

**Long Association—September 2013 IESBA Issues Paper****I. Background**

1. In December 2012, the IESBA approved this project to consider whether the long association provisions in the *IESBA Code of Ethics for Professional Accountants* (the Code) as a whole remain appropriate, with a specific focus on the rotation requirements for key audit partners for audits of public interest entities (PIEs).
2. In considering the provisions that address the potential threats to independence created by using the same senior personnel on an audit engagement over a long period of time, the Task Force (TF) has obtained the views of stakeholders and interested parties on whether these provisions continue to provide robust and appropriate safeguards against potential familiarity or self-interest threats, or whether the provisions can and should be revised to help enhance the independence and skepticism of audit engagement personnel.
3. The issues of mandatory firm rotation and mandatory retendering, on which the IESBA agreed to keep a watching brief, are not included in the scope of the project.
4. In March 2013, the IESBA received an update on the TF's research plans and timeline.
5. In April 2013, the IESBA CAG considered the project and provided advice to the TF.
6. In June 2013, the IESBA received a further update detailing the feedback received from the surveys conducted.
7. In July 2013, the TF met in London to consider the findings of the research undertaken, to discuss the core issues and to develop initial recommendations to present to the IESBA at the September 2013 meeting. The TF's deliberations took place in the light of:
  - The goal to promote and enhance audit quality, promote objectivity and professional skepticism and address perceptions regarding related threats to independence.
  - The fact that the profession is potentially subject to structural change and that any changes to the Code in relation to partner rotation, before such outcomes are known, runs the risk of unintended and negative consequences.
  - Consideration of whether there is a convincing case for change, particularly lack of any evidence that the current provisions are not working effectively.

**II. Overview of Research Undertaken**

8. The TF used the following methods to obtain data on existing requirements in different jurisdictions and the views of stakeholders and interested parties:
  - Benchmarking survey: A survey was distributed to the member firms of two of the large professional services networks in order to collect information about the partner rotation provisions in various jurisdictions – 82 responses were collected.
  - Online survey: An online survey was developed to obtain views on partner rotation requirements. Over 400 responses were received including over 50 from individuals in "Those Charged with Governance" (TCWG) roles.

- Survey issued through Forum of Firms: The TF invited views of firms through the Forum of Firms. Responses were received from a total of 13 firms.
- Survey issued to national standard setters (NSS): The TF solicited the views of NSS representatives at the May 2013 NSS meeting. In addition, 18 responses to the online survey were received from NSS participants.
- Review of academic literature: A high level review of academic research into the topic of long association was performed by the TF. Five different research papers issued between 2005 and 2013 were reviewed. On the basis of the high level review, the TF drew the following conclusions:
  - Mixed results as to whether partner rotation affects audit quality.
  - Geographical and cultural differences may play a part in different outcomes of the studies.
  - None of the studies considered the “time on” and “cooling off” issues.

Given these conclusions the TF made limited amount of reference to academic research during its deliberations.

- IFAC Small and Medium Practices (SMP) Committee (SMPC): The TF invited views of SMPs through the SMPC.

9. It is recognized that the number of responses received from individual constituent groups (such as TCWG) is not large, but taken in totality the TF believes that the various forms of research are helpful and form a basis for the board's consideration of the issues. The TF has reviewed the research findings and included the relevant data and feedback in the appropriate sections of this report.

10. The key issues addressed in this paper are as follows:

- A. Comment on potential structural changes affecting the profession
- B. General principles in paragraph 290.150
  - Involvement of TCWG
- C. Rotation requirements that currently apply to PIEs
  - (a) Who should be subject to rotation?
    - (i) Lead Audit Engagement Partner
    - (ii) Quality Control Review Partner
    - (iii) Other partners assigned to the audit engagement
    - (iv) Managerial staff assigned to the audit engagement
    - (v) Junior staff assigned to the audit engagement
  - (b) How long should the “time on” period be?
  - (c) Duration of “cooling off” period
  - (d) Permissible activities during “cooling off” period
- D. Exceptions to rotation requirements
- E. Mandatory rotation requirements for non-PIE audits

### III. Key Issues

#### A. Comment on Potential Structural Changes Affecting the Profession

11. As the Board is aware, the landscape of auditor regulation is currently subject to widespread review which could lead to profound structural change of the profession. Decisions have recently been made on matters such as mandatory firm rotation and mandatory tendering, particularly in the European Union (as a result of the European Commission's October 2010 Green Paper *Audit Policy: Lessons from the Crisis* and the UK Financial Reporting Council considering updating its Corporate Governance Code), but also in the USA (the US House of Representatives voted in favor of a bill in July 2013 that would prohibit the Public Company Accounting Oversight Board (PCAOB) from requiring mandatory audit firm rotation for public companies) and Canada.
12. These areas are interrelated with the questions raised here and the TF believes that making changes to the Code in isolation, without knowing the outcome of these structural proposals, runs the risk of causing unintended and negative consequences (for example, how the length of required partner rotation would work with any mandatory firm rotation period in a particular jurisdiction). Long association and rotation considerations for senior personnel on an engagement team should, as they do currently, reinforce and work within the construct of other safeguards.

#### Matter for Consideration

1. Do IESBA members consider that the outcome of these jurisdictional reviews should be awaited before the Board comes to its final conclusions, particularly in relation to any proposed changes to required partner rotation periods for audits of PIEs?

#### B. General Principles in Paragraph 290.150

13. The TF first considered whether the general provisions and principles in extant paragraph 290.150<sup>1</sup> remain appropriate and sufficient as applicable to all audit clients. Specific consideration was given to

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<sup>1</sup> Paragraph 290.150 of the Code states the following:

Familiarity and self-interest threats are created by using the same senior personnel on an audit engagement over a long period of time. The significance of the threats will depend on factors such as:

- How long the individual has been a member of the audit team;
- The role of the individual on the audit team;
- The structure of the firm;
- The nature of the audit engagement;
- Whether the client's management team has changed; and
- Whether the nature or complexity of the client's accounting and reporting issues has changed.

The significance of the threats shall be evaluated and safeguards applied when necessary to eliminate the threats or reduce them to an acceptable level. Examples of such safeguards include:

- Rotating the senior personnel off the audit team;
- Having a professional accountant who was not a member of the audit team review the work of the senior personnel; or
- Regular independent internal or external quality reviews of the engagement.

the following:

- Should there be additional guidance for each of the factors that could influence the significance of the threat?
- Are there other factors that should be included?
- Is there support for continued reference to a “self-interest” threat arising from long association?
- Could the Code be enhanced by identifying other internal and external safeguards which reduce the threats or complement partner rotation?

#### *Overview of Research Findings*

14. While the clear majority of respondents believe that threats to independence are created by using the same senior personnel over a long period of time, there is also a strong view that the benefit to audit quality of having developed an extensive knowledge of the client’s business can outweigh the potentially adverse effects on audit quality of these threats. In addition, some respondents have highlighted that the significance of the threat very much depends on the role of the individual.
15. When discussing threats, a large number of respondents only mention familiarity threats, not self-interest threats.
16. Where a significant threat is created, rotation is considered an important safeguard by a majority of respondents. However, there is also recognition that there are other safeguards available to potentially reduce the threat to an acceptable level.

#### *TF Considerations*

17. The TF agreed that there will be a benefit to first consider whether the framework of the provision<sup>2</sup> in the Code as a whole is sufficient or could be improved upon to provide more guidance regarding the circumstances and relationships that create or may create threats to independence in respect of all audit clients, which could then be followed by more specific requirements.
18. Currently, the threats and safeguards guidance is contained in one paragraph (290.150) which is then followed by five paragraphs of more specific provisions related to PIEs.
19. On review of the survey feedback and through discussion, the TF agreed that the general provisions in paragraph 290.150 are unclear and insufficient in places and could be enhanced so as to establish a more robust framework around the evaluation of threats created by long association for all audit clients. For example:
  - 290.150 provides that self-interest threats (the threat that a financial or other interest will inappropriately influence the professional accountant’s judgment or behavior) are created by long association. However, it is unclear what factors arising specifically from long association create self-interest threats that are not already covered elsewhere in the Code. For example, paragraph 290.131 addresses a member of the audit team having a close relationship with a director or officer or an employee in a position to exert significant influence over the preparation of the client’s accounting records or the financial statements on which the firm will express an opinion.

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<sup>2</sup> Long Association of Senior Personnel (Including Partner Rotation) with an Audit Client, *General Provisions*, paragraph 290.150

Paragraphs 290.220-222 address the self-interest threat arising from fee dependency on an audit client and the concern about losing the client and paragraphs 290.228-229 address evaluation and compensation.

- By applying the guidance in 290.150 to the audit of an entity that is not a PIE, a professional accountant may still reach the conclusion that rotation is the only appropriate safeguard. Accordingly, if rotation is applied as a safeguard, then some of the guidance under the PIE requirements (such as the roles that an individual can undertake while “cooling off”) should equally apply (or at least be considered in relation) to all audit clients.
- Conversely, it could be clearer that the principles established in paragraph 290.150 should also be considered in conjunction with the PIE requirements. For example, the structure of the extant Code may imply it is acceptable to apply a seven-year rotation requirement for key audit partners (KAPs) serving PIEs, without reference to any other safeguards or factors during the seven-year period.

#### *TF Proposals*

20. The TF proposes revising paragraph 290.150 based on the following approach:

- (a) Plain English introductory sentence or paragraph describing the issue and threats:
  - Addressing familiarity threats with both the relationship (with the client and senior management) and the business and its financial information.
  - Deleting the mention of self-interest threat or clarifying what specific factors are giving rise to the self-interest threat.
  - Describing the impact on integrity, objectivity and professional skepticism.
  - Application of the guidance to audit clients that are PIEs and non-PIEs.
- (b) Guidance on the factors that should be considered when evaluating the significance of the potential threat:
  - Factors related to the individual:
    - Current role on audit engagement (ability to influence the audit, whether the individual is subject to supervision, whether they make key decisions, application to managers on an audit).
    - Prior roles and length of overall relationship with the client and “time on” the audit.
    - Relationship with management.
    - Nature, frequency and extent of the individual’s interaction with management or TCWG.
  - Factors related to the client:
    - The nature and complexity of accounting and reporting issues.
    - The nature of the business (which may impact complexity of audit risks).
    - Audit committee involvement in auditor selection.

- Whether management has changed recently (which may reduce or eliminate the closeness of the relationship between the auditor and client management).
- Structural changes in client organization.

(c) Examples of safeguards:

- Current safeguards for all audit clients include rotating the individual off the audit team, having a professional accountant who was not a member of the audit team review the work of the senior personnel or regular internal independent internal or external quality reviews of the engagement.
- Consider other safeguards, for example:
  - Changing the individual's role on the audit if the familiarity threat is with management
  - Consider safeguards related to the firm, for example:
    - Safeguards in the work environment, e.g., policy on external quality control reviews or pre-issuance reviews.
    - Quality controls and management systems, policies and training.
- External safeguards including:
  - Inspections by external regulators or professional bodies.
  - Oversight of independence by TCWG (note, however, that the TF does not recommend adding involvement of TCWG as a safeguard – see next section).

(d) If the safeguard applied is rotating the individual:

- What factors should be considered with respect to the roles the individual can play during the “cooling-off” period?
- What factors are taken into account with respect to how long they need to “cool off”?

21. Taking into account that rotation could also be a safeguard applied on audits of non-PIEs, the TF considered whether the structure of the section might be enhanced by moving some of the guidance applicable to PIEs, such as the discussion on the roles that an individual can (or should not) play during the “cooling-off” period, to the front of the section, with a cross reference back in the PIE requirements (e.g., along with the mandatory period applicable for PIEs).

**Matters for Consideration**

2. Do IESBA members agree with the TF proposals? In particular:
- That paragraph 290.150 be redrafted to strengthen the framework for thinking about long association and to provide more guidance on factors and safeguards.
  - That the reference to the self-interest threat be clarified or deleted.
  - Restructuring the section so as to move some of the guidance contained specifically for PIEs into the general framework (such as roles an individual can or cannot play during “cooling off”).
3. If so, do IESBA members believe there would be benefits to changes being made to paragraph 290.150

even if no other changes were made to the section?

#### INVOLVEMENT OF TCWG

22. The TF considered whether the involvement of TCWG in rotation decisions should be made a recommended safeguard and, if so, how and to what extent TCWG should be involved. In addition, the TF considered whether to propose that communication with TCWG be enhanced as relates to the rotation decision.

#### *Overview of Research Findings*

23. A total of 409 responses were received from the online survey. Ninety four of these responses were from TCWG, regulators, and NSS. Approximately half (55.3%) of the 409 respondents and exactly 50% (47) of the group representing TCWG, regulators and NSS agreed that TCWG should not be involved in the rotation decision. The comments received from those who believed TCWG should be involved in the rotation decision were not consistent, and referred to a variety of levels of involvement, from communication only, to agreement on extensions or exceptions only, to being fully responsible for the rotation decision.
24. With respect to the involvement of TCWG in the rotation decision, a total of 47 comments were received from TCWG, regulators, and NSS. The more focused comments are summarized below:
- Six believe that a rotation decision should be that of the auditor alone.
  - Seven believe that TCWG should be consulted or be party to a discussion over rotation requirements.
  - Six believe that TCWG should either decide when a rotation occurs or have a right of veto over a rotation initiated by the auditor.
  - Four believe TCWG are responsible for ensuring a rotation takes place.
  - One believes that TCWG should be informed of any rotation decisions, but not be involved.
  - One believes that TCWG should be only involved in relation to an extension being considered.
25. The SMPC was similarly asked whether TCWG should be involved in the rotation decision and, if so, how and to what extent. The SMPC indicated that it does not believe TCWG should be involved in the rotation decision as it believes that the relationship between the audit partner and TCWG may contribute towards the risk of familiarity and TCWG are unlikely to voluntarily propose and/or reject rotation.
26. A total of 12 responses were received on this question from the 13 firms that are members of the Forum of Firms. Most did not support TCWG having a decision-making role with respect to rotation decisions. Two indicated there should be no involvement; three believe TCWG should be briefed and allowed to comment, but should otherwise not be involved; three believe they should be involved as related to exceptions only; two believe they should be involved in rotation decisions to an extent; and two indicated that TCWG should also be subject to rotation requirements.

### *TF Considerations*

27. The TF considered the responses and agreed with the views of the majority of respondents that TCWG should not have a decision-making role in relation to the rotation decision. The TF is of the view that since TCWG generally have the option to change the auditor or retender the audit engagement, there could be no additional benefit in considering the involvement of TCWG as a safeguard. The TF agreed that it is the responsibility of the auditor to decide on rotation decisions (in compliance with external requirements) in order to maintain independence.
28. The TF then considered the circumstances where discussion related to rotation requirements might take place between the auditor and TCWG, and the extent to which TCWG might be involved in providing input into the rotation considerations.
29. The TF considered whether auditors should be encouraged to seek greater involvement from TCWG when evaluating the independence of the lead audit engagement partner (LAEP) and other KAPs. The TF further considered whether TCWG should be consulted, potentially even having to provide approval, when exceptions to rotation requirements are sought.
30. Paragraph 290.28 of the Code currently encourages regular communication between the auditor and TCWG with respect to any matters that might, in the firm's opinion, reasonably bear on independence and cites discussing threats and safeguards with TCWG. The TF considered whether the Code could provide guidance on how to enhance transparency between auditors and TCWG threats and safeguards relating to independence and encourage auditors to seek greater involvement from TCWG in the process of evaluating the independence of the LAEP and KAPs.
31. The TF is of the view that while it is acceptable for TCWG to be consulted and informed about rotation decisions, an excessive involvement could raise doubts over the independence of the auditor. While input from TCWG should be considered in the rotation decision, and TCWG should certainly be kept informed, any increased involvement by TCWG in the rotation decision would also increase the familiarity threats to independence.

### *TF Proposals*

32. The TF proposes that involvement of TCWG in the rotation decision should not be included in the Code as a safeguard. The TF acknowledges that in practice, TCWG will be advised of the rotation requirements, how the requirement is to be applied, and who the proposed individual is. Also, clearly, TCWG may have a view on the proposed individual (recognizing that the ultimate decision must be with the firm).

<b>Matter for Consideration</b>
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| <ol style="list-style-type: none"><li>4. Do IESBA members agree with the TF proposals?</li></ol> |
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### **C. Rotation Requirements that Currently Apply to PIEs**

#### **(A) WHO SHOULD BE SUBJECT TO ROTATION?**

33. A clear majority of all respondents to the online survey (75.7%) consider that the role, or seniority an individual has on an audit team, impacts the significance of the threats to independence that may arise over a period of time.



34. The TF considered which audit engagement team members should be subject to the rotation requirements as relates to PIE audit clients. Consideration was given to various categories of engagement team members, as set out below:

*i) Lead Audit Engagement Partner*

Overview of Research Findings

35. The findings from the online survey indicated that the vast majority of respondents agreed that the LAEP should be subject to rotation requirements. Responses indicating a preference for rotation were:
- All participants 80%
  - NSS 100%
  - TCWG 100%
  - Regulators 97%
36. All 13 firms surveyed indicated that they believe the LAEP should be subject to rotation as did the SMPC.

TF Considerations

37. Given the research findings, the TF concluded that the LAEP on audits of PIEs should be subject to rotation requirements. This approach recognizes that the LAEP is responsible for the outcome of the audit. The TF recognizes that the familiarity threat is generally greatest in relation to the LAEP as this individual is responsible for the significant judgments made with respect to the audit and has the closest relationship with management.

TF Proposals

38. The TF does not propose any change to the requirement in the Code that the LAEP on audit of PIEs be subject to rotation.

*ii) Quality Control Review (QCR) Partner*

Overview of Research Findings

39. The findings from the online survey indicate that the vast majority of respondents also agreed that the QCR partner should be subject to rotation requirements, though less than with respect to rotation for the LAEP. Responses indicating a preference for rotation were:
- All participants 62%
  - NSS 85%
  - TCWG 80%
  - Regulators 79%
40. All but one of the firms surveyed indicated that the QCR partner should be subject to rotation. The SMPC also indicated that the QCR partner should be subject to rotation.

## TF Considerations

41. Given the research findings, the TF concluded that the QCR partner on audits of PIEs should be subject to rotation requirements. The QCR partner plays a significant role on the audit given that he or she is required to evaluate the significant judgments made by the audit team and the conclusions supporting the audit report.

## TF Proposals

42. The TF does not propose any change to the requirement in the Code that the QCR partner on audits of PIEs be subject to rotation.

### *iii) Other Partners Assigned to the Audit Engagement*

43. The TF considered whether a partner assigned to the audit engagement who is not the LAEP or QCR partner should be subject to rotation requirements. KAPs for audits of PIEs are currently subject to rotation requirements under the Code.

44. The Code defines a KAP as:

The engagement partner, the individual responsible for the engagement quality control review, and other audit partners, if any, on the engagement team who make key decisions or judgments on significant matters with respect to the audit of the financial statements on which the firm will express an opinion. Depending upon the circumstances and the role of the individuals on the audit, “other audit partners” may include, for example, audit partners responsible for significant subsidiaries or divisions.

45. Other partners who are not KAPs are subject to the general principles of paragraph 290.150 and the specific safeguards that may apply to “other partners” serving on audits of PIEs are currently provided in 290.153.

## Overview of Research Findings

46. The online survey asked if “other partners” (besides the LAEP and QCR partners) should be subject to rotation. The breakdown of survey respondents who believe that some category of “other partner” should be subject to rotation requirements is as follows:

- All respondents: 31%
- NSS: 70%
- TCWG: 50%
- Regulators: 55%

47. Individual respondents who believe certain “other partners” should be subject to rotation provided a wide range of examples of individuals that they believe should be covered:

- All audit partners
- Only KAPs
- Specialist partners, such as valuation, tax and IT partners
- Former engagement partner of the client

- Significant or material component auditors
  - Partners who have provided decisive services
  - Partners who have direct supervision, managerial or assessment responsibilities
  - Relationship or client service partners
48. There was no unanimous view from the online survey responses and there was no majority view that all “other partners” involved in an audit engagement should be subject to mandatory rotation. In fact, 70% of all respondents believe rotation requirements should not apply to any other partners (besides the LAEP and the QCR partner).
49. Firms and the SMPC were asked whether “other partners” should be subject to rotation and, if so, which other partners.
50. The SMPC is of the view that only if an “other partner” is classified as a KAP should he or she be subject to rotation requirements.
51. Three firms surveyed indicated that “other partners” should not be subject to rotation requirements.
52. One of the firms indicated that the definition of a KAP is sufficient and “other partners” not classified as a KAP should not be subject to rotation. This firm identified “numerous highly effective safeguards” which manage the long association threat. These include: supervision by more senior personnel; key decisions are the ultimate responsibility of the LAEP; internal engagement quality review; natural staff turnover; audit committee oversight; a changing business environment; and inspections by external regulators.
53. The remaining nine firms indicated that “other partners” should be subject to rotation. However, on review of the comments provided by these firms as to which “other partners” should be subject to rotation, it is apparent that each firm has a different interpretation of “other partner”. Overall, however, the types of characteristics noted appeared consistent with the current definition of a KAP (partners able to influence the audit opinion and, depending on their role and influence, partners on significant subsidiaries and second partners leading sections of the main audit).
54. The firms that responded to the forum of firms’ survey noted that partners are typically required to build up specialist industry knowledge or subject matter expertise, which is achieved through dealing with client issues in those specific areas over time. The pool of partners that can fill specialist roles and/or roles on clients in complex or highly specialized industries (that often pose the highest risk) is typically small, especially in smaller firms. Being further restricted from using the most appropriate partner in a particular industry or field is considered by firms that responded to the forum of firms’ survey to be a substantial threat to audit quality.
55. The firms that responded thus generally indicated that extending the scope of those subject to mandatory rotation or tightening the rotation requirements relating to KAPs increases the risk of a reduction in audit quality.

#### TF Considerations

56. The TF noted that there is a wide range of possible alternatives as to who should be included in the term “other partners.” The TF considered that “other partners” could include, in particular, partners on material subsidiaries and specialist partners (e.g., actuaries in insurance) on whom KAPs may place

reliance.

57. The TF considered all the research findings and concluded that the significance of the partner's role in the performance of the audit is the main consideration to take into account when deciding whether the threat created by the partners' long association with the audit client is so significant that rotation should be required. The TF therefore discussed whether the application of the rotation requirements to KAPs only remained appropriate.
58. The TF notes that the term KAP is used in other parts of the code (such as in relation to "cooling off" before joining an audit client).
59. Judgment is required in assessing who is a KAP in relation to the audit of a PIE. This depends on analyzing many potential factors, including the individual's role and whether an individual can make key decisions or judgments on significant matters with respect to the audit of the financial statements on which the firm will express an opinion.
60. The TF believes, and this is supported by the research findings, that other partners should continue to be required to rotate where they meet the definition of a KAP. The TF considers, however, that the long association with a client of a partner other than a KAP would not create threats to independence of such significance that this individual should be subject to a required rotation.

#### TF Proposals

61. Given the above considerations, the TF does not propose any change to the requirement that the KAP partner on audits of PIEs be subject to rotation requirements.
62. In addition, the TF does not propose extending the rotation requirements to "other partners" who do not meet the definition of a KAP.

#### Matter for Consideration

5. Do IESBA members agree with the TF's proposals with respect to the category of partners on audits of PIEs that should be subject to rotation requirements?

#### iv) Managerial Staff Assigned to the Audit Engagement

63. The TF then considered whether the rotation requirements should apply to managerial staff and, if so, who and based on what criteria (e.g., "growing up on the job").

#### Overview of Research Findings

64. Survey responses indicate that overall, respondents were more supportive of rotation requirements for managers than for partners other than the LAEP and QCR partners.
65. The findings from the online survey indicating a preference for rotation for "other partners" and managers were:

	"Other partners"	Managers
• All participants	31%	51%
• NSS	70%	55%

- TCWG 50% 70%
- Regulators 55% 70%

66. The responses from the benchmark survey indicated that nine of the 82 jurisdictions that provided responses had rotation periods in place for individuals not classified as partners (either managers or the whole audit engagement team). The requirement for managers to rotate in respect of three of these nine jurisdictions applies only in respect of the audits of banks or government entities.
67. Six of the 13 firms surveyed indicated that managers should be subject to rotation; one firm stated that the ability of the manager to influence the outcome of the audit is key to any rotation requirements. Five firms did not believe the manager should be subject to rotation, though several of these commented that they should still be subject to the general evaluation of threats taking into account their role and ability to influence the outcome of the audit engagement. One firm did not provide an opinion. The SMPC also indicated that managers should not be subject to rotation.
68. It was clear from the comments received from respondents who considered that managers should be subject to rotation that there were varying views regarding the “type” of manager that they thought should be subject to a required rotation – for example, the lead audit manager, senior managerial staff and managerial staff with close relationships with the client.
69. Comments from those who did not support rotation requirements for managers emphasized that:
- Continuity at a manager level is important for audit quality;
  - Decisions and work are reviewed by the partner so the threats are not significant;
  - Managers are more likely to rotate naturally; and
  - The decision depends on various factors such as their role and the effectiveness of other safeguards.
70. The survey asked which rotation period would be suitable for managers (options offered were: no rotation period, three, four, five, six, seven years or “other”). The single most favored option from those who responded to this question was ‘no rotation’, with results showing 28% of all responses choosing no rotation, 47% choosing three, four or five years, and 25% choosing six years or more, or “other.”
71. 24.7% of respondents from TCWG, regulators, and NSS chose no rotation; 40.7% chose three, four or five-year; and 34.6% chose six years or more or “other.”

#### TF Considerations

##### A. Rotation Requirements for Managers

72. In addressing the question as to whether the rotation requirements should apply to members of the audit engagement team at a managerial level, and in light of the research results, the TF considered there are three distinct types of managers, as follows.
- a. Career managers
73. Such managers tend to stay on one or more audit engagements for a long period of time, with little expectation of becoming a partner.

74. The TF is of the view that it is unlikely that the individual is making significant judgments on the audit and provided adequate safeguards (e.g., supervision) are in place, the familiarity threat caused by long association for career managers should be reduced to an acceptable level. The application of the proposed threats and safeguards approach in the proposed 290.150 could still lead to the conclusion that rotation is an appropriate safeguard depending on their role; however, it should not be considered necessary as a requirement.
- b. A manager acting as a partner
75. The TF is of the view that if the manager is performing a role that meets the definition of a KAP (such as taking lead responsibility for the audit and/or signing the audit report), then the current rotation requirements would be applicable to them in the same manner that they would be applicable to a KAP. It is noted that five jurisdictions in the benchmark survey indicated they have specific rules that acknowledge that those subject to rotation include any auditor signing the audit report, even if they are not a partner.
- c. Managers becoming audit partner on the same client
76. The TF considered the numerous issues relating to this situation and particular consideration was given to whether there might be certain situations where 'the clock' should start prior to the manager becoming a KAP. 53% of all respondents to the online survey did not consider that the length of time an individual has been a member of an audit team prior to becoming a partner could create threats such that rotation might be appropriate at an earlier stage or that time served prior to becoming a partner should count towards the period after which rotation is required.
77. The comments received from the firms on this question were extremely varied: six firms did not consider any additional requirements in this respect while five firms suggested that consideration should be given to a maximum period of continuous service, such as ten years.
78. The TF believes that the ability to influence significant decisions made with respect to the audit engagement is more important than the individual's job title. The audit firm, individual in question and that individual's supervisor(s) should apply professional judgment in deciding when a manager becomes able to exert significant influence on the outcome of an audit. The TF concluded that consideration should still be given to safeguards in place (namely the degree of supervision to which the manager is subject) when an assessment is made regarding the ability to influence the outcome of the audit.
- B. "Cooling off" for Managers
79. In addition to considering the various types of managers, the TF considered the possibility of introducing a "cooling off" period for managers before they become partners on the same audit engagement.
80. However, the TF is of the view that a "cooling off" period prior to being promoted to partner would be unfeasible as stepping away from an audit while a manager and returning as a partner several years later could adversely affect audit quality. While a staff member who remains on the client for several years may create an increased familiarity threat that may impact his or her professional skepticism, this must be balanced against the increased knowledge of the client's business gained, which can improve audit quality and also the individual's career development opportunities, and the availability of other

safeguards.

#### TF Proposals

##### A. Rotation Requirements for Managers

81. The TF considered the comments received from the surveys and the principles in the Code, and concluded that the influence an individual can exert on the outcome of an audit is more important than his or her job title when rotation requirements are being considered. Requiring rotation for all managers could be an arbitrary safeguard without considering the wide range of roles that can exist, nor whether they are in a role that can in fact influence the outcome of the audit.
82. The TF nevertheless acknowledges that a manager will always, to some extent, be able to influence an audit. However, given the need to consider many different facts and circumstances the TF does not believe that it would be appropriate to require all managers serving on audits of PIEs to be required to rotate after a specified period. The significance of any familiarity threat should be evaluated and then a conclusion should be reached on whether rotation would be an appropriate safeguard. This could be addressed in a revised paragraph 290.150.

##### B. “Cooling off” for Managers

83. The TF is of the view that the Code should not be amended to require a “cooling off” period before a manager becomes a partner on the same client.
84. However, the TF was unable to reach a conclusion or recommendation on whether the amount of time a manager has served a PIE audit client prior to becoming a KAP should be taken into account in some way with respect to the total length of time the individual should be able to then serve as a KAP.

#### **Matters for Consideration**

6. Do IESBA members agree with the TF’s proposals that rotation should not be required for managers on the audit of PIEs?
7. Do IESBA members believe the Code should be amended to clarify that a manager who meets the definition of a KAP, for example, because he or she signs the audit report, should be subject to rotation?
8. In the circumstances where a manager becomes a KAP with responsibility for the audit of a PIE, do IESBA members believe the “clock” should start early or should the individual’s total length of “time on” be shortened?

#### v) *Junior Staff Assigned to the Audit Engagement*

##### Overview of Research Findings

85. 84% of all respondents to the online survey were of the view that there is no need to rotate junior staff assigned to an audit engagement.
86. According to the benchmarking survey, only four jurisdictions have some sort of rotation requirement that applies to junior staff for listed companies or PIEs. Five others have requirements for junior staff to rotate for certain bank or government audits only.

87. Similarly, only one of the 13 firms surveyed believes junior staff should be subject to rotation requirements. The SMPC indicated that it does not believe junior staff should be subject to rotation.

#### TF Considerations

88. The TF agreed with the survey responses that there is no need for rotation requirements to be applied to junior staff. The TF is of the view that junior staff are unlikely to be able to influence the outcome of an audit or have the type of contact or relationship with client management that could give rise to significant familiarity threats that would require rotation in all circumstances and that other safeguards are effective.

#### TF Proposals

89. Given the research findings, the TF concluded that junior staff on audits of PIEs should not be subject to rotation requirements. The application of the threats and safeguards approach could nevertheless still result in a decision that rotation of the individual is required. However, it should not be mandatory for all junior staff regardless of an analysis of the facts.

#### **Matter for Consideration**

9. Do IESBA members agree with the TF's proposal?

#### (B) HOW LONG SHOULD THE "TIME ON" PERIOD BE?

90. The TF considered whether the length of time during which an individual could be a KAP on the audit of a PIE should be shortened to less than the current seven years. This was amid some concerns raised in the regulatory community that the current requirement, coupled with a "cooling off" period of two years, permits an individual to be in a KAP role for 14 out of 16 years.

#### *Overview of Research Findings*

91. Survey participants were asked which "time on" period they thought could be suitable (options offered were no rotation period, three, four, five, six or seven years) for several levels of engagement staff (LAEP, QCR partner, other partners and managerial staff). Results were split to show:
1. Responses from all participants.
  2. Responses from TCWG, regulators, and NSS only.
92. As relates to LAEP and QCR partners, results from all participants and TCWG, regulators, and NSS were approximately the same, with both groups indicating that five years was the most popular, though not the majority, of the rotation periods selected (approx. 35% in favor of a five-year rotation period for LAEPs and approx. 26% for QCR partners). 32% of all respondents selected six or seven years or "other" for LAEPs and 31.7% for QCR partners.
93. For other partners (including other KAPs), five years was the most favored single rotation period selected by TCWG, regulators, and NSS (approx. 26%); however, a total of 39.3% selected either six or seven years or "other". Approximately 28% of all respondents selected no rotation period followed by 21% who selected five years and a total of 30.6% who selected six or seven years or "other".



94. A total of 82 responses were reviewed with respect to the Benchmarking survey. Analysis of the largest 28 jurisdictions (from the total of 82) showed that 12 currently have five-year mandatory rotation periods for LAEPs for audits of listed companies imposed by local regulators. Of these 12 jurisdictions, seven also have five-year mandatory rotation periods for LAEPs for all PIE audits.
95. Analysis of the remaining 54 jurisdictions (i.e., the total of 82 jurisdictions less the 28 largest jurisdictions) showed that 17 currently have stricter mandatory rotation periods for LAEPs for listed companies implemented by local regulators. Of these 17 jurisdictions, 10 also have five-year mandatory rotation periods for LAEPs for all PIE audits.
96. So in total, out of 82 jurisdictions, 39 currently have stricter mandatory rotation periods specifically for LAEPs for listed companies as implemented by local regulators. Of these 39 jurisdictions, 17 also have five-year mandatory rotation periods for LAEPs for all PIE audits.
97. Given current requirements differ from the Code in various jurisdictions, the TF considered also that respondents to the online survey may be indicating a preference for the requirement that exists in their jurisdiction rather than expressing an opinion on what they believe to be an ideal rotation period.
98. Responses from the NSS noted that there is no empirical evidence to suggest that either five or seven years are preferable as the “on period.”
99. Further, the SMPC indicated that QCR partners and “other partners” could be subject to longer “time on” periods, for example ten years for QCR partners and 14 for other partners, in order to reflect the lower long association risks associated with these partners compared with LAEPs and also to ensure some continuity of key personnel.
100. From the firm survey, six of the 13 firms believe seven years continues to be a suitable rotation period, as did the SMPC. Three believe five years would be a suitable rotation period for LAEPs, one firm believes it should be up to the firm to decide, and two firms did not respond. One firm indicated that if change was deemed necessary then any changes should be focused only on the LAEP.

#### *TF Considerations*

101. The TF considered the need to strike the right balance between addressing the familiarity threats created by long association and the need to maintain continuity and audit quality. In considering whether the “time on” period should be shortened from the current seven years, the TF considered that more time spent on an audit helps improve knowledge of the client and hence audit quality. Conversely, an increase in familiarity may lead, or be perceived to lead, to a decrease in objectivity and skepticism which could negatively affect audit quality.
102. The TF considered the following reasons to reduce the “time on” period:
  - Five years as an “on period” is the most favored rotation period, as indicated from the survey (albeit a minority view).
  - A number of larger jurisdictions have a five-year mandatory rotation period for the LAEP and QCR with respect to listed companies imposed by relevant regulators.
  - Shortening the “time on” period would address perception concerns expressed with the current requirement.

- A view was expressed at the April 2013 CAG meeting that a five-years-on period could be better for careers than seven as partners would be able to spend a longer part of their careers on PIE audits. It was noted that in the UK, auditors tend to be in their early 40s before they are assigned a listed audit. They may only have time to be involved in two or three major audits. If they get to 53 or 54 and have to consider whether to do one more audit, they may agree to a five-year period but may be reluctant or unable to complete a full seven-year period.

103. Similarly, the TF considered the following reasons not to change the “time on” period:

- Survey results indicate there is no dominating preference for any one rotation period.
- Rotation periods that currently exist as determined from the benchmarking survey vary from jurisdiction to jurisdiction (but that the majority apply a seven-year rule in line with the Code).
- The IESBA previously reviewed the length of the “time on” period in 2009. Nothing has transpired since to indicate that a change in the “time on” period is necessary.
- There is no evidence that the current requirement is not working – indeed the current requirements have only been in effect from early 2011 and are yet to be implemented in terms of a rotation cycle (and which firms will be currently planning for).
- A “time on” period of five years for all KAPs on all PIE audits may be too short given the “learning curve” and the need for the continuity and knowledge of the client needed to support audit quality.
- A few regulators have recently increased rotation periods from five to seven years. Notably the UK regulator increased the rotation periods of QCR partners from five years to seven years and kept the rotation periods at seven years for other KAPs. It also has a rotation period of five years for the LAEP, with a possibility to extend by up to two years if TCWG believe it would improve audit quality. Australian legislation was amended to enable TCWG to approve an extension of the five-year length of service by up to two years for both the LAEP and QCR partners. The Canadian standard setter has also increased its “time on” period from five to seven years, though maintaining a “cooling off” period of five years.
- A change could have detrimental impacts on the careers of partners in firms. The increase in frequency of rotation is accompanied by an increase in logistical costs and risks, such as relocation and redeployment costs. These could affect the individual on a professional and personal level.

104. The TF believes there is an argument for a longer “time on” period for certain types of PIE audit, as this would allow for an opportunity to better learn about the client’s business, which would enhance audit quality.

105. However, there was an equally strong argument for a shorter “time on” period for the same PIE audit, as bringing in a fresh pair of eyes more frequently may arguably enhance audit quality.

#### *TF Proposals*

106. The TF has considered the research, current requirements and the variety of views it has received on the topic. The TF believes the current provisions, which apply to all PIE audits and all KAPs, continue to strike the right balance between addressing the familiarity threats and maintaining a level of continuity, experience and knowledge that is fundamental to audit quality. The TF has not seen any evidence to suggest a change is needed to improve independence and audit quality and in fact, the diversity of

opinion, jurisdictional requirements, types of entities and facts and circumstances relating to individual audits make it arbitrary to decide on a broad restriction of the period of service to deal solely with potential perception issues.

107. Therefore, taking into account the results of the surveys and other data and the pros/cons outlined above, the TF does not propose any changes to shorten the maximum seven-year period in which KAPs can serve prior to being required to rotate off the audit engagement.

#### **Matters for Consideration**

10. IESBA members are asked for views as to whether they agree with the TF's recommendation or whether there are sufficient arguments to consider a shortening of the seven-year "time on" period.
11. If the latter, IESBA members are asked for views on alternative "time on" periods.

#### **(C) DURATION OF "COOLING OFF" PERIOD**

108. The Code requires that "[i]n respect of an audit of a PIE, an individual shall not be a KAP for more than seven years. After such time, the individual shall not be a member of the engagement team or be a KAP for the client for two years."
109. The TF considered whether a "cooling off" period of more than two years for KAPs would strengthen auditor independence. In looking at this, the TF recognized that if the seven-year "time on" period is maintained then a two-year "cooling off" period means a KAP could serve on the audit engagement for 14 out of 16 years, which could give rise to a heightened threat to independence in appearance. The TF believes that this perception is the main reason for considering an increase in the "cooling off" period but that any consideration of a change needs to be weighed against the arguments against a longer period.
110. The TF considered the question regarding an appropriate "cooling off" period in the context of its proposal that the "time on" period not be shortened and that rotation should continue to only be required with respect to KAPs on PIE audits.

#### *Overview of Research Findings*

111. Some relevant findings from the benchmarking survey are summarized below.
- Of the total benchmarking population of 82 jurisdictions reviewed, 72 have a two-year "cooling off" period for the LAEP on listed companies, either because they follow the Code provisions, or because of local laws or standards. Twenty one of these jurisdictions have a two-year "cooling off" period for the LAEP in conjunction with either a stricter five- or six-year "time on" period. Five jurisdictions have a five-year "cooling off" period in conjunction with either a five- or seven-year "time on" period. Four jurisdictions have a three-year "cooling off" period in conjunction with three-, four-, five- and seven-year "time on" periods. Only five jurisdictions have stricter "cooling off" periods for QCR partners on listed companies.
  - 78 jurisdictions have a two-year "cooling off" period with respect to LAEPs serving other public interest entities; however, 13 of these jurisdictions have a two-year "cooling off" period in conjunction with a stricter five- or six-year "time on" period. Four jurisdictions have a one- or three-year "cooling off" period in conjunction with three-, four- or five-year "time on" periods. With

respect to QCR partners serving other PIEs, four jurisdictions have a two-year “cooling off” period in conjunction with a five-year “time on” period, and two have a three-year “cooling off” period in conjunction with a five- or six-year “time on” period.

112. The online survey responses from all respondents informed that either two or three years are the most supported “cooling off” periods for LAEPs and QCR partners, with 57.3% favoring two or three years for LAEPs and 60% favoring two or three years for QCR partners.
113. Similarly, on review of the online survey responses specifically from TCWG, regulators and NSS, two or three years were again the most supported “cooling off” periods for LAEPs and QCR partners, with 56.5% favoring two or three years for LAEPs and 58.2% favoring two or three years for QCR partners.
114. When considering all respondents, 29.0% favor a two-year rotation period for the LAEP and 32.4% favor a two-year rotation period for the QCR partner.
115. From the 13 responses from the firms, six firms supported a two-year “cooling off”, as did the SMP. Two firms thought it should be longer than two or three, and three firms supported a four-year or five-year “cooling off” period. Two did not indicate a preference.
116. The TF noted that the on and off periods are inter-related and hence any desire for two years as an off period could be linked to a preference for an “on period” of less than seven years. Overall, however, survey responses did not demonstrate any predominant desire for change.

#### *TF Considerations*

117. The TF considered the concern about perception and recognized that if a KAP did not return to the audit after two years then an increase in the “cooling off” period would actually add limited value. For the purpose of its discussions, the TF therefore assumed the KAP would return immediately after the two-year “cooling off” period when considering whether there would be a benefit to increasing the two-year “cooling off” period.
118. The TF considered the arguments for and against an increase in the two-year “cooling off” period. In addition to addressing the perception concern from serving 14 out of 16 years, the TF considered the following arguments in favor of an increase in the “cooling off” period:
  - A two-year “cooling off” period, when phasing-out and phasing-in periods are considered, may only essentially amount to one full fiscal year away from the audit engagement. A longer period would ensure that the KAP is away from the audit for at least two years.
  - The TF also considered whether a longer “cooling off” period could be considered specifically for the LAEP. The familiarity threat and perception concern over serving 14 out of 16 years on an engagement is greater for a LAEP than other engagement staff, and hence the TF considered whether a longer “cooling off” period could be appropriate only for LAEPs.
119. The TF considered the following arguments in favor of maintaining the two-year “cooling off” period:
  - When a KAP is rotated off an audit engagement he or she would likely be assigned to another PIE client, rather than just sitting out for two years before returning to the client.
  - The TF believes that a three-year “cooling off” period could be viewed as simply tinkering rather than adding value.

- The “cooling off” period in the Code was not changed in 2009 and the TF saw no evidence of significant problems having arisen since this decision.
- The majority of jurisdictions have a two-year “cooling off” period, hence the TF considered that it would be disruptive to try and overlay this with a stricter requirement.

#### *TF Proposals*

120. The TF recognizes that a perception issue has been raised by some stakeholders with respect to a seven-year “time on” period in conjunction with a two-year “cooling off” period, as it allows the possibility of a KAP to serve for 14 out of 16 years on an engagement, assuming the KAP returned to the audit once the “cooling off” period has been completed.
121. Taken in conjunction with the TF’s view that the “time on” period should not be shortened, the TF was split as to whether perception is a sufficient reason to increase the “cooling off” period. Two members believe that, on balance, the “cooling off” period should not be extended, particularly in light of current provisions in most jurisdictions. Two members believe that consideration should be given to extending the “cooling off” period, for example, to three years, as an extension could contribute to resolving the perception issue.
122. If the “cooling off” period were to be extended, the TF members could not agree whether such an extension should apply to all KAPs or only the LAEP.

#### **Matters for Consideration**

12. IESBA members are asked for their views whether the “cooling off” period should be changed.
13. If so, IESBA members are also asked whether LAEPs should have a different “cooling off” period.

#### **(D) PERMISSIBLE ACTIVITIES DURING “COOLING OFF” PERIOD**

123. The Code states that “during that period (the “cooling off” 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”.
124. The TF considered the nature of the involvement, if any, that the rotated individual may have with the audit or client during the “cooling off” period. The TF specifically considered whether it would be acceptable for the rotated individual to continue to be involved with the client even if he or she no longer participated in the audit engagement, for example, by providing non-audit services or acting as the partner responsible for leading or coordinating the firm’s professional services to the audit client or overseeing the firm’s general relationship with the audit client (often referred to as the “relationship partner”).

#### *Overview of Research Findings*

125. Exactly 50% of the online survey responses indicated a view that the rotated individual should have no relationship at all with the client while rotated off. Other respondents believe that other roles, such as providing non-audit services (28%) or acting as the person responsible for the overall relationship with the client (38%), should be permitted.

126. “Other” (8%) responses included the following suggestions:
- Acting as the partner in charge of the relationship is permissible, but only if the intention was not to go back to the audit engagement.
  - Social interactions only.
  - Any service that does not involve matters that may influence the audit engagement is permissible.
  - Any role is permitted but with the understanding that it would not count towards “cooling off.”
127. However, when responses from only TCWG, regulators, and NSS were considered, approximately 65% of respondents believe that no ongoing relationship should be permitted.
128. The SMPC indicated that it considers the current provisions to be adequate and does not believe further restrictions are necessary. It did suggest that clarification around the phrase “consult with the engagement team or the client regarding technical or industry-specific issues” could be beneficial, since a situation may arise where the rotated individual is asked isolated questions relating to work or conclusions from the previous year’s audit that are relevant to the current audit.
129. Responses from the firms were mixed. As relates to a “relationship partner” role, of the 13 responses received:
- Six believe the role as the relationship partner should be prohibited.
  - Three believe it to be acceptable, though two of the three indicated boundaries were necessary.
  - Three believe the current restrictions and directions in the code are adequate.
  - One did not provide a view on adopting a client relationship role.
130. Similarly, as relates to the provision of non-audit services:
- Seven firms believe non-audit services should be prohibited (one only if impacts the audit).
  - Two believe that non-audit services should be allowed.
  - One believe that the role once off the audit engagement is not important, but that the “cooling off” “clock” should not start until all relationships have ceased.
  - The remainder did not provide views on the provision of non-audit services.

#### *TF Considerations*

131. The TF considered the various arguments for and against ongoing relationships and roles during the “cooling off” period and concluded that the important factor is that the individual should not be a member of the engagement team for the audit, nor have any role that allows him or her to influence the audit (which might, depending on the facts and circumstances, result from having regular and ongoing contact with senior management or TCWG), or undertake any other services that would impact the outcome of the audit. This could include a role in which the individual continued to have regular or ongoing business or professional contact with senior management or the audit committee of the client.
132. The TF is of the view that if the role or position under consideration during the “cooling off” period does not result in the individual having an influence on the outcome of the audit and, therefore, such that there is no familiarity threat, then it is acceptable to undertake that role or occupy that position while “cooling off.”

133. The TF considered however that the Code could be amended to provide greater guidance as to activities that are permissible for a KAP to ensure that the perception risk is managed. The current wording in the Code does not seem to provide sufficient clarity regarding the types of roles and interactions with the audit client that could be permitted.
134. The TF discussed the fact that the current Code states that the individual must not “otherwise directly influence the outcome of the engagement” during the “cooling off” period. The current definition of audit team in the Code states that those who can directly influence the outcome of the engagement includes “those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the engagement partner in connection with the performance of the audit engagement including those at all successively senior levels above the engagement partner through to the individual who is the firm’s Senior or Managing Partner” (the “chain of command”). The TF considered that this technically means an audit partner could not cool off from any audit engagement if he or she were also audit practice leader or the firm’s Senior or Managing Partner. The TF believes this wording may create an unintended consequence that may need to be clarified.
135. The TF also considered whether the current provisions of the Code on permissible activities during the “cooling off” period are practical to implement and manage particularly where there are a limited number of specialist or industry partners. Further restrictions on permissible activities would have an even greater impact on smaller firms which do not have the same depth of resources as larger firms.

#### *TF Proposals*

136. The TF is of the opinion that the focus of any guidance regarding the role a partner can play during the “cooling off” period should be based around prohibiting the individual from being a member of the engagement team for the audit, or having any role that allows him or her to influence the audit or undertake any other services that would impact the outcome of the audit.
137. An activity, such as meeting the client from time to time to receive feedback on the firm’s services, should not be excluded simply because interaction with the audit client or engagement team is required. Consideration should be given to whether the outcome of the audit could be influenced as a result of that activity.
138. The TF believes that the content of the Code could be amended to provide additional guidance and clarification as to the nature of roles that could be considered permissible during the “cooling off” period.

#### **Matters for Consideration**

14. IESBA members are asked whether they agree with the TF’s view that the rotated individual should not be prohibited from having any ongoing relationship with the audit client during the “cooling off” period.
15. If so, IESBA members are asked for views as to whether the Code should be enhanced to include more specific details about the roles that are permissible and not permissible during the “cooling off” period, such as with regard to “relationship partners,” the provision of non-audit services and the interaction of the requirements with audit partners who are also in the firm’s “chain of command.”

#### **D. Exceptions to Rotation Requirements**

139. The TF considered whether there are any further circumstances where an exception to rotation requirements should be granted other than those that currently exist within the Code and whether the

current stipulations where an exception is permissible continue to be appropriate.

140. The Code currently allows exceptions under three clauses:

- 290.152 A KAP whose continuity is especially important to audit quality may, in rare cases due to unforeseen circumstances outside the firm's control, be permitted to serve an additional year on the audit team as long as the threat to independence can be eliminated or reduced to an acceptable level by applying safeguards.
- 290.154 When an audit client becomes a PIE, the length of time the individual has served the audit client as a KAP before the client becomes a PIE shall be taken into account in determining the timing of the rotation. If the individual has served the audit client as a KAP for five years or less when the client becomes a PIE, the number of years the individual may continue to serve the client in that capacity before rotating off the engagement is seven years less the number of years already served. If the individual has served the audit client as a KAP for six or more years when the client becomes a PIE, the partner may continue to serve in that capacity for a maximum of two additional years before rotating off the engagement.
- 290.155 When a firm has only a few people with the necessary knowledge and experience to serve as a KAP on the audit of a PIE, rotation of KAP may not be an available safeguard. If an independent regulator in the relevant jurisdiction has provided an exemption from partner rotation in such circumstances, an individual may remain a KAP for more than seven years, in accordance with such regulation, provided that the independent regulator has specified alternative safeguards which are applied, such as a regular independent external review.

#### *Overview of Research Findings*

141. The survey participants were asked whether there is a need for additional exceptions for the requirement to rotate apart from those currently detailed in the Code. 73% of all respondents indicated that there is no need for other exceptions. The figure rose to 77% when TCWG, regulators and NSS responses were also considered.

142. The SMPC believes that the current exception provisions detailed in the Code are appropriate and having varying rotation periods for LAEPs, QCR partners and KAPs could potentially address, or at least reduce the need for exceptions. It also supported the retention of paragraph 290.152 of the extant Code, when it is important to audit quality.

143. Responses from the firms were varied. Of the 13 responses received:

- Three believe no exceptions should be allowed.
- Two did not comment.
- Five believe exceptions only under paragraph 290.152 should be permitted, though four of these indicated that TCWG should have to approve the exception.
- Two believe exceptions under paragraphs 290.152 and 290.155 should be permitted, with one of these two indicating that paragraph 290.155 should be permitted with "rigorous oversight" from the regulator.
- One believes exceptions should be permitted under paragraph 290.155 only.

144. The TF also considered comments received in a recent letter from IOSCO responding to the IESBA's



January 2013 survey on its future strategy and work plan. The letter mentioned paragraph 290.154 of the Code which permits a KAP who has already served for six or more years when the audit client first becomes a PIE to continue in the role of a KAP for a further two years. IOSCO suggested that the maximum period of service should not be extended when the entity becomes a PIE. Hence the permitted “time on” period should be based on the current status of the entity and the total length of the relationship. Related to this, the TF noted that two jurisdictions, Spain and the Netherlands, have excluded the 290.154 exemption from their local rules.

#### *TF Considerations*

145. The TF believes that the rotation requirements should be overridden only in exceptional circumstances and for a limited period of time, but this would be appropriate if required to maintain the quality of the audit. The current exceptions in the Code take into account:

- (a) Circumstances which are beyond the firms’ control (290.152);
- (b) Issues arising from transition because the client has become a PIE (290.154); or
- (c) Limited specialist resources in some firms (290.155).

These all deal with circumstances that could affect audit quality in some way.

146. The TF considered situations other than those in the current Code, and the comments received in the online survey and did not identify any other situations that may need to be addressed through further exceptions. It, however, considered whether the current exceptions remain appropriate.

147. Paragraph 290.152 allows exceptions in “rare cases” which are “outside the firms’ control” and provides an example of a situation in which a required rotation may not be possible. Paragraph 290.155 allows exceptions with the approval of the regulator if rotation is not an available safeguard because there are only a few people with the necessary knowledge and experience to serve the client. Both paragraphs require additional safeguards to combat any long association threat. The TF is of the view that the reasons for having these exceptions remain appropriate as they take into account circumstances that can occur in reality and can impact audit quality, while being limited and specific as to their application. A firm can only apply the exemption in the appropriate circumstances with the consideration of safeguards and either for a very limited time or with the approval of a regulator. The TF is thus of the view that these exception clauses remain adequate and appropriate.

148. The TF further considered the IOSCO letter and its suggestion that when an entity becomes a PIE no exceptions should be granted to allow the “time on” period to be extended. The TF did not support this suggestion as it considered that preventing the application of an exception could adversely impact audit quality. Without an exception all key audit partners on the audit engagement would be required to immediately rotate without consideration of any transition period – and in the case of a newly listed company, at a time that audit quality is most important. The TF believe that the need to maintain audit quality should prevail over rotation requirements in exceptional circumstances and for a limited period of time.

149. The TF did, however, consider that the extant Code under paragraph 290.154 allows an individual who has served the audit client as a key audit partner for six or more years when the client becomes a PIE, to continue to serve in that capacity for a maximum of two additional years before rotating off the engagement. Hence, a KAP could serve a total of 16 out of 18 years on a PIE client, albeit that the client became a PIE during that period. A perception concern may exist, similar to the concern over a

KAP serving 14 out of 16 years on the audit of a PIE. The TF thus believes that paragraph 290.154 should be amended to allow an extension of only one-year for KAPs after the audit client becomes a PIE, as opposed to the current possible two-year extension. This would give sufficient time for the relevant KAPs to complete the current audit and have a year to organize the transition.

#### *TF Proposals*

150. Given the above analysis, the TF believes that no further exceptions paragraphs should be added to the Code.
151. The TF is of the view that exception paragraphs 290.152 and 290.155 remain appropriate, as they relate to circumstances that could affect audit quality and are balanced with appropriate safeguards and/or are for a limited time.
152. In addition, the TF proposes that 290.154 be amended to state that when an entity becomes a PIE during the period under consideration an extension of one-year (not two) should be permitted for any individuals who have already served the client as a key audit partner for six or more years.

#### **Matters for Consideration**

16. Do IESBA members agree that the exceptions in 290.152 and 290.155 remain appropriate?
17. Do IESBA members believe paragraph 290.154 should be amended to shorten the available extension from two years to one year?

#### **E. Mandatory Rotation Requirements for Non-PIE Audits**

153. The TF considered whether there is a need for rotation requirements to apply to partners serving non-PIEs and, if so, how might these differ from those for PIEs.
154. In addition, the TF considered whether the long association concerns relating to a manager becoming a partner on the same client are applicable to non-PIEs and, if so, how these differ from those for PIEs.

#### *Overview of Research Findings*

155. The SMPC did not believe that partners or managers serving non-PIEs should be required to rotate, as the threat to the public interest is limited. However, the SMPC did indicate that certain regulated categories of companies, such as financial sector firms, should be subject to rotation, especially where the firms do not fall under the definition of a PIE. It suggests that the determining factors around the rotation could be left to the local jurisdiction or regulator to decide.
156. Responses from the firms were once again mixed. The 13 responses received indicated:
  - No           Seven firms
  - Yes          Four firms, of which two firms specifically mentioned rotation for financial sector clients, however it was not clear whether these were or weren't entities already covered by the PIE definition.
  - Maybe       Two firms

157. The survey asked participants which type of entities should be subject to rotation. Results for all respondents indicated that 23% of respondents believe entities other than PIEs should be subject to rotation. The majority of these respondents believed rotation should be mandatory for all audits, however some others stated that they selected “other” because they did not agree rotation should be required at all for any entities. When responses from TCWG, regulators and NSS only were considered this figure rose to 28%. 11 of these 26 respondents commented that rotation should apply to all audits.

#### *TF Considerations*

158. The TF believes there is no evidence to suggest a need for a mandatory rotation for partners serving non-PIEs. The TF believes that the Code should address the circumstances where, because of the heightened public interest in an audit, the Code should prescribe rotation periods regardless of the evaluation of threats to independence that would arise from the application of the general framework. While some respondents mentioned audits of financial institutions as a category of audit that should also be subject to rotation requirements, the TF considered that the type of financial institution that would give rise to heightened public interest impact would generally already be covered by the PIE definition. The TF did not consider that the audits of all banks or financial institutions should be covered by a blanket rotation requirement.
159. The TF considers that strengthening the guidance provided in paragraph 290.150 would ensure that rotation is appropriately considered as a safeguard and more consistently applied for non-PIEs than is the case with the current provisions.

#### *TF Proposals*

160. The TF does not propose that any changes be made to require partners or other senior personnel serving non-PIEs to rotate. The TF believes that strengthening the guidance in paragraph 290.150 would lead to more appropriate evaluations of the threats to independence created by long association of personnel with non-PIEs as the underlying considerations relating to long association are essentially the same, for an entity that is a PIE and one that is not.

#### **Matter for Consideration**

18. Do IESBA members agree with the TF’s views above?

## **IV. Forward Timeline**

161. Subject to the Board’s deliberations, the TF proposes the following forward timeline for the project:
- Q4 2013: Consultation with CAG and drafting of proposed changes to the Code, if any
  - Dec 2013: First read of proposed changes to the Code, if any
  - March 2014: Consultation with CAG
  - April 2014: IESBA approval of exposure draft, if any