

PROJECT PROPOSAL—LONG ASSOCIATION OF SENIOR PERSONNEL (INCLUDING PARTNER ROTATION) WITH AN AUDIT CLIENT

I. Subject

1. The provisions in the subsection of the IESBA *Code of Ethics for Professional Accountants* (the Code) addressing long association of senior personnel (including partner rotation) with an audit client (“long association provisions”).

II. Background and Relevant Developments

2. Familiarity and self-interest threats are created by using the same senior personnel on an audit engagement over a long period of time. Paragraph 290.150 of the Code provides guidance to assist the professional accountant to evaluate the significance of the threats and provides examples of safeguards that may be applied when necessary to eliminate the threats or reduce them to an acceptable level. Such safeguards include rotating the senior personnel off the audit. Further, Paragraphs 290.151-155 provide specific rotation requirements for audit clients that are public interest entities (PIEs), including a seven year on / two year off rotation requirement for key audit partners.¹
3. The IESBA recognizes that a threat to professional skepticism is created by the long association of senior personnel on an audit engagement. In the IESBA's view, the rotation of key audit partners balances the need for a fresh look on the audit with the need for continuity of knowledge of the client's business and the risks inherent in that business in order to maintain audit quality.
4. The IESBA also recognizes that there have been initiatives undertaken in many jurisdictions to address the question of whether there are ways in which to promote greater professional skepticism and auditor independence, and therefore enhance audit quality.
5. In addition, feedback from certain of the IESBA's constituents has suggested that the two-year time-out period is too short when placed together with the permissible seven years of service, because it would potentially allow a key audit partner to serve on the audit engagement for a PIE for 14 out of 16 consecutive years.
6. In light of this feedback, and the manner in which rotation provisions have developed across a range of jurisdictions, the IESBA agreed that it would be appropriate to reconsider the long association provisions in the Code, particularly the rotation requirements, and determine whether the provisions continue to provide robust and appropriate safeguards against familiarity and self-interest threats arising from the long association of senior personnel with an audit client.²

¹ The Code defines key audit partners as follows: “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.”

² The IESBA's due process requires that prior to the Board initiating a new project, the Board consider and approve a project proposal that gives consideration to, among other things, the public interest and the costs and benefits of the proposed project.

III. Project Objective and Scope, and How They Serve the Public Interest

Project Objective

7. The project objective is to review the long association provisions in Section 290 of the Code to ensure that they continue to provide robust and appropriate safeguards against the familiarity and self-interest threats arising from long association with an audit client.

Project Scope

8. The scope of this project encompasses the long association provisions in the subsection *Long Association of Senior Personnel (Including Partner Rotation) with an Audit Client* (paragraphs 150-155) of Section 290 of the Code.

How the Project Serves the Public Interest

9. The project will serve the public interest by ensuring that the long association provisions in Section 290 of the Code continue to provide robust and appropriate safeguards against familiarity and self-interest threats arising from long association with an audit client, thereby helping to enhance professional skepticism and independence and thus audit quality.

IV. Outline of the Project

Issues that Will Be Addressed

10. In 2005, the Board determined that a principles-based framework together with a specific seven-year on/two-year off requirement for certain audit partners serving listed audit clients reflected an appropriate approach for responding to familiarity and self-interest threats created by long association of senior personnel with audit clients. . For example, the rotation requirements were consistent with those adopted by the EU in its Eighth Directive. However, views on this issue in some parts of the regulatory community have changed. For example, today, only a few major jurisdictions in the G20 appear to utilize a 7/2 approach for the lead audit and review partners on the audits of listed entities.
11. In the light of developments in a broad range of jurisdictions, the IESBA should consider whether the long association provisions as a whole remain appropriate, specifically considering the rotation requirements for key audit partners for audits of PIEs. In particular, feedback from certain of the IESBA's constituents has suggested that the two-year time-out period is too short, if placed together with seven years of service, because it would allow a key audit partner to serve on the audit for 14 out of 16 years.
12. Consideration should also therefore be given to whether a shorter period on the engagement team and/or a longer time-out period would strengthen auditor independence and, if so, how such a change could operate in a global code. As part of this consideration, the project will seek to understand why regulators or national standard setters in different jurisdictions have chosen the periods that should apply in their national contexts.

OTHER ISSUES

13. In order to conclude whether the long association provisions remain appropriate or whether there are ways in which the provisions could be strengthened, the project should consider other aspects such as:
 - The types of entities with respect to which rotation requirements should apply (e.g., all PIEs or other entities according to industry, size, or market characteristics).
 - The partners covered in the definition of key audit partners.
 - Whether the PIE rotation requirements should apply to other individuals involved in the audit in addition to key audit partners.
 - The implications of any relationship between the individual rotating off the engagement and that individual's replacement;
 - The nature of the involvement, if any, that the rotated individual may have in the audit while rotated off.
 - Any specific exemptions that should be provided.
 - Whether those charged with governance should be involved in the rotation decision and, if so, how and to what extent.
14. To inform the IESBA's consideration of these issues, the project will research the senior personnel rotation requirements in the major jurisdictions around the world. It will also seek to understand firms' approaches to dealing with the threats arising from long association of senior personnel with audit clients and how they have addressed any practical challenges related to the implementation of rotation requirements.

Impact Analysis Considerations

15. Should the long association provisions in the Code be further enhanced, the primary benefit would be to promote greater professional skepticism and auditor independence, and therefore enhance audit quality.
16. There would likely be implementation costs at the national and firm levels if the Code's long association provisions were to be further strengthened, including costs to bring national rules in line with the Code and operational costs within firms to comply with potentially stricter rotation requirements. These costs would vary depending on national and firm-specific circumstances.
17. Further consideration of costs and benefits will be an important part of the IESBA's evaluation of proposals in progressing the project. IFAC is currently developing an impact analysis framework for the standard-setting bodies that it supports.

V. Implications for any Specific Persons or Groups

18. The project has particular implications for national standard setters and IFAC member bodies that have adopted the Code, or use it as a basis or a benchmark for their own ethical standards, and firms that are subject to these national standards.
19. Depending on the nature of the proposals, there may be implications for smaller practices that audit small- and medium-sized entities. IFAC's Small and Medium Practices (SMP) Committee will be kept apprised of developments to ensure appropriate input is received at key stages of the project.
20. This project also has implications for the IAASB relative to the alignment of the rotation provisions in ISQC 1³ with those of the Code.
21. The project may also have specific implications for other stakeholders in the financial reporting supply chain, in particular preparers and regulators, in addition to the audited entities themselves.

VI. Development Process, Project Timetable and Project Output

Development Process

22. It is anticipated that the project will follow the normal development process of the IESBA if it concludes that changes to the Code are required.
23. The project approach will include appropriate dialogue with policy makers or others able to influence policy in this area so that, to the extent possible, consistent requirements and guidance are developed.

Project Timetable

24. Subject to the IESBA's approval of the project proposal, this project will commence immediately. The specific project milestones and outputs will be dependent on the matters that the project Task Force ultimately determines are appropriate to address as part of the project, and the priorities assigned to those matters.

Indicative Timing	Milestone
December 2012	Approval of project proposal
December 2013	Approval of exposure draft
Ongoing	Dialogue with stakeholders on key issues and proposals ⁴

Project Output

25. The output of the project may take the form of additional or revised requirements and guidance in the Code regarding long association of senior personnel with an audit client.

³ ISQC 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

⁴ To include discussion with the IESBA CAG and IESBA-NSS Liaison Group

VII. Resources Required

26. A project Task Force will be established, consisting of four individuals, including an IESBA member as chair.
27. Consideration will also be given as to how best to obtain appropriate input from other stakeholders who have similar projects (in particular, regulators). This may be through membership on the project Task Force, correspondent membership, or by other means.
28. IESBA Staff will provide support to the project Task Force.

VIII. Relevant Sources of Information that Address the Matter Being Proposed

29. Relevant sources of information include:
 - Rotation provisions in major jurisdictions around the world.
 - Firms, with regard to their approaches to compliance with national rotation requirements.

Appendix

Comments by IFAC Technical Managers

The comments of IFAC Technical Manager from each technical area are required before this Project Proposal is considered by the board or committee proposing to undertake the project.

Technical Manager to the Compliance Advisory Panel and Professional Accountancy Organization Development Committee

No comments.

Signed: Szymon Radziszewicz

Date: November 5, 2012

Technical Manager to the International Accounting Education Standards Board (IAESB)

I have read the proposal and agree with the aim and purpose of the project. The proposed project proposal on Partner Rotation, as indicated above, is not expected to have a direct impact on the current work of the IAESB or the Board's work to revise its International Education Standard on the professional development of engagement partners.

Signed: David McPeak

Date: November 19, 2012

Technical Manager to International Auditing and Assurance Standards Board (IAASB)

For IAASB, duly noted, and I'd like to suggest the following comment.

The project proposal appropriately identifies the need to assess the potential implication of the project in relation to the provision of ISQC 1. It is requested the IESBA staff undertake to periodically brief IAASB staff, and as appropriate the IAASB Steering Committee, on major developments on the project. It is also requested that at an appropriate pre-determined stage in the development of any exposure draft the IAESB and IAASB consider whether a suitable degree of coordination is being achieved on issues of mutual interest.

Signed: James Gunn

Date: November 9, 2012

Technical Manager to the Professional Accountants in Business (PAIB) Committee

From a PAIB perspective I have no comments to make at this stage although I think the preparer will have an input to make on the mechanisms for ensuring independence.

Signed: Stathis Gould

Date: November 2, 2012

Technical Manager to the International Public Sector Accounting Standards Board

No comments.

Signed: Stephenie Fox

Date: November 2, 2012

Technical Manager to the Small and Medium Practices Committee

Although this project may eventually prove to have little impact on SMPs generally, we are cognizant that moves to make rotation requirements more stringent, or wider in scope, could potentially have a

disproportionate impact for SMPs, given their limited resources. In such a situation, the benefits of any proposed changes to the Code would need to be apparent, including the resultant effect on audit quality and competition in the audit market. We therefore appreciate the opportunity for input and liaison as set out in paragraph 22 and will be happy to assist the IESBA in any way we can.

Signed: Paul Harrison

Date: November 9, 2012

Technical Manager to the Transnational Auditors Committee (TAC)

The broader subject area for this project proposal is extremely topical at present and will need to be handled with sensitivity. Many Forum of Firms members would have already provided views in this broader area in comments responding to materials from other regulatory agencies and as such we think it would be useful to ensure that these get taken into serious consideration as part of the project research.

A further point is the need to be cognizant of the practical realities – is a global indicator like, for example, 7 years / 2 cooling-off suitable for ALL jurisdictions regardless of size of the profession vs. number of public interest entities etc. This may be contributing to why currently there is great variation amongst jurisdictions. I guess the broader point being that it is important to give serious consideration to the implementation challenges/considerations and global differences in determining how to construct an international benchmark.

Signed: Barry Naik

Date: November 13, 2012