

**IESBA**

## **Strengthening Safeguards Against Familiarity Threats**

**Jörgen Holmquist  
Chair  
IESBA**

# Background

- Code recognises that long-standing audit relationships can create threats to, and undermine confidence in, the independence of the auditor
- Recent initiatives propose stronger safeguards:
  - EC Green Paper
  - PCAOB concept release
  - Various national proposals
- IESBA agreed to consider whether its requirements remain appropriate

# EC Green Paper

- Focus on independence
- Concern about auditor tenure
- Proposals:
  - Mandatory firm rotation after 6 years (9 years for joint audits); 4 year cooling-off period
  - Partner rotation every 7 years; 3 year cooling-off period
  - Would apply to PIEs

# PCAOB concept release

- Focuses on independence, objectivity and professional skepticism
- ‘Significant inherent risk’ in relationship between auditor and client
- MFR suggested as one possible response

# IESBA Code

- Long-standing audit relationships can create 2 types of threat:
  - Familiarity (100.12(d))
  - Self-interest (100.12(a))
- Addressed through audit partner rotation
- Other potential responses:
  - Mandatory audit firm rotation (MFR)
  - Mandatory firm re-tendering

# Code requirements: Partner rotation

“In respect of an audit of a PIE, an individual shall not be a key audit partner for more than seven years. After such time, the individual shall not be a member of the engagement team or be a key audit partner for the client for two years. During that period, the individual shall not participate in the audit of the entity, provide quality control for the engagement, consult with the engagement team or the client regarding technical or industry-specific issues, transactions or events or otherwise directly influence the outcome of the engagement.” (290.151)

# Code requirements: Partner rotation

- 2001 – maximum period of 7 years for lead engagement partner introduced for PIEs
- 2005 – extended to EQCR partner
- 2009 – extended to Key Audit Partners
- Appropriate at that time
- Now out of step?

# Some partner rotation requirements

	Term	Cooling-off period
IESBA code	7	2
Australia	5	2
Brazil	5	3
Canada	7	5
China	5	2
India	7	2
Japan	5	5
Russia	7	Not stated
United Kingdom	5	5
United States	5	5



# Partner rotation: issues

- Period on engagement team
- Cooling-off period
- Definitions of key audit partner and other terms
- Types of entity

# Mandatory firm rotation

- Limited practical experience
- Extensive academic literature
  - Little that directly examines the effect of MFR (see above)
  - Use of proxies such as restatements
- Little evidence available

# Arguments in favor of MFR

- Most effective means of strengthening “independence in appearance”
- No evidence that it has damaged audit quality
- New personnel would bring fresh eyes to the audit
- Regular re-tendering may reduce audit fees

# Arguments against MFR

- New firm's lack of client knowledge may increase risk of audit failure especially large complex entities
- Particular challenges for multi-jurisdictional companies
- May increase costs for both company and firm
- May lead to increased market concentration
- May increase difficulty of recruiting/retaining specialist audit staff
- May impinge on audit committee role

## Arguments in favor of mandatory tendering

- May reduce perception of familiarity threat
- Promotes judgments about balance of risk between familiarity and inexperience
- May stimulate competition and innovation

## Arguments against mandatory tendering

- May restrict auditor performance evaluation
- May lead to increased market concentration
- May increase costs for both firm and company
- Impact on audit quality?

# IESBA discussion

- Overarching objective of audit quality
- Complex issue
- Arguments finely balanced
- Need to understand partner rotation requirements and MFR experiences in jurisdictions
- Mandatory tendering introduced in UK
- Mandatory Comprehensive Review considered in Canada

## Tentative Conclusions of IESBA meeting

- Arguments on MFR and mandatory tendering are finely balanced
- Further research and monitor developments
- Review partner rotation provisions
- Project Proposal on partner rotation to be prepared for December IESBA