

Meeting: IESBA CAG

Meeting Location: New York, USA

Meeting Date: March 10, 2014

Agenda Item

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Long Association – Cover Note and Report-Back

Objectives of Agenda Item

1. To provide a report-back on comments received from CAG Representatives on this project at the October 2013 CAG Teleconference.
2. To obtain CAG Representatives' views on key matters arising from the research undertaken on the project, the Task Force's (TF's) proposals presented at the December 2013 IESBA meeting and the IESBA's responses thereto and the tentative views that the TF came to when it met in January 2014.

Project Status and Timeline

3. The IESBA approved the project proposal at its meeting in December 2012. At its June 2013 meeting, it received an update on the project, including the research being undertaken to gather stakeholder views on a number of matters being considered in the project.
4. At its September 2013 meeting, the IESBA considered the research findings and the TF's preliminary analysis of those findings and its proposals on the various matters under consideration.
5. At its 2013 October teleconference the CAG considered the proposals presented at the September 2013 IESBA meeting and the IESBA's response to those proposals.
6. At its December 2013 meeting, the IESBA considered the TF's revised proposals on the matters under consideration. The main issues considered were:
 - (a) Strengthening the general framework in the Code surrounding long association
 - (b) Communication with those charged with governance (TCWG) as it relates to partner rotation
 - (c) Time served on an audit before becoming a Key Audit Partner (KAP)
 - (d) Duration of the cooling-off period
 - (e) Permissible activities during cooling-off
7. In January 2014, the TF convened to consider the feedback from the Board and the CAG.

October 2013 CAG Discussion

8. Below are extracts from the draft minutes of the October 2013 CAG teleconference,¹ and an indication of how the project TF or IESBA has responded to date to CAG Representatives' comments:

Representatives' Comments	Task Force/IESBA Response
GENERAL COMMENTS	
Ms. de Beer expressed a view by email that the IESBA should bide its time before making any firm decision in the project to allow consideration to be given to developments, but still proactively considering appropriate revisions to the Code.	Point noted. The IESBA is actively considering developments in the environment and their implications for the project.
DEVELOPMENTS WITHIN THE ACCOUNTING PROFESSION	
Mr. Koktvedgaard briefly reported on recent developments in the European Union (EU), noting that the Council of Ministers had backed proposals to introduce a 10-year mandatory firm rotation for audits of public interest entities (PIEs). This limit could be extended to 15 or 20 years in certain circumstances, namely when there is tendering for audit or in the case of joint audits. The European Parliament's currently favored a mandatory 14-year firm rotation that could be increased to a 25-year maximum with tendering and joint audits.	Point noted.
Ms. Molyneux was of the view that the maximum periods that audit firms are able to provide audit services to clients appeared excessively long and out of line with the general principles of the Code. She was of the view that some guidance was needed in terms of what would be considered too long, for example, 25 years.	Point noted. Considerations pertaining to the length of audit firm tenure are outside the scope of this project.
RESEARCH	
Ms. Molyneux asked what percentage of the approximately 400 respondents to the research survey had come from the firms.	Ms. Orbea responded that among the respondents, 60% had indicated they were professional accountants (PAs) and 40% auditors but it would be difficult to single out firms as respondents were invited to check all categories of stakeholder groups (PAs, auditors, audit committee members, audit regulators, IFAC member bodies, etc.) that

¹ The minutes will be approved at the March 2014 IESBA CAG meeting.

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	applied to them. However, in terms of types of organization to which the respondents belong, or which they regulate or serve, the majority were small- and medium-sized entities.
Mr. Hansen asked whether the public interest had been reflected in the survey. He felt that the public interest is given insufficient consideration when Long Association requirements are being considered. He was of the view that firms and audit committees would tend to be resistant to change as this would not be in their interests. Accordingly, he felt that the question was how to weigh the survey responses. Mr. Morris agreed.	Ms. Orbea noted that the majority of survey respondents were likely providing responses from their perspectives and not necessarily from the public interest perspective. However, the TF had made an effort in the issues paper to separate out regulators' views and no significantly different perspectives had stood out in the population.
Mr. Koktvedgaard noted that he had asked Mr. Waldron and Ms. Molyneux to attend the call as representatives of the broader public interest and was pleased that Ms. Molyneux could make it. He added that responses from the investor community to the survey had been poor.	Ms. Orbea noted that while the majority of respondents belonged to the professional accountant category (60%), the categories to which respondents overall belonged were so broad and their responses so varied that it was difficult to point to any particular sway in one direction. She, however, agreed that investor representation in the survey responses was poor and that obtaining input from that constituency continued to prove a challenge for the Board.
GENERAL PRINCIPLES IN PARAGRAPHS 290.150	
Ms. Molyneux supported staying with general principles. She was of the view that these should cover everything that can be required. Then one could drill down into guidance. She therefore supported strengthening the general principles addressing long association. She added that she felt the Code could provide greater guidance around what could be considered a Long Association threat.	Support noted. The IESBA is considering enhanced guidance to strengthen the overall framework of principles addressing long association.
Mr. Morris expressed support for distinguishing between PIEs and non-PIEs as an overriding principle and that this should be the starting point. He was of the view that bright lines may not work as well around the world. He felt that the brighter the lines, the more difficult it would be to address	Support noted.

Representatives' Comments	Task Force/IESBA Response
every circumstance. So he preferred an approach with broad principles.	
Ms. Molyneux noted her expectation that standards serve the public interest and not the interests of the firms, and that the audit exists to serve investors. Accordingly, the principles need to be broad, hence her comment about considering individuals in the firm who are able to influence the audit outcome as opposed to specific types of engagement team members. Therefore, her concern was about robust principles regarding who can influence the audit.	Ms. Orbea acknowledged Ms. Molyneux's concerns, noting the TF's aim to establish a robust framework in paragraph 290.150 of the Code. This would then provide a foundation for considering more specific application of the broad principles relative to PIE/non-PIE requirements.
Ms. Lopez expressed her support for pursuing general principles.	Support noted.
Mr. Fukushima expressed his support for a review of the framework of principles addressing long association.	Support noted.
Ms. de Beer expressed a view by email that there was a need to clarify the self-interest threat and she did not believe that this should be deleted from paragraph 290.150.	Point accepted.
INVOLVEMENT OF THOSE CHARGED WITH GOVERNANCE	
Ms. Molyneux supported strengthening the role of TCWG in this regard and their relationship with the auditor, with greater communication between TCWG and the auditor should a long association threat arise. However, she believed that TCWG should not have a decision-making role in auditor rotation. She emphasized that she would be opposed to the auditor losing or reducing his or her accountability for independence.	Point noted. The Code already encourages the firm to communicate with TCWG regarding independence matters. In addition, the IESBA directed the TF to consider adding that the concurrence of TCWG should be obtained, in relation to the specific exception provisions in that part of the Code.
Mr. Hansen was of the view that the input of TCWG to the partner rotation decision is important, but they should not override the Code. He added that the Code has no jurisdiction over them.	Point accepted. The TF has added proposed language to require the concurrence of TCWG in relation to specific exception provisions.
Ms. Lopez was of the view that strengthening the relationship between the auditor and TCWG would	Point noted. See responses to Ms. Molyneux and Mr. Hansen above.

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assist in addressing long association concerns.	
ROTATION REQUIREMENTS THAT CURRENTLY APPLY WITH RESPECT TO PIEs	
<i>Who should be subject to rotation?</i>	
Mr. Fukushima was of the view that rotation provisions for non-partners should be considered.	Point not accepted. The IESBA has not supported implementing rotation requirements for non-partners. However the TF is proposing enhancing the general provisions within paragraph 290.150 of the Code to address the need to consider time served on an audit client prior to an individual (who could be a non-partner) becoming a KAP. Rotation is also an available safeguard in the general provisions.
Ms. Molyneux was of the view that there needed to be a move in emphasis away from the individual's job title or position in the firm to considering the length of the relationship between the individual and the audit client. She agreed, however, with the distinction between PIEs and non-PIEs. Mr. Hansen also agreed with this distinction.	Ms. Orbea noted that the principles would be applicable to managerial staff, especially those who would go on to become partners.
Ms. de Beer expressed a view by email that managers should also be subject to rotation and should a manager progress to become a partner on the same audit client, the years served as a manager on that client should be considered for mandatory partner rotation purposes. Ms. de Beer added that her own personal experience of a manager becoming a partner on an audit resulted in the audit becoming 'stale'.	Point taken into account. See response to Mr. Fukushima's comment.
<i>How long should the "Time On" period be?</i>	
Mr. Fukushima asked why the Task Force had felt that there was no compelling reason to change the "time on" period, given the research data indicated that five years was the most popular period. He was of the view that many stakeholders, including some IOSCO members, believe five years to be the most appropriate period. He felt that a shorter "time on" period would help bring fresh eyes to the audit and hence improve audit quality. He also asked	Ms. Orbea noted that while a five-year "time on" period was a popular option among a group of respondents, it was not the option of the majority and was only marginally more popular than six or seven years. She emphasized that when respondents indicated a preference for a particular "time on" period, the preference would likely be linked to the respondents' corresponding preference for the "cooling off" period, as the two

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<p>why no consideration was being given to having different "time on" periods for different categories of partners.</p>	<p>are not necessarily mutually exclusive.</p> <p>In addition, the research indicated that while there was a degree of support for separate rotation requirements for different categories of partners, this was not the view of the majority. Overall, given that the Code has to apply in an international context and that the scope of the provision is broader than just listed entities or lead audit partners, there was no strong view that five years was a better period than seven years. Accordingly, the Board had provisionally chosen to stay with seven years but in conjunction with a review of the "cooling off" period. However, the TF has been asked by the Board to also consider whether different "cooling off" periods should apply for different categories of partners.</p>
<p><i>Duration of "Cooling Off" period.</i></p>	
<p>Mr. Fukushima and Ms. Lopez were of the view that the two-year "cooling off" period was not sufficient and should be increased.</p>	<p>Point noted. The IESBA is considering alternative "cooling off" periods.</p>
<p>Mr. Hansen was of the view that the "cooling off" period should be the same as the "time on" period. He felt that if it had taken a certain amount of time for a familiarity concern to develop, it would take an equal amount of time for that concern to be dissipated.</p>	<p>Ms. Orbea noted that the Board had asked the Task Force to reconsider the length of the "cooling off" period.</p>
<p>Ms. Blomme was of the view that the Task Force's proposals were heading in the right direction. However, she felt it was unclear whether the Task Force was aiming for a longer "cooling off" period. She noted that among the EU Member States and the Parliament, there was consensus for a three-year "cooling off" period for partners and senior staff, and that there would be benefit if EU and IESBA positions on this could be harmonized.</p>	<p>Point taken into account. The TF proposed increasing the cooling-off period to three years at the December Board meeting, in conjunction with an increase in limitations on permissible activities during "cooling off". The Board was split about this and the option of having different "cooling off" periods for different roles.</p>
<p><i>Permissible activities During "Cooling Off"</i></p>	
<p>Mr. Hansen agreed with the Board in terms of taking a principles-based approach. With respect to</p>	<p>Point taken into account. See discussion of issue of permissible activities in Agenda Item D-1.</p>

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<p>permissible and non-permissible roles, he was of the view that once an individual is off the audit engagement, that individual should stay off. He felt that any role with the client that is of an ongoing nature should be banned. However, it would be appropriate to permit social interactions.</p>	
<p>Mr. Fukushima was of the view that permissible activities during cooling off should limit the contact that an individual has with the client and the audit engagement team.</p>	<p>Point accepted.</p>
<p>Ms. de Beer expressed a view by email that during "cooling off" the rotated individual should not have any interaction with the client. The individual could interact with the audit engagement team to explain decisions made in the prior year, but should not be influencing the audit outcome.</p>	<p>Point taken into account. See discussion of issue of permissible activities in Agenda Item D-1.</p>
EXCEPTIONS TO ROTATION REQUIREMENTS	
<p>Mr. Hansen was of the view that there should be no exceptions. He felt that whenever exceptions were provided, this tended to weaken the standards and encourage thinking about how to circumvent them.</p>	<p>Point not accepted. The IESBA believes that the limited exceptions in the Code are in the public interest. For example, an entity's transition to a PIE can be highly complex and last over a year. A two year extension would assist with an orderly change without adversely affecting audit quality.</p>
<p>Mr. Koktvedgaard observed that there are circumstances where exceptions can serve audit quality, citing a hypothetical example of a merger occurring at approximately the same time as the key audit partner is due to rotate off. An exception would allow that individual to remain on the audit engagement for a limited period and thus allow a continuation of knowledge and provide stability at a time of upheaval. He also noted that regulators can permit an exception.</p>	<p>Point taken into account.</p>
<p>Mr. Fukushima referred to IOSCO's comment letter on the January 2013 strategy survey and its concern over the two-year extension period currently available under paragraph 290.154. He was of the view that objectivity and independence</p>	<p>Ms. Orbea noted that the Task Force did consider whether a one-year transition would be more appropriate. However, at the September 2013 Board meeting, the overwhelming view of the Board was that two years may be necessary in</p>

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become even more important when an entity becomes a PIE. Accordingly, he was concerned about this exception.	circumstances and the provisions remained appropriate.
Ms. Molyneux recounted her experience of companies misstating financial statements with the assistance of auditors prior to listing, who then utilized the exception to continue on the audit engagement and also continue with the misstatement when the companies had become PIEs. She therefore supported stronger consideration that it should be the regulator's role to approve an extension.	Point taken into account. See response to Mr. Hansen's comment above.
Ms. Molyneux asked whether consideration had been given to providing a disclosure within the financial statements or at the AGM to explain to shareholders the rationale behind the granting of an extension.	Ms. Orbea noted that this had not been considered as it was beyond the remit of the project.
MANDATORY ROTATION REQUIREMENTS FOR NON-PIE AUDITS	
Ms. Molyneux, and Messrs. Fukushima, Hansen and Morris were of the view that there was no need to establish rotation requirements with respect to non-PIEs.	Point noted and agreed.

Matters for CAG Consideration

9. Representatives are asked for views on the matters raised in Agenda Item D-1.

Material Presented – CAG Papers

Agenda Item D-1 Long Association – Issues Paper

Agenda Item D-2 Long Association – Proposed Revised Provisions