In our experience, this two year period allows sufficient time for the individual to "reset" and approach the audit

engagement partner role with objectivity, but it is not so long that the individual loses all of the understanding of the audit client and its environment that will allow him to perform his new role to a sufficient level of quality. However, extending this time off to five years would undoubtedly mean that he will have lost any knowledge of the client that he had built up in his time as a KAP. This would be detrimental to audit quality.

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 <u>any time</u> as the engagement partner during the seven year period as a KAP?**

We do not agree with this proposal as it is extreme and the proposed application is unclear.

As explained in our response to question 5, we believe the current Code provides appropriate safeguards against familiarity and self-interest threats and should be afforded the time to be fully implemented before considering changes needed to improve effectiveness. Notwithstanding this view, if a five year cool-off is ultimately adopted for the audit engagement partner, then we believe that it is inappropriate to trigger the five year cool-off after only one year as engagement partner during the seven year period as KAP. This would be inappropriately restrictive for the related risk and does not align with the logic of the other current and proposed provisions, which appropriately focus on those roles and situations that create or have the potential to create the greatest risk of familiarity or self-interest threats.

The proposed approach makes no distinction between the familiarity threats created for an individual who serves as audit engagement partner for just one year (for example where a KAP steps into the lead engagement partner role for a year to cover a maternity break) as compared to one who serves as audit engagement partner for seven years. Even acknowledging that the role of audit engagement partner carries greater responsibility and therefore greater risk of a familiarity threat than other KAP roles, we disagree that the safeguard of a five year cool-off should be applied equally to these different scenarios. The threats arising are very different in these situations and we believe a reasonable and informed third party would see the threats as different.

We understand the Board considered other alternatives and acknowledges that this proposal could be viewed as excessive but set forth this proposal, not because of concerns over an increased threat or a lack of safeguards in the event an individual acts as an engagement partner for even one year during the seven year period, but rather that other options would be too complex to implement. We do not agree that this is an appropriate basis for determining a requirement in the Code. Rather, the approach ultimately adopted should reflect a reasoned evaluation pursuant to the IESBA's Conceptual Framework that aligns each safeguard (in this case, the cool-off period) with the level of threat (in this case, the increasing familiarity threat based on number of years served as audit engagement partner).

If the Board decides to extend the cooling-off period for the audit engagement partner given the nature of his/her role, we acknowledge that as a result, some number of the seven years' service

as engagement partner should subject the partner to a five year cool-off. We recommend that four years, representing a majority of the seven year period, would be a reasonable measure of the combination of years as audit engagement partner and KAP that would trigger the five year cool-off. This approach would reflect the Board's position that an increased threat is presented for an individual serving in the audit engagement partner role (as compared to other KAP roles), but it would also convey the concept that the increased familiarity threat at the engagement partner level is incurred after a substantial amount of time in the role. We believe this modification adopts the Board's principle to safeguard against the threat while reducing the extreme effect of a five year cool-off after only one year as engagement partner.

We note that the Code, in referencing "more than seven years", appears to assume seven years continuous service as a KAP and does not provide further guidance on on/off situations, such as the one mentioned above, which are common in practice or on the concept of "aggregate" time. The proposed provision highlights the need for additional guidance for on/off situations as it would introduce additional complexities in terms of implementation. As the Code does not explicitly address the very common scenario of a break in a KAP's service to a client for a year or more (after having served for less than seven years) with that KAP returning to the team thereafter, the new provision may produce a result in these cases that may have been unintended by the Board. These breaks in service may be for medical or other personal reasons, such as maternity leave, or for practice management reasons, such as scheduling challenges for the partner or firm. Guidance, perhaps by way of supplementary FAQs, could be provided to address the implications of "time-out" in such circumstances where the audit engagement partner or another KAP takes time out of the engagement for a period of time less than or equal to the required cooling-off period. Such guidance should address the implications for both the outgoing and incoming engagement partner. Without additional guidance, the proposed provision may be subject to interpretation and inconsistent application.

The proposal as it stands could have negative consequences on partner career development prospects and would significantly reduce flexibility in managing practices around these common issues. This provision as it is currently proposed would lead to the Code being more restrictive than current US SEC regulations, which would be extremely problematic for even the biggest practices, and likely impossible to implement for a smaller practice.

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 think paragraphs 290.150C and 290.150D are needed as it is sufficiently clear that all individuals are subject to the General Provisions as well as any other specific provisions that apply.

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?**

    We agree this should be permitted. While we appreciate this provision was added to provide more support for engagement teams in being allowed to consult with former engagement partners after a cooling-off period of two years, we would still like to point out that restricting this type of consultation at all has the potential to harm audit quality, particularly in smaller practices where industry or subject matter expertise may be limited to a small group of individuals.

    We would also like to point out that another important safeguard that does not get mentioned in the Code, and that is particularly relevant in this situation, is the independence and objectivity of the incoming engagement partner and other KAPs.

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 believe that it is very important to highlight the key principle to help teams and firms determine which roles may not be appropriate in a given situation. We believe that by highlighting the principle in the provision, it will be sufficiently clear that it would be difficult to demonstrate the appropriate level of independence and objectivity for certain roles, even if only as a matter of perception and that the application of principles is preferable to providing a list of specific restrictions.

    We believe that the provision should state the general principle that a role which provides the former KAP with the ability to exert direct influence on the outcome of the audit engagement would be restricted during the cooling-off period. While having significant or frequent interaction with senior management or TCWG could also be listed as an example of a factor to consider, this in and of itself does not create a threat. It is the ability to exert direct influence on the outcome of the audit that creates a potential threat. Any activity that allows the partner to directly influence the outcome of the audit should not be permitted. We do not believe that specific roles, such as the client relationship partner, need to be explicitly mentioned.

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

    The Code currently encourages regular communication between the auditor and those charged with governance with respect to any matters that might, in the firm's opinion, reasonably bear on independence and cites discussing threats and safeguards with TCWG as an example safeguard.

We support a holistic approach to reinforce auditor independence, objectivity and professional scepticism including enhancements to those areas within the Code where there is scope for more detailed or clearer guidance on auditor communication with, or the responsibilities of, TCWG.

We believe the provisions in paragraphs 290.151 and 290.152 enhance transparency by auditors to audit committees on the threats and safeguards and encourage auditors to seek greater audit committee involvement in the process of evaluating the independence of the audit engagement partner and other KAPs and as such, we are very supportive of these provisions.

**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"?**

While we agree with limiting the provisions in Section 291 to assurance engagements "of a recurring nature", our responses to the corresponding changes to Section 290 apply equally to Section 291 where relevant. Please refer to our responses above.

**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?**

Please refer to our responses to the specific questions above with respect to the analysis of the impact of the proposed changes as well as the operational and implementation related considerations. As indicated we are not persuaded that the costs of the proposals (not just financial consequences but also the impact on careers and the loss of expertise and experience which could impact audit quality) are outweighed by the benefits such changes would bring in reality. We do believe that the proposals create risks to the delivery of quality audits performed by skilled people in a profession that is attractive and well regarded.