

Draft Minutes of the Teleconference of the IESBA Consultative Advisory Group (CAG)

Held on October 10, 2013

Present: **Representatives of Member Organizations**

Kristian Koktvedgaard (Chair)	BusinessEurope
Hilde Blomme	Fédération des Experts Comptables Européens (FEE)
Anne Molyneux	International Corporate Governance Network (ICGN)
Seiya Fukushima	International Organization of Securities Commissions (IOSCO)
Gaylen Hansen	National Association of State Boards of Accountancy (NASBA)
David Morris	North American Financial Executives Institute
Irina Lopez	World Bank

Public Interest Oversight Board (PIOB)

Michael Hafeman	PIOB Member
-----------------	-------------

IESBA

Jörgen Homquist	IESBA Chair
Marisa Orbea	IESBA Member
Gary Hannaford	IESBA Member
Chishala Kateka	IESBA Member
Andrew Pinkney	IESBA Technical Advisor

IESBA Staff

Ken Siong	IESBA Technical Director
Chris Jackson	IESBA Technical Manager
Kaushal Gandhi	IESBA Technical Manager

<i>Regrets:</i> Conchita Manabat	Asian Financial Executives Institutes
Markus Franz Grund	Basel Committee on Banking Supervision
Matthew Waldron	CFA Institute
Dr Juan Maria Arteagoitia	European Commission (EC)
Frederico Diomeda	European Federation of Accountants and Auditors of SMEs

Draft Minutes of October 2013 IESBA CAG Teleconference
IESBA CAG Meeting (March 2014)

Marie Lang	European Federation of Accountants and Auditors for SMEs
Georges Couvois	European Federation of Financial Executives Institutes
Jean-Luc Peyret	European Federation of Financial Executives Institutes
Myles Thompson	FEE
Obaid Saif Hamad Al Zaabi	Gulf States Regulatory Authorities
Glenn Darinzo	Institute of Internal Auditors
Tom Finnell	International Association of Insurance Supervisors (IAIS)
Andrew Baigent	International Organisation of Supreme Audit Institutions (INTOSAI)
Nigel James	IOSCO
Martin Baumann	U.S. Public Company Accounting Oversight Board
Linda de Beer	World Federation of Exchanges

A. Opening Remarks

Mr. Koktvedgaard welcomed all participants, and in particular Mr. Hafeman, observing on behalf of the PIOB. He then outlined the background to the teleconference.

B. Long Association

Ms. Orbea outlined the background to the project and the research the Task Force had undertaken. She then summarized the key issues in the project and the related outcomes of the discussion at the September 2013 Board meeting.

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.

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.

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.

RESEARCH

Representatives commented as follows:

- 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 applied to them. However, in terms of types of organization to which the respondents belong, 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 Task Force 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 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 PARAGRAPH 290.150

Representatives commented as follows:

- 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. She also suggested that the focus should not be solely on the engagement team members but also on other personnel within the firm who can influence the audit.
- 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 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 Task Force'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. Mr. Fukushima expressed his support for a review of the framework of principles addressing long association.
- 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.

INVOLVEMENT OF TCWG

In response to an invitation from Mr. Hafeman for reactions to the issue of the role of TCWG with respect to long association, Representatives commented as follows:

- 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. 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.

- Ms. Lopez was of the view that strengthening the relationship between the auditor and TCWG would assist in addressing long association concerns.

ROTATION REQUIREMENTS THAT CURRENTLY APPLY WITH RESPECT TO PIEs

Who Should Be Subject To Rotation?

Representatives commented as follows:

- Mr. Fukushima was of the view that rotation provisions for non-partners should be considered.
- 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 were 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'.

How Long Should The "Time On" Period Be?

Representatives commented as follows:

- 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 why no consideration was being given to having different "time on" periods for different categories of partners. 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 consideration of the "cooling off" period in relation to the "time on" period is also needed as the two are not necessarily mutually exclusive. 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 chosen to stay with seven years but in conjunction with a review of the "cooling off" period.

Duration of “Cooling Off” Period

Representatives commented as follows:

- Mr. Fukushima and Ms. Lopez were of the view that the two-year “cooling off” period was not sufficient and should be increased.
- 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. Ms. Orbea noted that the Board had asked the Task Force to reconsider the length of the “cooling off” period.
- 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. Ms. Orbea noted that the Task Force would take this into account in further reflecting on the matter.

Permissible Activities During “Cooling Off” Period

Representatives commented as follows:

- Mr. Hansen agreed with the Board in terms of taking a principles-based approach. With respect to 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.
- 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.
- 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.

EXCEPTIONS TO ROTATION REQUIREMENTS

Representatives commented as follows:

- 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. 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.
- 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 become even more important when an entity becomes a PIE. Accordingly, he was concerned about this exception. 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 and that if all the audit partners on the engagement had to rotate off at the same time, this would be detrimental to audit quality.

- 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. Ms. Orbea noted that the Task Force would consider the matter further.
- 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

Representatives commented as follows:

- 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.

PIOB OBSERVER'S REMARKS

Mr. Hafeman noted that this was a useful call, with good input provided to the Task Force.

C. Closing Remarks

Ms. Orbea thanked the Representatives for their input and outlined the way forward on the project. Mr. Holmquist also took the opportunity to thank the Representatives on behalf of the IESBA.

Mr. Koktvedgaard thanked all the participants for their contributions. He then closed the meeting.