

**Meeting:** IESBA CAG  
**Meeting Location:** Teleconference  
**Meeting Date:** June 30, 2014

## Agenda Item

# A

### Long Association – Cover Note and Report-Back

#### Objectives of Agenda Item

1. To provide a report-back on comments received from CAG Representatives on this project at the March 2014 CAG Meeting.
2. To obtain CAG Representatives' views on the Task Force's (TF's) proposals with regard to:
  - (a) A five-year cooling-off period applying only to lead audit engagement partners (LAEPs) on the audit of public interest entities (PIEs); and
  - (b) The revised proposals describing the roles and activities related to the audit client that can and cannot be undertaken during the cooling-off period.

#### Project Status and Timeline

3. The IESBA approved the project proposal at its meeting in December 2012. It has subsequently met to discuss the project in June and December 2013 and April 2014.
4. The main issues considered in the project are:
  - (a) Strengthening the general framework in the Code surrounding long association
  - (b) Communication with those charged with governance (TCWG) as it relates to partner rotation
  - (c) Time served on an audit before becoming a key audit partner (KAP)
  - (d) Duration of the cooling-off period
  - (e) Permissible activities during cooling-off
5. The remaining issues which the IESBA will consider prior to voting out an exposure draft at its July 2014 meeting are set out in paragraph 2(a) and (b) above.

#### March 2014 CAG Discussion

6. Below are extracts from the draft minutes of the March 2014 CAG Meeting,<sup>1</sup> and an indication of how the project TF or IESBA has responded to date to CAG Representatives' comments:

COOLING-OFF PERIOD	
Mr. Koktvedgaard wondered whether the revised	Ms. Orbea explained that the TF proposed to deal

<sup>1</sup> The minutes will be approved at the September 2014 IESBA CAG meeting.

<p>rotation provisions also covered senior personnel other than KAPs.</p>	<p>with this under the general framework of principles addressing long association.</p>
<p>Ms. de Beer was of the view that a bifurcation of cooling-off periods, coupled with coverage of different roles, would create a level of complexity that would be impractical to manage and oversee, particularly from the perspective of those charged with governance (TCWG). She was of the view that a three-year cooling-off period would be better than a two-year one. Mr. Waldron and Ms. Lopez shared Ms. de Beer's view that a bifurcation would create unnecessary complications.</p>	<p>Ms. Orbea noted the views expressed.</p>
<p>Mr. James was of the view that the role(s) a KAP takes with the audit client should not dictate the cooling-off period. He noted a hypothetical situation where a significant amount of audit work could be performed on a subsidiary in another jurisdiction, with the KAP for the subsidiary) not being subject to the longer cooling-off period applicable to the LAEP. Mr. Waldron expressed a similar view, noting that since all KAPs are involved in the decision-making process, a consistent approach to rotation would be preferable.</p>	<p>Ms. Orbea explained that the original TF proposal of a three-year cooling-off period did consider that all KAPs have a role in decision-making. However, the TF considered if a five-year cooling-off period was applied then it would be too extreme for it to apply to all KAPS. As a bifurcation of cooling-off periods for LAEPs and EQCRs does exist in a number of jurisdictions, the TF aimed to reflect this situation in the revised proposal.</p>
<p>Mr. Dalkin asked whether audits of governmental agencies were exempted from the rotation requirements.</p>	<p>Ms. Orbea confirmed that the rotation requirements currently apply to KAPs on audits of PIEs. A government agency may be defined as a PIE in a jurisdiction. She added that the Code does not override legal requirements.</p>
<p>Ms. Blomme summarized the new EU mandatory firm rotation requirements. She expressed the view that setting mandatory rotation requirements for KAPs globally presented a difficult challenge as in some jurisdictions, these must be overlaid with mandatory firm rotation. She noted that countries currently operating with bifurcated KAP rotation requirements did not have mandatory firm rotation. She expressed the view that from the point of view of the European Union, a simple uniform rotation requirement would be preferable to a bifurcation.</p>	<p>The point was considered by the Board but on balance the Board felt that it was outweighed by the issues surrounding perception of a lack of independence and accordingly a longer period off the engagement by the LAEP was more appropriate.</p>
<p>Mr. Koktvedgaard asked whether the TF had, in its deliberations, considered how mandatory firm</p>	<p>Ms. Orbea indicated that mandatory firm rotation had been considered by the TF. Certain</p>

<p>rotation might affect the proposed revised cooling-off period.</p>	<p>jurisdictions had very short firm rotation requirements that essentially negated the need for partner rotation. With longer firm rotation requirements, the mandatory firm rotation would need to be overlaid with the partner rotation requirements. The TF therefore considered that a revised proposal would still need to take into account the need to ensure that a new partner is in place for a sufficient amount of time to provide a fresh look to the audit, even in some cases where there is firm rotation.</p>
<p>PERMISSIBLE ACTIVITIES</p>	
<p>Ms. Blomme was of the view that, with a five-year cooling-off period, restrictions on permissible activities should not be relaxed part way through the cooling-off period.</p>	<p>This point was noted but on balance the Board felt that the overall strengthening of Section 290 meant that it was appropriate to allow some latitude on this point, given the limitations regarding specialist resources.</p>
<p>Mr. Thompson noted that there could be situations where there would be benefit to the rotated partner being able to discuss matters with the new partner. He felt that a degree of interaction could be permissible as long as there would be no influence on the audit outcome.</p>	<p>Ms. Orbea noted that the TF had given consideration to situations when interaction between the rotated and the incoming KAP could be beneficial. Revised wording in paragraph 290.150 reflected this.</p>
<p>Mr. James felt that there was a need to define certain words used, notably "limited" as related to "limited discussion" and "directly" as related to "directly influence." He added that the objective of the cooling-off period should be taken into account when considering which activities should be permissible during cooling-off.</p>	<p>Point noted and adjustments made to the proposed wording.</p>
<p>Mr. Waldron was of the view that consideration should be given to how interaction could take place between the rotated and incoming partner when deciding which activities are permissible. He pointed out that, in practice, it could be quite possible for the incoming partner to raise a question with the rotated partner as they walk past each other in the office.</p>	<p>Point noted and adjustments made to the proposed wording.</p>
<p>Mr. Baumann agreed that the rotated partner should not be able to influence the audit outcome.</p>	<p>Point noted and adjustments made to the wording.</p>

<p>However, he noted that there could be situations where the LAEP rotates off an audit and takes a key responsibility for industry practice within the audit firm. He felt that it could be impractical to prevent any interaction in this situation and doing so could adversely impact audit quality. Hence, he sympathized with many of the comments made.</p>	
<p>As Mr. Koktvedgaard's invitation, Ms. Blomme briefed Representatives on the key elements of the recently agreed audit reform regulatory package in the EU.</p>	<p>The TF noted the position in the EU.</p>
<p>STRENGTHENING THE FRAMEWORK PRINCIPLES</p>	
<p>Ms. Blomme noted that while mandatory partner rotation for audits of non-PIEs had been considered by the TF and deemed inappropriate, rotation now appeared to be suggested for such audits within the proposed revised wording.</p>	<p>Ms. Orbea responded by noting that this is intended to be guidance and not a requirement. Adjustments have been made to the wording.</p>
<p>Ms. de Beer expressed the view that the minimum rotation period of one year was too low, even if the decision to rotate was a voluntary one. Ms. Lang agreed with Ms. de Beer and felt that the proposed revised text appeared somewhat confusing. Noting that if any decision to rotate was voluntary, Ms. Lang wondered why a mandatory minimum period would be necessary.</p>	<p>Ms. Orbea explained the TF's view that, should rotation be used as a safeguard, it would be beneficial to provide guidance on an appropriate minimum rotation period. The Board considered this point and the mandatory minimum period has been replaced with the requirement that the firm determine a period of "sufficient duration" to allow the threats to be eliminated or reduced to an acceptable level.</p>
<p>Mr. Fukushima expressed the view that as some of the safeguards being suggested would be required in most audit engagements, regardless of any long association concerns, they should not be considered incremental safeguards. He noted that this had been mentioned in IOSCO's comment letter on the Board's January 2013 strategy survey. He was of the view that some of the safeguards duplicated requirements of ISQC 1<sup>2</sup> and suggested that the TF reconsider the nature of the safeguards as part of this project and not as part of a future project.</p>	<p>IOSCO's comments had been noted and were being considered in the Board's overall Strategy and Work Plan deliberations.</p>

<sup>2</sup> ISQC1, *International Standard on Quality Control 1*

INVOLVEMENT OF TCWG	
Representatives had no comments on this matter.	
TIME-ON PERIOD	
Ms. de Beer asked what consideration had been given to the adequacy of the current seven-year time-on period.	Ms. Orbea explained that at the inception of the project, the TF had researched current engagement periods in a large number of jurisdictions and surveyed stakeholders regarding their views as to what the maximum length of the time-on period should be. The findings from the research showed that most of the jurisdictions covered in the research had a seven-year maximum. A few jurisdictions had a lower maximum period, but also allowed the maximum period to be extended if deemed to be beneficial to audit quality. In view of the findings, the TF has proposed, and the Board has agreed, that there was no need to amend the current seven-year maximum.
Mr. James expressed the view that, from his own personal experience, he had never known a situation where an individual's relationship with an audit client prior to becoming a KAP had been taken into account when rotation requirements were being considered. He wondered whether the new principles would be noted by audit teams going forward, adding that he felt that stronger wording could be appropriate.	Ms. Orbea acknowledged Mr. James's view, noting that there was the possibility to reconsider the position if it were felt that the objective of the new principles was not being achieved.

**Matters for CAG Consideration**

7. Representatives are asked for views on the matters raised in Agenda Item A-1.

**Material Presented – CAG Papers**

Agenda Item A-1	Long Association – Issues Paper
Agenda Item A-2	Long Association – Section 290 – Proposed Revisions (Mark Up)
Agenda Item A-3	Long Association – Section 290 – Proposed Revisions (Clean)
Agenda Item A-4	Long Association – Section 291 – Proposed Revisions (Mark Up)
Agenda Item A-5	Long Association – Section 291 – Proposed Revisions (Clean)