

**Meeting:** IESBA CAG

**Meeting Location:** Paris, France

**Meeting Date:** March 7, 2016

## Agenda Item D-2

### Report Back – Long Association

#### Objectives of Agenda Item

1. To note the report-back on the September 2015 CAG discussion.
2. To encourage CAG member organizations to respond to the re-Exposure Draft, [\*Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client\*](#) (re-ED).

#### Project Status and Timeline

3. Appendix 1 to this paper provides a history of previous discussions with the CAG on this topic.
4. The re-ED was approved at the November/December 2015 IESBA meeting and issued in early February 2016. It is open for comment through **May 9, 2016**. **CAG Member Organizations are strongly encouraged to respond to the re-ED and to submit their comments to the IESBA by the comment deadline.** Feedback from the formal responses to the re-ED will be considered by the Long Association Task Force and the IESBA in Q2 2016. A summary of the responses to the re-ED will be presented to the CAG at its September 2016 meeting.
5. The IESBA anticipates finalizing the document under the extant structure and drafting conventions (“close-off” document) at its September 2016 meeting. The close-off document will then be restructured under the new Structure format being developed under the Structure of the Code project for public comment on the restructuring exercise only.
6. The re-ED includes a Basis for Conclusions for proposals the IESBA has now finalized as well as an Explanatory Memorandum with respect to proposals being re-exposed concerning three specific issues. The re-ED has been circulated to the Representatives in PDF format as well as via hyperlink.

#### September 2015 CAG Discussion

7. Below are extracts from the draft minutes of the September 2015 CAG meeting,<sup>1</sup> and an indication of how the Task Force or IESBA has responded to CAG Representatives’ comments.

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<sup>1</sup> The draft September 2015 CAG minutes will be approved at March 2016 IESBA CAG meeting.

Matters Raised	Task Force/IESBA Response
COOLING-OFF PERIOD FOR THE EQCR ON PIE AUDITS	
<p>Mr. Hansen thanked the Board for responding to his concerns, noting that any outcome on this issue will necessarily incorporate a degree of arbitrariness. He was of the view that the “middle-ground” approach was reasonable, balanced and responsive to the public interest vis-à-vis investors while at the same time recognizing global diversity in PIEs.</p>	<p>Support noted.</p>
<p>Mr. Ahmed noted opposition to these proposals mainly from the private sector that did not favor fixed rotation periods. He commented that some jurisdictions are moving in an opposite direction by removing fixed rotation periods in general, but retaining them for state-owned enterprises. He was of the view that the IESBA's proposals could play a role in influencing those jurisdictions regarding the merits of rotation in addressing threats created by long association. However, with regard to state-owned enterprises, he noted a trend towards global convergence, even in those jurisdictions discussing removing fixed rotation periods, which are keeping them in place for such entities. He congratulated the Board on the middle-ground approach, which he felt was a balanced proposal.</p>	<p>Support noted.</p>
<p>Mr. James noted that the Board appeared to have considered Representatives' views on this issue and that the new proposal seemed more balanced than the previous proposal. He observed that non-listed PIEs can include very large entities such as financial institutions, which would not be covered by this new proposal. He wondered whether the Board had considered such entities.</p>	<p>Ms. Orbea noted that the Board did consider the matter, adding that the Board had tried to find a balance that took into account the diversity of non-listed PIEs. She noted that ISQC 1<sup>2</sup> requires EQCRs to cool off only on audits of listed entities, adding that many jurisdictions that have defined what a PIE means would have the ability to change that definition or make rotation stricter.</p>
<p>Mr. James observed that coverage of financial institutions seems to be a recurring issue and</p>	<p>Ms. Orbea explained the Code's definition of a listed entity, noting that she was not aware of any</p>

<sup>2</sup> International Standard on Quality Control (ISQC) 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

Matters Raised	Task Force/IESBA Response
<p>wondered whether it would be appropriate to exclude them from the scope of the proposals. He encouraged further Board consideration of this issue.</p> <p>With respect to Mr. James's question regarding financial institutions, Mr. Hansen inquired about the Code's definition of a listed entity, noting that if there is any lack of clarity the provision would be difficult to apply.</p>	<p>interpretation issues. She added that the Board had adopted a broad definition of a PIE to allow jurisdictions to recognize specific types of non-listed entities that they deem to be of public interest and that should therefore be subject to the same provisions. Thus, some entities covered under the PIE definition in some jurisdictions are small entities such as charities. Hence, the revised proposal took a slightly stricter approach for listed PIEs vs. non-listed PIEs.</p> <p>The Task Force noted that the Board had considered the matter of scoping in non-PIE financial institutions in the provision at its July 2015 meeting. The Board generally did not agree to pursue this further level of disaggregation given the potential for even greater complexity. In addition, this matter overlaps with the broader question of whether the definition of a PIE should encompass specific types of financial institution. That matter is outside the scope of this project.</p>
<p>Ms. Molyneux complimented the Board on steering the course to this middle-ground proposal, noting that from an investor perspective, there is a need for a clear and robust principle. She commented that when making the distinction between listed and non-listed PIEs, it is necessary to think about them being PIEs. However, the focus should remain on the public interest and, therefore, there is a need to make clear that this proposal represents a minimum. Accordingly, she encouraged further emphasis on enhancing standards. Mr. Hansen shared Ms. Molyneux's view regarding the focus on the public interest.</p>	<p>Point and support noted. The Code sets an international benchmark, with jurisdictions not precluded from establishing stricter requirements depending on their specific national circumstances.</p>
<p>Expressing a personal opinion, Mr. Iinuma noted that the middle-ground proposal was quite different from the original proposal that was exposed. Accordingly, he was of the view that there should be re-exposure.</p>	<p>Dr. Thomadakis commented that the Board would consider the need for re-exposure after concluding its final discussions as part of due process.</p> <p>The proposal has now been <a href="#">re-exposed</a>.</p>
<p>Ms. McGeachy-Colby noted that the IFAC SMP Committee did not support having the same</p>	<p>Ms. Orbea acknowledged that adoption and implementation will not be easy. She noted that</p>

Matters Raised	Task Force/IESBA Response
<p>cooling-off period for EQCRs as for EPs on the grounds that the roles are different. With regard to non-listed PIEs, she noted that ISQC 1 is adopted and implemented differently in different jurisdictions. She expressed a concern that the extension of the EQCR cooling-off period from two to three years for non-listed PIEs would represent a significant change for SMPs. She therefore supported re-exposure of this provision.</p>	<p>moving away from the current 7/2 partner rotation regime will give rise to a need for much guidance, including FAQs. She noted that the Task Force had discussed this matter at length.</p> <p>The proposal has now been <a href="#">re-exposed</a>. IESBA Staff has developed a set of proposed Staff Q&amp;As to assist implementation of the provisions. These have been included in the Appendix to the explanatory memorandum accompanying the <a href="#">re-Exposure Draft</a>.</p>
<p>Mr. Ayoub wondered how to achieve more effective adoption and implementation if the revised proposal were to move forward in different jurisdictions.</p> <p>Regarding adoption and implementation, Ms. Molyneux commented that there would be benefit in greater transparency as to how the provisions are applied, for example, through a series of reviews regarding how jurisdictions are applying the provisions to listed entities and other PIEs. Doing so would help illustrate good practice and provide motivation for improvement by virtue of national peer review. Such reviews would also assist investors to better understand accounting and auditing practice in the jurisdictions in which they invest. Accordingly, she advocated a post-implementation review of the revised proposals.</p>	<p>IESBA Staff has developed a set of proposed Staff Q&amp;As to assist implementation of the provisions. These have been included in the Appendix to the explanatory memorandum accompanying the <a href="#">re-Exposure Draft</a>.</p> <p>The Board has committed in its Strategy and Work Plan 2014-2018 to considering whether there is a need to gather information from relevant stakeholders such as regulators, firms and TCWG regarding how effectively selected aspects of specific standards are being implemented in practice. The Board will consider whether to undertake such post-implementation review with respect to the long association proposals once these are issued.</p>
<p>Echoing Mr. Ayoub's comment regarding monitoring of adoption and implementation, Ms. Robert suggested that the IESBA could make a link with the work of the IAASB concerning the role of the EQCR in ISQC 1. She was of the view that it should not be just for the IESBA to address the issue regarding the EQCR but that it would be better for ISQC 1 to address it.</p>	<p>Dr. Thomadakis responded that the IESBA had already been liaising with the IAASB regarding coverage of non-listed PIEs under ISQC 1. Mr. Gunn noted that the IAASB had already initiated work regarding financial institutions and a review of ISQC 1 in tandem, although it is still early days. He added that the two boards were liaising on the issue of an EP moving immediately into an EQCR role and the scoping for the EQCR cooling-off requirement under ISQC 1.</p> <p>The matter of whether the scope of the EQCR requirement in ISQC 1 should be broadened to cover all PIEs and not just listed entities has been raised in the IAASB's December 2015 Invitation to Comment</p>

Matters Raised	Task Force/IESBA Response
	(ITC), <a href="#">Enhancing Audit Quality in the Public Interest</a> (see paragraph 143 in the ITC).
<p>Ms. Robert, although concurring with Mr. Hansen, expressed a concern about the complexity of the provisions and how their implementation will be monitored. She suggested that the IESBA strive towards more harmonization. However, she acknowledged the need to find a consensus.</p> <p>Mr. Horstmann commented that he was very impressed with the focus on public interest in the discussion. He noted that the PIOB had not concluded on this issue. Accordingly, he was expressing his personal views. He felt that adding complexity to the Code is not warranted unless this has been carefully thought through. He also felt that the impact of the principle might be lost if it is too nuanced. He noted that entities sometimes move into different categories, so this would need some reflection too. He added that historically the Board had strived so that its principles apply across all types of entities but had decided that a distinction was needed for PIEs in certain areas, an approach that the public understands. He felt that slicing this distinction further could risk losing the principle. Mr. Dalkin concurred with Mr. Horstmann, noting that the more complex the provisions, the more challenging the implementation becomes. He added that INTOSAI had in the past needed to rewrite some of its standards because of implementation difficulties.</p> <p>Regarding the comments about complexity, Mr. James noted that complexity should be put into context as the provisions could be much more complex than they are now. He added that there is some simplicity as the provisions do not affect every type of partner. In addition, the range of entities under consideration has been narrowed. He agreed with Ms. Molyneux that the Board should strive for the higher standard in the public interest and not lower the bar for everyone.</p>	<p>Ms. Orbea responded that the Board does strive for the higher standard in the public interest. However, it does also recognize that there are other public interest considerations that come into play, including audit quality principles.</p> <p>Dr. Thomadakis noted that the whole Board had very consciously thought about the issue of complexity. He observed, however, that the reality itself is very complex. Accordingly, any attempt to achieve a balance will itself be complex. He added that the middle-ground proposal may be inconvenient in some ways. However, it is balanced in a complex world.</p> <p>The Board recognizes that this position represents a careful balance. The position weighed in particular the views of those stakeholders who believe the same cooling-off requirement is needed for the EQCR as for the EP given the importance of the EQCR role and the EQCR's proximity with the audit issues; and the views of those who believe an increase in the cooling-off period is unnecessary given the different role and responsibilities of the EQCR vs. the EP. The Board accepts that there will be a trade-off in terms of additional complexity in practice, which it considered in formulating the proposal. Acknowledging the practical challenges, the Board has only increased the cooling-off period for the EQCR to three years in respect of non-listed PIEs rather than five years.</p> <p>To alleviate concerns about complexity, the Board has commissioned Staff to develop a set of proposed Q&amp;As to facilitate understanding of the provisions. These have been included in the Appendix to the explanatory memorandum accompanying the <a href="#">re-Exposure Draft</a>.</p>

Matters Raised	Task Force/IESBA Response
LENGTH OF COOLING-OFF PERIOD – RECOGNIZING DIFFERENT LEGISLATIVE OR REGULATORY REQUIREMENTS	
<p>Mr. Thompson supported the proposal because it addressed a potential conflict with European legislation that mandates a three-year cooling-off period for key audit partners (KAPs).</p>	<p>Support noted.</p>
<p>Mr. Ahmed suggested that it would be useful to frame the debate by reference to the direction taken by some large jurisdictions such as the EU, which have high governance standards and which have implemented mandatory firm rotation (MFR), cooling-off for KAPs on PIE audits, etc. By framing the decision as part of this broader picture as opposed to simply making a decision per se, this would enable stakeholders to see that the proposal has overall merit and enable them to accept a global solution.</p>	<p>The debate at the Board was indeed framed in the context of developments relating to MFR, etc in the EU and other jurisdictions. The Board had acknowledged that in the context of such developments, overlaying the proposals over regulatory requirements might have the unintended consequence of making the requirements applicable in that jurisdiction stricter than those proposed by the Code, or make the overlay of requirements too complicated to interpret and apply. The Board agreed that both these outcomes could actually detract from its goal of promoting widespread adoption and implementation of the Code.</p>
<p>Mr. Hansen commented that fundamentally, he saw some logic to the proposal. However, he wondered whether MFR and individual partner rotation are reconcilable given that they have different objectives.</p>	<p>Ms. Orbea acknowledged that MFR does not go to the heart of an individual's familiarity threat. However, although the two forms of rotation have different objectives, when coupled, they serve to provide a more robust framework to address long association threats.</p>
<p>Referring to the phrase “implemented a regulatory inspection regime” in the proposal, Ms. Molyneux wondered whether more robust guidance might be provided as some inspections regimes are robust but not others. Mr. James commented that there was a need to understand the type of regulatory inspection regime that was envisaged and, in particular, whether this was intended to refer to an audit oversight body that belongs to the International Forum of Independent Audit Regulators (IFIAR), or that has enforcement powers, etc.</p>	<p>Ms. Orbea responded that the Code already refers to the concept of an oversight authority. However, it would be beyond the Board's remit to define what is a good inspection regime.</p> <p>The Task Force does not believe that it would be practicable for the Code to specify the type or quality of regulatory inspection regime that jurisdictions should put in place. This is a matter for individual jurisdictions to address. The Task Force has, nevertheless, accepted that the regime should be an independent one and amended the provision to refer to “an <u>independent</u> regulatory inspection regime.” (See paragraph 290.150D of the <a href="#">re-Exposure Draft</a>.)</p>

Matters Raised	Task Force/IESBA Response
<p>Mr. James wondered whether the reference to a ten-year MFR provision was overly specific and whether it might not be more appropriate for the Board to consider a more principles-based approach to take account of the variety of MFR periods in different jurisdictions.</p>	<p>Ms. Orbea explained that the Task Force had previously presented a more principles-based option but that the Board had determined that more specificity was required to mitigate the potential for misuse. She added that the Board was comfortable with the proposal as it was understandable and easy to apply without leaving matters open to interpretation.</p>
<p>Ms. Borgerth noted that in Brazil, MFR is imposed in addition to partner rotation, and it is 10 years if the entity has an audit committee and five years if it does not. She indicated that this was more restrictive than what the IESBA was proposing.</p>	<p>Point noted. The Code does not preclude jurisdictions from establishing stricter requirements to suit their specific national circumstances.</p>
<p>RESTRICTIONS ON ACTIVITIES THAT CAN BE PERFORMED BY A KAP DURING THE COOLING-OFF PERIOD</p>	
<p>Mr. Dalkin was not supportive of the proposed provision. Except in the case of a small firm, he did not believe that there would be only one individual in the firm with the necessary technical expertise. Ms. Molyneux agreed with Mr. Dalkin, believing that the proposal clouds the principle and that the relationship should be broken. Mr. Hansen generally agreed that “off means off.” However, he noted that the individuals who cool off often are a fount of knowledge. Accordingly, he was of the view that such knowledge could be tapped into as long as the individual cooling off is not be part of decision-making process on the current engagement. Mr. Ayoub supported the principle that “off means off.” He acknowledged that an individual being off an engagement could cause operational difficulties for firms and clients. However, he noted that it is not easy to write a provision to prevent the relationship from being influenced as there needs to be a clear indication that this individual cannot directly or indirectly influence the decision-making process.</p> <p>Ms. McGeachy-Colby commented that those who have the greatest influence are the EP and the EQCR. She indicated that these individuals</p>	<p>The Board broadly reaffirmed its view that on balance the benefit to audit quality of allowing such limited consultation in narrower circumstances would outweigh the perceived risk of the EP exerting influence over the engagement team.</p> <p>To convey the Board's intention that the use of the provision should not be for a firm's convenience but only where absolutely necessary, the Board agreed to further tighten the conditions under which a rotated individual could be consulted within the firm on a technical or industry-specific issue relating to the client. Compared with what was proposed in the <a href="#">August 2014 Exposure Draft</a>, the revised proposal in paragraph 290.150E of the <a href="#">re-Exposure Draft</a>:</p> <ul style="list-style-type: none"> <li>(a) Requires that there be no other partner within the firm expressing the audit opinion with the expertise to provide the advice (in order to promote consultation with other experts first if available);</li> <li>(b) Refers to an “issue,” a “transaction” or an “event” in the singular rather than the plural (in order to emphasize that the provision is intended to be used only in limited circumstances); and</li> </ul>



Matters Raised	Task Force/IESBA Response
<p>should be trusted as professionals and therefore that they will not inappropriately influence the engagement. However, there is a need to see how the provision would be implemented. Mr. James commented that the concept of rotation exists because bias can develop over time which the individual might not recognize, not because there is a lack of trust. He expressed support for a stronger stance.</p>	<p>(c) Emphasizes that such consultation should only be with the engagement team and not involve contact with the client.</p>
<p>Mr. Thompson noted that a similar provision is already used in the UK without any problem. He noted that the issue can be more complex, especially in highly specialized areas such as the financial services industry. He noted that seeking advice outside the firm can be difficult given potential liability issues. In addition, he noted that the proposal already restricted the provision to circumstances where there is no other individual with the necessary expertise in the firm. He therefore supported the proposal.</p>	<p>Point taken into account and support noted.</p>
<p>Mr. Ahmed wondered whether the Task Force had considered a requirement that a second partner in the firm work with the EP as is the case in some jurisdictions. He was of the view that this could be a mitigating measure.</p>	<p>The Task Force did not consider that it would be practicable for a Code for global application to impose such a requirement, as firms need to assign their engagement teams in accordance with the requirements of ISQC 1.</p>
<p>Ms. Ceynowa indicated that the proposal seemed to address smaller firms. She noted that the PCAOB has an exemption for smaller firms as long as they are subject to inspection.</p>	<p>Ms. Orbea explained that the Board did not believe that there should be a small firm exemption. Rather, the Board was aiming to set principles that can be applied by any firm with proper consideration of the circumstances. She added that the Board cannot prevent individuals from circumventing the requirements. She emphasized that the principles should be in the public interest as they give due regard to audit quality. She commented that it is important for individuals to be available for consultation in the rare situation where there is no other person with suitable expertise available. She noted that the provision might find greatest use in smaller firms.</p>



Matters Raised	Task Force/IESBA Response
Ms. Molyneux commented that the issue was one of principle. She added that if an exception is made, then it must be justified, transparent and documented so that a third party is able to review any decision taken against an objective standard.	Ms. Orbea explained that the Code does not allow for exceptions to compliance with requirements because such exceptions are breaches which need to be reported to those charged with governance. She explained that the Code does not have a mechanism for exceptions unless they are written into the provisions.
Ms. McGeachy-Colby supported the proposal on the grounds that it is balanced with appropriate safeguards. She commented that in a small firm environment, clients are looking for partners with expertise. She was of the view that more audit quality is delivered when the appropriate individual can be consulted. Ms. Lang, supporting Ms. McGeachy-Colby's view, commented that the consultation issue is not isolated to smaller firms.	Ms. Orbea acknowledged that the proposal is more likely to apply to smaller firms. However, she emphasized that the proposal is not a small firm exemption.
Ms. Molyneux inquired whether the Board had considered the perception issue in terms of the EP being seen to continue to influence the relationship.	Ms. Orbea indicated that the whole project is about addressing perceptions. She therefore confirmed that the Board did consider the issue of perception at length.
ENHANCEMENTS TO THE GENERAL PROVISIONS (GP)	
Ms. Ceynowa wondered whether there should be concurrence with those charged with governance where, in the circumstances outlined in paragraph 290.153, a regulator may provide no general exemption but may grant individual one-off exemptions on a case-by-case basis.	The Board carefully considered an option proposed by the Task Force. However, the Board concluded that in such circumstances, the client would be aware of an application for a specific exemption because of the regulatory process that would have to be undertaken. The Board did not consider it necessary to highlight this in the provisions.
Mr. James inquired about the Board's approach to highlighting that rotation should also be considered for firm personnel other than partners.	Ms. Orbea explained that coverage of the issue had been added to the GP <sup>3</sup> so that if a firm determines that the threats relative to these other individuals are significant, then their rotation from the engagement is the necessary safeguard. She indicated that this principle can be further emphasized in the Basis for Conclusions.

<sup>3</sup> In paragraph 290.149B

Matters Raised	Task Force/IESBA Response
	The Board reaffirmed in the re-Exposure Draft that the general provisions apply to evaluating the potential threats created with respect to <i>all</i> individuals on the audit team, not just senior personnel (see paragraphs 290.148A – 290.149B in the <a href="#">re-Exposure Draft</a> ).

#### Matters for Consideration

- Representatives are asked to note the report back.

#### Material Presented – FOR IESBA CAG REFERENCE PURPOSES ONLY

Long Association re-Exposure Draft: *Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client*

<http://www.ifac.org/publications-resources/exposure-draft-limited-re-exposure-proposed-changes-code-addressing-long>

## Appendix

### Project History

#### Project: Long Association

#### Summary

	CAG Meeting	IESBA Meeting
Project commencement	April 2013 September 2013	December 2012 June 2013 September 2013
Development of proposed international pronouncement for Phase I (up to exposure)	October 2013 March 2014 June 2014	December 2013 April 2014 July 2014
Exposure Draft	August 2014 – November 12, 2014	
Consideration of significant comments on Exposure Draft	March 2015 September 2015	January 2015 April 2015 June/July 2015 October 2015 November/December 2015
Exposure Draft	February 2016 – May 9, 2016	