

Long Association—Issues and Task Force Proposals**I. Background**

1. Subsequent to Board approval of the Long Association close-off document at the September 2016 IESBA meeting, the IESBA Chairman was alerted around mid-October to the possibility that PIOB approval of the document might not be forthcoming. This was attributed primarily to concern that the provisions were too complex and that the “jurisdictional clause” resulted in only a limited improvement in the cooling-off provisions.
2. In early November, at the request of the IESBA Chairman and Task Force Chair, the PIOB Chairman and staff sent a note of the specific issues that the PIOB had identified (see the Appendix). A week later, the IESBA Chairman and Task Force Chair submitted a written response to the various matters the PIOB had raised (see **Agenda Item 8-F**).
3. Further discussions between the IESBA and PIOB representatives ensued, including an in-person meeting among the Task Force Chair and the PIOB Chairman and Secretary General on November 17, in an attempt to resolve the issues.
4. As a result of those discussions, the PIOB’s concerns were narrowed down to three key areas, namely:
 - (a) The jurisdictional clause;
 - (b) The provision lifting a prohibition on the engagement team consulting an engagement partner (EP) or engagement quality control reviewer (EQCR) if they have taken on a primary role as a technical specialist in their firms after they have cooled off for two years on a public interest entity (PIE) audit; and
 - (c) The need for transitional provisions relative to the effective date.
5. The discussions led to a tentative agreement with the PIOB representatives on changes to the close-off document that they felt would address the PIOB’s key concerns above. In addition, there was tentative agreement on two clarifications to the close-off text. These changes are outlined in Section II below.
6. During the discussions, the IESBA and PIOB representatives agreed on the need for closer liaison between the PIOB and IESBA to mitigate or eliminate the risk of a similar situation arising in future. The PIOB representatives acknowledged the importance of the PIOB being clear about its views on substantive issues as a project progresses and the associated transparency needs with respect to reports back to the PIOB after each IESBA meeting.
7. The Task Force convened via teleconference in the latter part of November to be briefed on the issues raised by the PIOB and the discussions with the PIOB representatives. The Task Force expressed strong concerns that the matters raised by the PIOB representatives, and the timing in which these have been raised, gave rise to significant issues. However, the Task Force recognized that the overarching public interest lies in ensuring that the provisions secure PIOB approval. The Task Force also accepted that the proposed changes, while not being changes which it would have advocated, do not affect the conceptual structure of the revised provisions. Against that

background, the Task Force agreed to recommend the proposed changes for consideration and approval by the Board.

8. The Task Force Chair subsequently presented the proposed changes to the PIOB for discussion at its December 1-2 meeting (see **Agenda Item 8-D**).
9. At that meeting, the PIOB took note of the substance and formulation of the proposals. The PIOB indicated that it would welcome receiving IESBA approval of these proposals and, subsequently, the IESBA's submission of the revised close-off document for the PIOB's conclusions on due process and in regards to the public interest.

II. Proposed Changes to September 2016 Close-off Document

10. Given the circumstances and in the light of the various discussions outlined above, the Task Force accepted the following changes to the close-off document in order to address the PIOB concerns.

Jurisdictional Clause

11. The Task Force proposes that this provision be replaced with the following revised provision (see paragraph 290.163):

Where a legislative body or regulator (or organization authorized by such legislative body or regulator) has established a cooling-off period for an engagement partner of three consecutive years, that three-year period shall be substituted for the cooling-off period of five consecutive years specified in paragraphs 290.155, 290.158 and 290.160(a) provided that the applicable time-on period does not exceed seven years. This paragraph shall cease to have effect on December 15, 2023.
12. This approach would allow the Board to monitor developments in the area of long association, including implementation of the revised provisions in the Code, and subsequently make any adjustments that the Board might consider necessary. Specifically, through the “sunset mechanism” embedded in the revised provision, the Board would review the provision about a year or so before its expiry and determine whether to withdraw it or extend the period during which it would remain operative.
13. The approach to the review of the provision would be determined in due course.

Permission for Limited Consultation during the Cooling-off Period

14. The Task Force proposes that this permission be withdrawn (paragraph 290.164(b)). Consequently, subject to the exception noted below, consultation between the engagement team and the EP or EQCR would be prohibited during the period when they would be cooling off from the PIE audit engagement. The Task Force recognizes that while it is unlikely that the withdrawal of this permission would affect the larger firms to any significant extent, it would likely add to the challenges smaller firms face in auditing PIEs.
15. However, in accordance with paragraph 290.168 (restructured paragraph R540.9), relief would be available where an independent regulator in a particular jurisdiction provides an exemption from partner rotation. In such circumstances, the individual could remain as a key audit partner on the audit engagement and be consulted within the engagement team.
16. The only exception to the prohibition would be in relation to discussions between the individual and the engagement team that would be 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 (see paragraph 290.164(b)).

Transitional Provisions

17. The Task Force proposes in the light of PIOB concerns that no transitional provisions be provided. Accordingly, with respect to audit engagements (extant Section 290/restructured Section 540), the revised provisions (issued in the new structure format) would become effective for audits of financial statements for years beginning on or after December 15, 2018.
18. Subject to Board agreement that there be no transitional provisions, firms will have a two-year window to make the necessary arrangements for partner rotation on relevant PIE audit engagements before the new provisions become effective. To maximize awareness, the Task Force recommends that communication of the effective date be included as part of the IESBA Update to be issued with the release of the second Structure Exposure Draft (Structure ED-2) in January 2017. This would be in addition to making the close-off document available on the IESBA website (with a clear indication of when the revised and restructured provisions would become effective), outreach to the Forum of Firms, IFAC Small and Medium Practices (SMP) Committee, IFAC member bodies and national standard setters, and communication via the Board's other messaging channels, including IESBA e-News.
19. With respect to other assurance engagements (extant Section 291/restructured Section 940), the revised provisions (also issued in the new structure format) would become effective as of December 15, 2018.
20. In both cases, early adoption would be permitted.

Matters of Clarification

21. In addition to the above, the Task Force proposes two clarifications as follows:
 - (a) In paragraph 290.152, adding the word "or" in the third line to make it clearer that the individual not only ceases to be a member of the engagement team but also cannot provide quality control for the audit engagement or exert direct influence on the outcome of the audit engagement (a corresponding change has been made to paragraph 291.141). This change would be carried through to the restructured text; and
 - (b) Amending paragraph 290.168 to read:

If an independent regulator in the relevant jurisdiction has provided an exemption from partner rotation in such circumstances, an individual may remain a key audit partner for more than seven years, in accordance with such regulation, provided that the independent regulator has specified ~~alternative other~~ requirements which are to be applied, such as the length of time that the key audit partner may be exempted from rotation or a regular independent external review.

This is to avoid suggesting that the exemption from the partner rotation requirement could be indefinite.

Matter for Consideration

1. In the light of the circumstances and PIOB support for the proposed changes to the close-off document, do IESBA members agree with the revised provisions and their effective date?

III. Consideration of the Need for Re-Exposure

22. The Task Force considered but did not believe that re-exposure would be warranted in the circumstances for the following reasons:
 - The further changes relate to matters that have all been subject to lengthy Board deliberation and public exposure previously. Re-exposure would unlikely add any new knowledge to guide the Board's considerations in finalizing the relevant provisions.
 - The proposed changes do not affect the conceptual structure of the revised provisions.
 - It is imperative to secure PIOB approval of the revised provisions, which contain significant improvements over the extant provisions, in the overall public interest. Failure to secure such approval would result in the current out-of-date provisions remaining in effect for the foreseeable future until the Board determines a new way forward.

Matter for Consideration

2. Do IESBA members agree that *in the circumstances* the changes to the close-off document do not warrant re-exposure?

IV. Restructured Text

23. With input from the Structure Task Force, the Long Association Task Force has restructured the close-off document incorporating the further changes made in response to the matters raised by the PIOB. The changes arising from the restructuring exercise are set out in **Agenda Item 8-B**.

Matter for Consideration

3. IESBA members are asked to consider the proposed restructured text and approve it for exposure.

V. Way Forward

24. Subject to Board approval of the changes to the close-off document:
 - The Chair of the CAG has agreed to brief the CAG on the outcome of the Board's deliberations at this meeting.
 - The revised close-off document will be submitted for PIOB approval at a teleconference which the PIOB has agreed to arrange at the earliest opportunity in January 2017.
 - As soon as PIOB approval is secured, the restructured text will be included as part of Structure ED-2 for issuance in January 2017.

- Staff will liaise with the Task Force in reviewing the proposed Q&As to be released with the final restructured provisions for any consequential changes. The revised Q&As will be presented for Board input at the March 2017 IESBA meeting.

APPENDIX

Note from PIOB Chairman and Staff

Questions on the proposed provisions

This paper focuses on the main elements which improve the public interest responsiveness of the proposed standard as well as the effectiveness of its safeguards against threats to independence.

Complexity

The complexity of the proposed regime makes it very difficult to understand and will make implementation and monitoring extremely difficult. The Staff Q&A Paper is an indicator of such complexity. Can it be made simpler? Does par. 290.160 add any substantial condition? Could this paragraph be eliminated?

Scope

The proposed regime for the non-PIEs is very weak and essentially based on assessment of the threats and safeguards: could it be made stricter?

Can the definition of the PIE be adapted to include all larger entities such as, e.g., large unlisted public entities?

Exceptions to cooling off

The jurisdictional safeguards proposed seem unnecessary and weaken the proposed regime (i.e. reducing the cooling-off period). Stricter rules in domestic legislation (i.e. mandatory firm rotation) prevail and apply. Could these exceptions (par. 290.163) be eliminated?

Can a professional standard reduce the cooling-off years when the regulator has determined what cooling off will apply and under which conditions? Is the provision relating to mandatory rotation an effective solution?

Is the exception in para. 290.168 needed? Is it not a decision of the regulator?

Exceptions to prohibition to consult during cooling-off period

In principle, consulting with an EP or an EQCR is prohibited during their cooling-off period. However, after only two years of cooling-off, they can be consulted in specific circumstances (par. 290.164). Consultation should be limited to cases where the firm has no technical or industry-specific auditors and such consultation should be limited only to one year and to work undertaken or conclusions reached in the last year, after which the firm should be able to consult a specialist in the market. Could provisions in par. 290.164 (b) be simplified to establish this simple principle, eliminating (b) (i), (ii), (iii)?

Transitional Provisions

EPs and EQCRs on audits of PIEs who have served their seven cumulative years of service and have started their cooling off at the time the LA provisions become effective (December 15, 2018) must cool off for two years (extant provisions in the Code). In all other circumstances, the cooling-off periods introduced with the revised LA provisions (5 years for EP, 3 years for EQCR) will be applied.

Is there a need of transitional provisions? If so, why do they allow the application of the old regime (extant Code)?

Why is the effective date established in two years (December 2018)?

Concerns raised by the IOB Observers at IESBA and CAG meetings in 2015

Table from the 11th IOB Public Report

WHEN	PUBLIC INTEREST ISSUES
IESBA January 2015 meeting	<p>Scope does not include audit firm rotation</p> <p>No reference is made to firm rotation. At least some mention should be made, allowing for firm rotation in jurisdictions where this is mandatory or accepted practice.</p>
IESBA June 2015 meeting	<p>Cooling-off period of EPs and EQCRs in LA provisions should be aligned</p> <p>The regime has now been strengthened for EPs (five-year cooling-off period). Rotation of the other leading auditors should not be more lax as that may be detrimental to audit quality.</p>
IESBA June 2015 meeting	<p>Weakness of LA provisions</p> <p>The overall weakness of the new regime may affect audit quality and influence the structure of the profession and its attitude toward effective oversight of companies' accounting systems. The regime should be extended to a wider range of PIEs, including (in addition to listed companies) financial institutions and large companies such as government-owned entities, where the need for reliable accounting is significant. Also, the consultancy activity of the EP in the cooling-off period should be described more clearly and limited to specific services for which few or no alternatives are available on the market. Therefore, the IAASB also needs to strengthen the PIE regime.</p>
IESBA October 2015 teleconference and CAG September 2015 meeting	<p>Complexity of LA provisions</p> <p>The proposal is quite complex and difficult to analyze.</p> <p>The added level of complexity to the code risks taking the focus off the key independence principles and making understanding, acceptance, application, compliance, and convergence more difficult.</p>