

Agenda Item 5-H

Proposed Section 540

Long Association of Personnel (Including Partner Rotation) with an Audit Client (Restructured from Extant Revised Provisions (Mark-up))¹

Introduction

540.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.

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General Provisions

540.2 290.148 —When an individual is involved in an audit engagement over a long period of time, familiarity and self-interest threats might be created, which may impact an individual's objectivity and professional skepticism, may be created and may increase in significance when an individual is involved in an audit engagement over a long period of time. Section 540 sets out requirements and application material relevant to long association of personnel with an audit client.

Commented [KS2]: Safeguards conforming amendment.

Requirements and Application Material

General Provisions

540.3 A1 Although an understanding of an audit client and its environment is fundamental to audit quality, a familiarity threat may ~~might~~ be created as a result of an individual's long association as a member of the audit team with:

Commented [IS3]: 290.148

- (a) The audit client and its operations;
- (b) The audit client's senior management; or
- (c) The financial statements on which the firm will express an opinion or the financial information which forms the basis of the financial statements.

540.3 A2 A self-interest threat may ~~might~~ be created as a result of an individual's concern about losing a longstanding client or an interest in maintaining a close personal relationship with a member of senior management or those charged with governance, and which ~~Such a threat may might~~ inappropriately influence the individual's judgment inappropriately.

Commented [IS4]: 290.148

540.3 A3 290.151 The significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such actions that might be safeguards to address familiarity and self-interest threats include:

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- Rotating the individual off the audit team.
- Changing the role of the individual on the audit team or the nature and extent of the tasks the individual performs.

¹ The extant revised provisions are those presented at the September 2016 IESBA meeting for approval for close-off under the extant structure and drafting conventions.

- Having a professional accountant who was not a member of the audit team review the work of the individual.
- Performing regular independent internal or external quality reviews of the engagement.
- Performing an engagement quality control review.

R540.4 290.152 If a firm decides that the level of the threats are so significant that created can only be addressed by rotating on of an the individual off the audit team is a necessary safeguard, the firm shall determine an appropriate period during which the individual shall not:

Commented [KS6]: Safeguards conforming amendment.

- (a) ~~be~~ a member of the engagement team;
- (b) ~~provide~~ quality control for the audit engagement; or
- (c) ~~exert~~ direct influence on the outcome of the audit engagement.

The period shall be of sufficient duration to allow the familiarity and self-interest threats to independence to be eliminated or reduced to an acceptable level. In the case of a public interest entity, paragraphs ~~R540.5~~290.153 to ~~R540.19~~290.168 also apply.

540.4 A1 290.149 Factors, individually or in combination, that are important to evaluating the significance level of the any threats created from an individual being involved in an audit engagement over a long period of time include: will depend on factors, individually or in combination, relating to both the individual and the audit client.

Commented [KS7]: Safeguard conforming amendment.

- (a) ~~Factors relating In relation~~ to the individual include:
 - The overall length of the individual's relationship with the client, including if such relationship existed while the individual was at a prior firm.
 - How long the individual has been an engagement team member ~~of the engagement team~~, and the nature of the roles performed.
 - The extent to which the work of the individual is directed, reviewed and supervised by more senior personnel.
 - The extent to which the individual, due to the individual's seniority, has the ability to influence the outcome of the audit, for example, by making key decisions or directing the work of other ~~members of the engagement team~~ members.
 - The closeness of the individual's personal relationship with senior management or those charged with governance.
 - The nature, frequency and extent of the interaction between the individual and senior management or those charged with governance.
- (b) ~~Factors relating In relation~~ to the audit client include:
 - The nature or complexity of the client's accounting and financial reporting issues and whether they have changed.
 - Whether there have been any recent changes in senior management or those charged with governance.

- Whether there have been any structural changes in the client's organization which impact the nature, frequency and extent of interactions the individual ~~may~~ might have with senior management or those charged with governance.

540.4 A2 ~~290.150~~ The combination of two or more factors ~~may~~ might increase or reduce the significance level of the threats. For example, familiarity threats created over time by the increasingly close relationship between an individual and a member of the client's senior management would be reduced by the departure of that member of the client's senior management and the start of a new relationship.

Commented [KS8]: Safeguards conforming amendment.

Audits of Public Interest Entities

R540.5 ~~290.153~~ Subject to paragraphs R540.6 to R540.8, ~~in~~ respect of an audit of a public interest entity, an individual shall not act in any of the following roles, or a combination of such roles, for a period of more than seven cumulative years (the "time-on" period):

- (a) The engagement partner;
- (b) The individual appointed as responsible for the engagement quality control review; or
- (c) Any other key audit partner role.

After the time-on period, the individual shall serve a cooling-off period in accordance with the provisions in paragraphs R540.9 to R540.17~~290.155 – 290.163~~.

540.5 A1 ~~290.154~~ In calculating the time-on period, the count of years may be restarted if the individual ceases to act in any one of the ~~above~~ roles in paragraph R540.5(a) to (c) for a consecutive period equal to at least the cooling-off period determined in accordance with paragraphs R540.9~~290.155~~ to R540.11~~290.157~~ as applicable to the role in which the individual served in the year immediately before ceasing such involvement. For example, an individual who served as engagement partner for four years followed by five consecutive years off the audit engagement may thereafter return to the same audit engagement for a cumulative period of seven years in any one of the above ~~in paragraph 290.153(a) – (c) above~~ or a combination of such roles.

R540.6 ~~290.166~~ As an exception to R540.5 ~~Despite paragraphs 290.153 – 290.164~~, key audit partners whose continuity is especially important to audit quality may, in rare cases due to unforeseen circumstances outside the firm's control, and with the concurrence of those charged with governance, be permitted to serve an additional year as a key audit partner as long as the threat to independence can be eliminated or reduced to an acceptable level by applying safeguards.

Commented [KS9]: Safeguard conforming amendment.

540.6 A1 For example, a key audit partner may remain in that role on the audit team for up to one additional year in circumstances where, due to unforeseen events, a required rotation was not possible, as might be the case due to serious illness of the intended engagement partner. The firm shall discuss with those charged with governance the reasons why the planned rotation cannot take place and the need for any safeguards to reduce any threat created.

Commented [KS10]: 290.166

R540.7 ~~290.167~~ ~~If~~ When an audit client becomes a public interest entity, a firm shall take into account the length of time ~~the~~ an individual has served the audit client as a key audit partner before the client becomes a public interest entity ~~shall be taken into account~~ in determining the timing of the rotation. If the individual has served the audit client as a key audit partner

for a period of five cumulative years or less when the client becomes a public interest entity, 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 key audit partner for a period of six or more cumulative years when the client becomes a public interest entity, the ~~partner individual~~ individual may, as an exception to R540.5, continue to serve in that capacity with the concurrence of those charged with governance for a maximum of two additional years before rotating off the engagement.

R540.8 ~~290.168~~ When a firm has only a few people with the necessary knowledge and experience to serve as a key audit partner on the audit of a public interest entity, rotation of key audit partners ~~may~~ might not be possible ~~an available safeguard~~. If an independent regulator in the relevant jurisdiction has provided an exemption from partner rotation in such circumstances, an individual may, as an exception to paragraph R540.5, remain a key audit partner for more than seven years, in accordance with such regulation. This is provided that the independent regulator has specified alternative safeguards which are applied, such as a regular independent external review.

Commented [KS11]: Safeguard conforming amendment.

Cooling-off Period

R540.9 ~~290.155~~ Subject to paragraph R540.17, ~~if~~ the individual acted as the engagement partner for seven cumulative years, the cooling-off period shall be five consecutive years.

R540.10 ~~290.156~~ Where the individual has been appointed as responsible for the engagement quality control review and has acted in that capacity for seven cumulative years, the cooling-off period shall be three consecutive years.

R540.11 ~~290.157~~ If the individual has acted ~~in any other capacity~~ as a key audit partner other than in the capacities set out in R540.9 and R540.10 for seven cumulative years, the cooling-off period shall be two consecutive years.

Service in a combination of key audit partner roles

R540.12 ~~290.158~~ Subject to R540.17, ~~if~~ the individual acted in a combination of key audit partner roles and served as the engagement partner for four or more years, the cooling-off period shall be five consecutive years.

R540.13 ~~290.159~~ Subject to paragraph R540.14(a), ~~if~~ the individual acted in a combination of key audit partner roles and served as the key audit partner responsible for the engagement quality control review for four or more years, the cooling-off period shall, ~~subject to paragraph 290.160(a),~~ be three consecutive years.

R540.14 ~~290.160~~ ~~if~~ an individual has acted in a combination of engagement partner and engagement quality control review roles for four or more years in aggregate during the time-on period, the cooling-off period shall ~~be:~~

- (a) As an exception to R540.13 and subject to R540.17, ~~be~~ five consecutive years where the individual has been the engagement partner for three or more years; or
- (b) Be ~~three~~ consecutive years in the case of any other combination.

R540.15 290.161 If the individual acted in any other combination of key audit partner roles other than those addressed in R540.12 to R540.14, the cooling-off period shall be two consecutive years.

Service at a Prior Firm

R540.16 290.162 In determining the number of years that an individual has been a key audit partner under paragraphs R540.5, 290.153 to 290.154, the length of the relationship shall, where relevant, include time while the individual was a key audit partner on that engagement at a prior firm.

Alternative Jurisdictional Approaches to Addressing Threats Created by Long Association

R540.17 290.163 A legislative body or regulator (or organization authorized by such legislative body or regulator) ~~may~~might have evaluated the familiarity and self-interest threats to independence that arise from long association with an audit client and determined that a different set or combination of requirements to those established in this Section is appropriate to reduce the threats to an acceptable level. In such circumstances, as an exception to paragraphs R540.9, 290.155, R540.12, 290.158 and R540.14(a)~~290.160~~, the cooling-off period of five consecutive years ~~specified in paragraphs 290.155, 290.158 and 290.160~~ may be reduced to three consecutive years if, in relation to the audit of that public interest entity:

- (a) The legislative body or regulator (or organization authorized by such legislative body or regulator) has established requirements for:
 - (i) A time-on period shorter than seven years during which an individual is permitted to be the engagement partner; or
 - (ii) Mandatory firm rotation or mandatory re-tendering of the audit appointment after a predefined period; or
 - (iii) Joint audits; and
- (b) An independent regulatory inspection regime operates in the jurisdiction.

Restrictions on Activities During the Cooling-off Period

R540.18 290.164 For the duration of the relevant cooling-off period, the individual shall not:

- (a) Be ~~an member of the engagement team~~ member or provide quality control for the audit engagement;
- (b) Consult with the engagement team or the client regarding technical or industry-specific issues, transactions or events affecting the audit engagement (other than discussions with the engagement team limited to work undertaken or conclusions reached in the last year of the individual's time-on period where this remains relevant to the audit). ~~However~~As an exception, if an individual who has acted as the engagement partner or the individual responsible for the engagement quality control review is also, or becomes, an individual whose primary responsibility is to be consulted within a firm on a technical or industry-specific issue, the individual may provide such technical consultation to the engagement team provided:

- (i) Two years have elapsed since the individual was a member of the engagement team or the individual responsible for the engagement quality control review;
 - (ii) There is no other partner within the firm expressing the audit opinion with the expertise to provide the advice; and
 - (iii) Such consultation is in respect of an issue, transaction or event that was not previously considered by that individual in the course of acting as the engagement partner or the individual responsible for the engagement quality control review;
- (c) Be responsible for leading or coordinating the firm's professional services to the audit client or overseeing the firm's relationship with the audit client; or
- (d) Undertake any other role or activity not referred to above with respect to the audit client, including the provision of non-assurance services, that would result in the individual:
- (i) Having significant or frequent interaction with senior management or those charged with governance; or
 - (ii) Exerting direct influence on the outcome of the audit engagement.

540.18 A1 ~~The provisions of R540.18 this paragraph are not intended to prevent the individual from assuming a leadership role in the firm, such as that of the Senior or Managing Partner Chief Executive or equivalent.~~

Commented [KS12]: 290.164

Other Matters Considerations

R540.19 ~~In evaluating the threats created by an individual's long association with an audit engagement, a firm shall give particular consideration shall be given to the roles undertaken and the length of the an individual's association with the audit engagement prior to an the individual becoming a key audit partner.~~

Commented [KS13]: 290.165

540.19 A1 290.165 ~~There may might be situations where a the firm, based on an evaluation of threats in accordance with the general provisions above in applying the conceptual framework, concludes that it is not appropriate for an individual who is a key audit partner to continue in that role even though the length of time served as a key audit partner is less than seven years. In evaluating the threats, particular consideration shall be given to the roles undertaken and the length of the individual's association with the audit engagement prior to an individual becoming a key audit partner.~~

Proposed Section 940
Long Association of Personnel with an Assurance Client
(Restructured from Extant Revised Provisions (Mark-up))

Introduction

940.1 ~~Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats.~~

Commented [IS14]: New paragraph

940.2 291.137 ~~When an individual is involved in an assurance engagement of a recurring nature over a long period of time, familiarity and self-interest threats, which may be created, impact an individual's objectivity and professional skepticism, may be created and may increase in significance when an individual is involved on an assurance engagement of a recurring nature over a long period of time. Section 940 sets out requirements and application material relevant to long association of personnel with an assurance client.~~

Commented [KS15]: Safeguards conforming amendment.

Requirements and Application Material

940.3 A1 ~~A familiarity threat may be created as a result of an individual's long association with:~~

Commented [KS16]: 291.137

(a) ~~The assurance client; or~~

(b) ~~The subject matter and subject matter information of the assurance engagement.~~

940.3 A2 ~~A self-interest threat may be created as a result of an individual's concern about losing a longstanding assurance client or an interest in maintaining a close personal relationship with the assurance client or a member of senior management, and which may Such a threat might inappropriately influence the individual's judgment inappropriately.~~

Commented [KS17]: 291.137

940.3 A3 291.140 ~~The significance of any threats shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such actions that might be safeguards to address familiarity and self-interest threats in relation to a specific engagement include:~~

Commented [KS18]: Safeguards conforming amendment.

- ~~Rotating the individual off the assurance team.~~
- ~~Changing the role of the individual on the assurance team or the nature and extent of the tasks the individual performs.~~
- ~~Having a professional accountant who is not a member of the assurance team review the work of the individual.~~
- ~~Performing regular independent internal or external quality reviews of the engagement.~~
- ~~Performing an engagement quality control review.~~

Commented [KS19]: Subject to further review by Safeguards TF pending completion of its deliberations on Safeguards Phase 2 for Sept 2016 IESBA meeting.

R940.4 291.141 If a firm decides that the level of the threats created can only be addressed by ~~are so significant that rotating~~ ~~of an~~ ~~the~~ ~~individual~~ ~~off the assurance team~~ ~~is a necessary safeguard~~, the firm shall determine an appropriate period during which the individual shall not:

- (a) ~~b~~ Be a member of the engagement team;
- (b) ~~p~~ Provide quality control for the assurance engagement; or
- (c) ~~e~~ Exert direct influence on the outcome of the assurance engagement.

The period shall be of sufficient duration to allow the familiarity and self-interest threats to be eliminated or reduced to an acceptable level.

940.4 A1 291.138 Factors, individually or in combination, that are important to evaluating the significance level of the any threats created from an individual being involved in an assurance engagement over a long period of time include ~~will depend on factors, considered individually or in combination, such as:~~

- The nature of the assurance engagement.
- How long the individual has been ~~a member of the~~ an assurance team member, the individual's seniority on the team, and the nature of the roles performed, including if such a relationship existed while the individual was at a prior firm.
- The extent to which the work of the individual is directed, reviewed and supervised by more senior personnel.
- The extent to which the individual, due to the individual's seniority, has the ability to influence the outcome of the assurance engagement, for example, by making key decisions or directing the work of other ~~members of the~~ engagement team members.
- The closeness of the individual's personal relationship with the assurance client or, if relevant, senior management.
- The nature, frequency and extent of interaction between the individual and the assurance client.
- Whether the nature or complexity of the subject matter or subject matter information has changed.
- Whether there have been any recent changes in the individual or individuals who are the responsible party or, if relevant, senior management.

Commented [KS20]: Safeguards conforming amendment.

940.4 A2 291.139 The combination of two or more factors ~~may~~ might increase or reduce the significance level of the threats. For example, familiarity threats created over time by the increasingly close relationship between an individual and the assurance client would be reduced by the departure of the person who is the responsible party and the start of a new relationship.

Commented [KS21]: Safeguards conforming amendment.