

Meeting: IESBA CAG

Meeting Location: New York

Meeting Date: September 7-8 & 20, 2021

Agenda Item

E

Long Association Post-Implementation Review (Phase 1)

Objective of Agenda Item

1. To consider key issues and comments raised by respondents to the [questionnaire](#) circulated as part of the Working Group's¹ information gathering under Phase 1 of the Long Association Post-Implementation Review (LAPIR Phase 1) and the Working Group's responses.
2. To provide input to the Working Group's recommendations in relation to the expiration of the jurisdictional provision contained in [paragraph R540.19](#) of the Code in light of the IESBA discussions in September 2021.

Background

1. In January 2017, the IESBA issued the Close-Off Document, [Changes to the Code Addressing the Long Association of Personnel with an Audit or Assurance Client](#). Those changes strengthened the provisions of the Code dealing with long association of personnel with an audit or assurance client ('long association').
2. With respect to audits of public interest entities (PIEs), the revisions in the Close-Off Document, among other things:
 - Retained the time-on period for key audit partners (KAPs) at seven years;
 - Extended the mandatory cooling-off period for engagement partners (EPs) from two years to five years; and
 - Introduced a provision that allows a jurisdiction to substitute the cooling-off period of five years for EPs with a shorter cooling-off period established by law or regulation or by a body authorized or recognized by law or regulation but not less than three years, provided that the time-on period in that jurisdiction does not exceed seven years (the "jurisdictional provision"). This provision is due to expire for audits of financial statements for periods beginning on or after December 15, 2023.

¹ Members:

- Richard Fleck, Chair, former IESBA Deputy Chair
- Saadiya Adam, IESBA Member
- Sung-Nam Kim, IESBA Member
- Kristen Wydell, IESBA Technical Advisor

3. The jurisdictional provision as approved by the IESBA (paragraph 290.163 in the Close-Off Document), subsequently became paragraph R540.19 in the current Code following completion of the IESBA's Restructuring the Code Project in December 2017.

Extract from the IESBA Code

Shorter Cooling-off Period Established by Law or Regulation

R540.19 Where a legislative or regulatory body (or organization authorized or recognized by such legislative or regulatory body) has established a cooling-off period for an engagement partner of less than five consecutive years, the higher of that period or three years may be substituted for the cooling-off period of five consecutive years specified in paragraphs R540.11, R540.14 and R540.16(a) provided that the applicable time-on period does not exceed seven years.

4. When finalizing the Long Association project, the IESBA committed to review the revised provisions to take account of, among other matters:
 - Other legislative or regulatory developments implemented by regimes around the world to address long association; and
 - Matters arising from the practical application of the revisions to the Code.
5. As set out in the IESBA's Strategy & Work Plan 2019-2023 (SWP), the LAPIR is to be carried out in two phases:

Phase 1

Phase 1 will review the implementation status of the five-year cooling-off requirement for EPs on audits of PIEs, and any issues arising from the implementation of such requirement before the expiry of the transition period for the jurisdictional provision. This phase commenced in Q1 2021.

Phase 2

Phase 2 is due to commence in Q2 2023. It will review how effectively the other revised long association provisions in the Code are being implemented in practice, taking into account legislative or regulatory developments implemented by other regimes around the world to address long association, such as mandatory firm rotation (MFR) and mandatory retendering (MRT). To achieve synergies, the LAPIR Phase 2 will be undertaken in conjunction with the post-implementation review of the restructured Code.

LAPIR Phase 1

6. At its December 2020 meeting, the IESBA established a working group to conduct Phase 1 of LAPIR. Under this phase, the IESBA will consider all relevant information received in relation to the expiration of the jurisdictional provision for audits of financial statements for periods beginning on or after December 15, 2023 and any issues arising therefrom.
7. The IESBA will not seek or analyze information about the efficacy of the five-year cooling-off requirement under Phase 1 as:

- It would be premature to review the requirement as only two years have elapsed since the provision became effective and the first full five-year period has not yet been completed.
- Such a matter should not be addressed in isolation of the remaining long association provisions in Section 540 and, therefore, would be best addressed as part of the broader review under Phase 2 of the LAPIR.

Activities since March 2021 IESBA Discussion

11. In March 2021, the IESBA released an [update](#) of its LAPIR work stream. This was followed by the release of its [LAPIR Phase 1 questionnaire](#) in April 2021. Among other things, this questionnaire aimed to establish:
 - The level of adoption of the five-year cooling-off period by jurisdictions and firms as required by Section 540 of the Code;
 - The extent to which those jurisdictions and firms that have not adopted a five-year cooling-off period have done so in reliance upon the jurisdictional provision (paragraph R540.19);
 - Whether jurisdictions that have not adopted a five-year cooling-off period in reliance upon the jurisdictional provision intend to adopt a five-year cooling-off period on the expiration of the jurisdictional provision on December 15, 2023; and
 - Whether transition to the five-year cooling-off requirement is expected to give rise to any potential issues or concerns when the jurisdictional provision expires for audits of financial statements for periods beginning on or after December 15, 2023.
12. Following closure of the comment period which was extended by one month to June 30, 2021, a total of 32 responses were received. Refer to the Appendix for extracts of key comments from respondents that have raised issues regarding the expiry of the jurisdictional provision in December 2023.
13. At its September 2021 meeting (September 17), the IESBA will discuss the issues identified by the Working Group from these comments and its proposed responses (see **Agenda Item E-1**). The Working Group Chair will update the CAG of the key points from the IESBA discussion during his presentation.
14. Subject to feedback received from the IESBA and the CAG, the Working Group plans to present its final LAPIR Phase 1 report and recommendations to the IESBA in December 2021.

Matter for CAG Consideration

15. CAG Representatives are asked to provide input on the Matters for CAG Consideration in **Agenda Item E-1**.

Material Presented

For Discussion

Agenda Item E-1 Long Association PIR - Presentation

Appendix

The following table contains extracts of key comments (de-identified) received to the [questionnaire](#) that was circulated under Phase 1 of the Long Association Post-Implementation Review.

Stakeholder Group	Extract of Comments
PAO	<p>The EU Audit Regulation, which is directly binding in all European Member States, stipulates for a cooling-off period of three years for EPs on audits of PIEs (Art. 17 VII). This cooling-off period can not be varied by the Member States (the time-on period of seven years can be varied, only).</p>
PAO	<p>The cooling-off period of three years is derived from the European regulation. Three years is in accordance with the cooling-off period for " Key audit partner / Key audit partners responsible for conducting a statutory audit" in Article 17, paragraph 7, of the European Regulation.</p>
PAO	<p>As a member of the European Union, Jurisdiction A has to apply the EU Regulation 537/2014 which stipulates a cooling-off period of 3 years. This period is not subject to a member state option and therefore cannot be extended by national law.</p> <p>Our law or regulation does not require the application of the IESBA Code. However, if companies have voluntarily committed to applying the Code, then they are referring to the mandatory jurisdictional provision.</p> <p>We currently have no information about whether the EU intends to change the existing legislation. Likewise, we do not know the underlying considerations of the EU legislator.</p>
PAO	<p>Jurisdiction B has not adopted the Code amended in 2018. Instead, it has complied with the law (requirements for both partner rotation and periodic auditor designation by the government agency) and the older version of the Code.</p> <p>From our perspective, compliance with the aforementioned three-year time-on, three-year cooling-off partner rotation requirement and the mandatory auditor designation by the government agency on a periodic basis translate into automatic compliance with the seven-year time-on, five-year cooling-off rotation requirement under the amended IESBA Code.</p> <p>Adoption of the amended Code in the future would be most likely to create complexity and significant confusion in practice as auditors will still be required to comply with the requirements for both partner rotation and auditor designation by the government agency under the law as well as the partner rotation requirement under the amended Code.</p> <p>Further review will be required to decide whether to adopt the five-year cooling-off period requirement when adopting the amended Code.</p>
PAO	<p>For large auditing firms, we believe the impact of the implementation has been relatively limited. This is partly because the large auditing firms had implemented a five-year cooling-off period for the engagement partners on audits of "listed" entities before Section 540 of the IESBA Code was implemented, and implemented the five-year</p>

Stakeholder Group	Extract of Comments
	<p>cooling-off period for EPs on audits of “non-listed” PIEs at the implementation of Section 540...For small and medium-sized auditing firms, we understand that the five-year cooling-off period for EPs would have brought considerable impact on those firms which have a limited number of eligible EPs.</p>
PAO	<p>COVID-19 has resulted in a significant reduction in mobility between and within countries, whether due to border restrictions, people wanting to stay close to look after family and other reasons.</p> <p>The ability of audit firms to move appropriately qualified individuals to service entities has been restricted and this is likely to continue well into 2022 and even 2023. This inhibits the ability to plan for this significant change on 15 December 2023.</p> <p>In addition, we note that IESBA proposed an effective date of 15 December 2024 for the PIE project revisions based on the IESBA’s Exposure Draft on <i>Proposed Revisions to the Definitions of Listed Entity and Public Interest Entity in the Code</i>.</p> <p>An expanded PIE definition coupled with the implementation of a five-year cooling-off period will add business complexity and costs as the number of entities impacted will increase significantly, particularly for highly specialised industries.</p> <p>We wish to highlight that a hard-line five-year cooling-off period does not allow any flexibility to deal with this issue and could cause unintended consequences in terms of availability of appropriately qualified partners.</p>
PAO	<ul style="list-style-type: none"> • If there is an insufficient number of audit partners in a firm to manage partner rotation successfully it may result in a de facto mandatory audit firm rotation... • Even in firms that have a sufficient number of audit partners to manage rotation, it is likely that there will be an increase in the number of engagements where the engagement partner is located in a different geographical location to the audited entity and the engagement team. • The increased cooling off period will also impact on the availability of EPs in specialised industries such as banking or insurance, where, even in large firms, there may only be a small number of partners with specialist knowledge. • The coordination of EPs and EQRs rotation is already time consuming and costly for firms. A system where the cooling-off period is different for EPs and EQRs and for listed entities and PIEs increases the administrative complexity...
PAO	<p>The IESBA provisions require a minimum of four licensed auditors per firm to meet the suggested requirements. There are a large number of smaller audit firms in Jurisdiction C and most likely in other jurisdictions that do not have enough audit partners to rotate their clients.</p> <p>As noted above, 3 years since implementation is too soon to measure the full impact of the provisions. The pandemic and the new IAASB quality management requirements for</p>

Stakeholder Group	Extract of Comments
	firms may have a further impact on the number of available auditors in small and medium practices.
PAO	<ul style="list-style-type: none"> • The transition to a 5-year cooling-off period is likely to lead to an audit market contraction and reduced competitiveness in the provision of audit services for PIEs. In Jurisdiction D, it is likely to lead to an audit market oligopoly, contrary to the global view of the importance of preventing such an occurrence. • The proposed end of the transition relief will have a disadvantageous impact on small and medium practices and firms operating in regional locations and specialised industries. These audit practices are already experiencing difficulties in allocating the best resources to PIE audits, including those that require expertise in specialised industries. • The high level of direct involvement from the engagement partner and engagement quality control review (EQCR) partner is acknowledged as key drivers of audit quality. However, with the introduction of the revised long association provisions in Jurisdiction D in 2018, stakeholders have noticed an increase in EQCR partners' number in different geographical locations and offices from the engagement team. The concern is that firms may also need to have Engagement Partners in different geographical locations once the jurisdictional relief is removed. This is likely to make audits more challenging to conduct and could negatively impact audit quality.
PAO	All international audit standards, including all provisions of the IESBA Code, were adopted in Jurisdiction E through rules issued by the jurisdiction's professional accountant body. However, certain regulations which are applied to listed entities, insurance companies and financial institutions have allowed a cooling-off period of 3 (three) years. This shorter period should be viewed as the application of the paragraph R540.19 of the IESBA Code even though those regulations are in place prior of the IESBA Code provision... since there are other cooling-off periods provisions in certain types of entities which are also considered PIE, this differentiation might create some misleading for the Firms to monitor those periods. In addition, smaller audit firms will be more impacted by the reduced number of audit partners.
PAO	<p>There is no law or regulation relating to the cooling-off period of engagement partners in Jurisdiction F. However, there are sector specific legal requirements for rotation of firms among PIEs instead of the recommended cooling off period. For example, the relevant Acts for financial institutions and insurance companies, both stipulate a four-year rotational period for a firm performing audit services... given the fact that most PIEs apply a four-year firm rotational period, then there are no significant differences between the common practice and the requirements of Section 540. Financial institutions, insurance companies and listed entities apply a mandatory firm rotation every four years...</p> <p>There are ongoing discussions to consider an Engagement Partner cooling off period rather than a firm rotational period as the former seems to be preferred among the practitioners due to the fact that it ensures proper management of long associations with</p>

Stakeholder Group	Extract of Comments
	<p>a client but also adequate inflows for the firms. Therefore, the cooling off period is rather preferred.</p>
Firm	<p>The expiry of the jurisdictional provision is expected to impact the long-term rotation strategy in the smaller firms in our network. The challenges will most notably affect the parts of the audit practices where the pool of partners with the specialized industry expertise or the requisite jurisdictional license is limited, as the longer cooling-off period may result in reduced number of partners available to take on the roles of the engagement partner. In effect, to be able to ensure quality of audits of public interest entities in certain specialized/regulated sectors, a firm would need to expand the pool of partners with specific accreditations or industry expertise, which might not always be possible or practicable...</p> <p>In addition, the expiry of the jurisdictional provision might result in inconsistent approach to long association in jurisdictions where a shorter cooling-off period is established by legislative body or regulation, as is the case for example in the European Union. This might mean that in a particular jurisdiction, the Forum of Firms will follow the Code, but other audit firms might only follow the local standards and regulations. This may be particularly pronounced where joint audits are required and the firms follow different approaches while auditing the same PIE client. This inconsistency in the application of the standards within the same jurisdiction, or even with respect to the same entity, is not in the public interest and might create confusion and harm the public trust in the profession.</p>
Firm	<p>Some Member Firms within the Network have adopted a three year cooling-off period based on either local regulations or local professional standards. In addition, for example, the Member Firm in Jurisdiction G adopts the local legislation of three years on followed by three years off. Member Firms within Europe have adopted a policy in line with paragraph 7 of Article 17 of Regulation (EU) 537/2014 which includes a legal requirement that after seven years from the date of appointment, “they [key audit partners] shall not participate again in the statutory audit of the audited entity before three years have elapsed following that cessation”. This is applied directly, even if the local regulator has not formally adopted the jurisdictional clause.</p> <p>With the exception of small firms, which we comment on below, we do not generally foresee any particular issues or concerns with the expected end of the jurisdictional provision in the Code...</p> <p>A five year cooling off requirement will create challenges for smaller member firms (both in our Network and presumably others) which may have very limited number of partners, with signing rules unique to the jurisdiction. Even in slightly larger firms, partners with relevant industry expertise may be limited and therefore the challenge remains as they are likely to be key audit partners on their engagements. There are a number of jurisdictions with shorter cooling off periods and as such even when a particular firm is re-appointed after the mandatory rotation period, the partner with the relevant industry expertise may still be excluded from returning to the engagement due to the IESBA cooling off period.</p>

Stakeholder Group	Extract of Comments
Firm	<p>We have member firms in a small number of jurisdictions where, in order to comply with the local regulations that require two partner signatories and a max of three years on followed by one year cooling-off, they currently rotate the multiple partners on and off in increments of three years. This three-year cycle allows them to comply with the jurisdictional provision and meet local rotation requirements by moving between clients and keeping to the max three years on without further inefficiencies. The expiry of the transition provision in these jurisdictions will mean a further two years to be added to the cooling-off period, such that the partners will have inefficiencies in moving between clients to maximize the three years on. In addition, they will have six cumulative years on and eight cumulative years off. The use of a cumulative cooling-off period in these jurisdictions would allow the partners to serve six cumulative years on with six cumulative years of cooling-off.</p>