

Proposed Section 540

Long Association of Personnel (Including Partner Rotation) with an Audit Client (CLEAN)

Note to Meeting Participants:

Text highlighted in gray includes conforming amendments arising from the Safeguards project. The rationale for those conforming amendments are explained in **Agenda Item 4-A**. IESBA members will be asked to comment on the conforming amendments during the Safeguards session of the meeting.

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 to independence.
- 540.2 When an individual is involved in an audit engagement over a long period of time, familiarity and self-interest threats might be created .
- 540.3 Section 540 sets out requirements and application material relevant to applying the conceptual framework to long association of personnel with an audit client.

Requirements and Application Material

General

- 540.4 A1 Although an understanding of an audit client and its environment is fundamental to audit quality, a familiarity threat might be created as a result of an individual's long association as an audit team member with:
- (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.
- 540.4 A2 A self-interest threat 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. Such a threat might influence the individual's judgment inappropriately.
- 540.4 A3 Examples of actions that might be safeguards to address familiarity and self-interest threats include:
- Changing the role of the individual on the audit team or the nature and extent of the tasks the individual performs.
 - Having a professional accountant who was not an audit team member review the work of the individual.

- Performing regular independent internal or external quality reviews of the engagement.
- Performing an engagement quality control review.

Another action that might address the threats would be to rotate the individual off the audit team.

R540.5

If a firm decides that the level of the threats created can only be addressed by rotating the individual off the audit team, the firm shall determine an appropriate period during which the individual shall not:

- (a) Be a member of the engagement team; or
- (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 R540.6 to R540.20 also apply.

540.5 A1

Factors, individually or in combination, that are relevant to evaluating the level of any threats created from an individual being involved in an audit engagement over a long period of time include:

(a) In relation to the individual:

- 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, 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 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) In relation to the audit client:

- 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 might have with senior management or those charged with governance.

540.5 A2 The combination of two or more factors might increase or reduce the 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.

Audits of Public Interest Entities

R540.6 Subject to paragraphs R540.7 to R540.9, 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 R540.10 to R540.18.

540.6 A1 In calculating the time-on period, the count of years cannot be restarted unless the individual ceases to act in any one of the roles in paragraph R540.6(a) to (c) for a consecutive period equal to at least the cooling-off period determined in accordance with paragraphs R540.10 to R540.12 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 three years off can only act thereafter as a key audit partner on the same audit engagement for three further years (making a total of seven cumulative years). Thereafter, that individual is required to cool off in accordance with paragraph R540.13.

R540.7 As an exception to R540.6, 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.

540.7 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.

R540.8 If an audit client becomes a public interest entity, a firm shall take into account the length of time an individual has served the audit client as a key audit partner before the client becomes a public interest entity 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 individual may, as an exception to R540.6, 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.

R540.9 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 might not be possible. 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 R540.6, remain a key audit partner for more than seven years, in accordance with such regulation. This is provided that the independent regulator has specified 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.

Cooling-off Period

R540.10 Subject to paragraph R540.18, if the individual acted as the engagement partner for seven cumulative years, the cooling-off period shall be five consecutive years.

R540.11 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.

R540.12 If the individual has acted as a key audit partner other than in the capacities set out in R540.10 and R540.11 for seven cumulative years, the cooling-off period shall be two consecutive years.

Service in a combination of key audit partner roles

R540.13 Subject to R540.18, if the individual acted in a combination of key audit partner roles and served as the engagement partner for four or more cumulative years, the cooling-off period shall be five consecutive years.

R540.14 Subject to paragraph R540.15(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 cumulative years, the cooling-off period shall be three consecutive years.

R540.15 if an individual has acted in a combination of engagement partner and engagement quality control review roles for four or more cumulative years during the time-on period, the cooling-off period shall:

- (a) As an exception to R540.14 and subject to R540.18, 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.

R540.16 If the individual acted in any combination of key audit partner roles other than those addressed in R540.13 to R540.15, the cooling-off period shall be two consecutive years.

Service at a Prior Firm

R540.17 In determining the number of years that an individual has been a key audit partner under paragraph R540.5, 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.

Position where Three-year Cooling-off Period for Engagement Partners is Established by Law or Regulation

R540.18 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 R540.10, R540.13 and R540.15(a) provided that the applicable time-on period does not exceed seven years. This paragraph shall cease to have effect on December 15, 2023.

Restrictions on Activities During the Cooling-off Period

R540.19 For the duration of the relevant cooling-off period, the individual shall not:

- (a) Be an 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);
- (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.

540.19 A1 The provisions of R540.19 are not intended to prevent the individual from assuming a leadership role in the firm, such as that of the Chief Executive or equivalent.

Other Considerations

R540.20 In evaluating the threats created by an individual's long association with an audit engagement, a firm shall give particular consideration to the roles undertaken and the length of an individual's association with the audit engagement prior to the individual becoming a key audit partner.

540.20 A1 There might be situations where the firm, 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.

Proposed Section 940
Long Association of Personnel with an Assurance Client
(CLEAN)

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 to independence.
- 940.2 When an individual is involved in an assurance engagement of a recurring nature over a long period of time, familiarity and self-interest threats might be created..
- 940.3 Section 940 sets out requirements and application material relevant to applying the conceptual framework to long association of personnel with an assurance client.

Requirements and Application Material

- 940.4 A1 A familiarity threat might be created as a result of an individual's long association with:
- (a) The assurance client; or
 - (b) The subject matter and subject matter information of the assurance engagement.

- 940.4 A2 A self-interest threat might 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. Such a threat might influence the individual's judgment inappropriately.

- 940.4 A3 Examples of actions that might be safeguards to address familiarity and self-interest threats in relation to a specific engagement include:

- 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 an assurance team member review the work of the individual.
- Performing regular independent internal or external quality reviews of the engagement.
- Performing an engagement quality control review.

Another action that might address the threats would be to rotate the individual off the assurance team.

- R940.5** If a firm decides that the level of the threats created can only be addressed by rotating the individual off the assurance team, the firm shall determine an appropriate period during which the individual shall not:

- (a) Be a member of the engagement team; or
- (b) Provide quality control for the assurance engagement; or
- (c) 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.

940.5 A1

Factors, individually or in combination, that are relevant to evaluating the level of any threats created from an individual being involved in an assurance engagement over a long period of time include:

- The nature of the assurance engagement.
- How long the individual has been 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 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.

940.5 A2

The combination of two or more factors might increase or reduce the 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 individual who is the responsible party and the start of a new relationship.

Effective Date

Section 540 is effective for audits of financial statements for years beginning on or after December 15, 2018. Section 940 is effective as of December 15, 2018. Early adoption is permitted.