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Mr. Ken Siong
Technical Director
International Ethics Standards Board for Accountants
International Federation of Accountants
529 Fifth Avenue, 6th Floor,
New York, NY 10017
USA

Dear Mr. Siong:

Re: JICPA comments on the IESBA Exposure Draft *Proposed Changes to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client*

The Japanese Institute of Certified Public Accountants ("we," "our" and "JICPA") is grateful for the opportunity to comment on the International Ethics Standards Board for Accountants (IESBA) Exposure Draft *Proposed Changes to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client* (ED).

We believe the proposed changes ensure and strengthen independence in appearance of members of audit and assurance teams from their audit and assurance clients and, accordingly, enhance credibility in audit and assurance. Therefore, we agree, in principle, with the proposed changes with the exception of the effective date.

We propose that the provisions in paragraphs 290.150A and 290.150B be effective for the audits of financial statements for years beginning on or after December 15, 2019.

We are proposing this because a considerable amount of lead time is necessary to respond to the following required steps and surrounding facts and circumstances in order to introduce the revised provisions of the IESBA *Code of Ethics for Professional Accountants* (the Code) in our jurisdiction:

- Revisions to Japan's Certified Public Accountants Act ("CPA Act") may possibly be required to introduce the revised engagement partner rotation requirements.*1
- It is necessary to take sufficient time for those charged with governance (TCWG) to understand the revised engagement partner rotation requirements.
- Small and Medium Practices (SMPs) which abide by the current requirements and audit quality, but do not have a sufficient number of partners for the proposed rotation requirements, need enough time to prepare for the practical implementation of the revised engagement partner rotation while continuing to maintain audit quality. *2

*1 The ethics code for professional accountants and independence requirements in Japan are stipulated based on both Japan's CPA Act and JICPA code of ethics. Japanese Diet approval is necessary to revise Japan's CPA Act.

*2 SMPs operate and establish organizational structures, including the number of partners, in order to fulfill the current rotation requirement of seven year time-on period and two year cooling-off period, which are applicable to all key audit partners in our jurisdiction.
If the rotation requirements are revised, SMPs need considerable time to carry out responses, which include reorganization, changing organizational structure and increasing the number of partners.
In contrast, in accordance with Japan's CPA Act and other related regulations, large audit firms are currently required to rotate lead audit engagement partners based on the time-on period of five years and cooling-off period of five years, and rotate other key audit partners based on the time-on period of seven years and cooling-off period of two years.

The following are our comments in response to the questions posed by the IESBA:

Request for Specific Comments

General Provisions

Question 1

Do the proposed enhancements to the general provisions in paragraph 290.148 provide more useful guidance for identifying and evaluating familiarity and self-interest threats created by long association? Are there any other safeguards that should be considered?

We support the proposed enhancements to the general provisions. This revision provides useful guidance.

Question 2

Should the General Provisions apply to the evaluation of potential threats created by the long association of all individuals on the audit team (not just senior personnel)?

We support this revision. All individuals on the audit team, not just senior personnel, could give rise to the potential threat created by the long association and, therefore, the General Provisions should apply to the evaluation of potential threats created by the long association of all individuals on the audit team.

Question 3

If a firm decides that rotation of an individual is a necessary safeguard, do respondents agree that the firm should be required to determine an appropriate time-out period?

We support this revision. If the rotation of an individual is a necessary safeguard, the firm should be required to determine an appropriate time-out period in order to reduce the threats created by the long association of individuals. When the firm determines an appropriate time-out period, it should be determined based on an evaluation of the significance of the threats with consideration to each firm's rotation policy and circumstances.

Rotation of KAPs on PIEs

Question 4

Do respondents agree with the time-on period remaining at seven years for KAPs on the audit of PIEs?

We support this revision. The seven year time-on period is appropriate because this struck the right balance between addressing the threats and maintaining audit quality.

Question 5

Do respondents agree with the proposal to extend the cooling-off period to five years for the engagement partner on the audit of PIEs? If not, why not, and what alternatives, if any, could be considered?

We support this revision with the exception of the following:

We strongly request insertion of the wording "an individual **who has most influence** on

the outcome of the audit" instead of mentioning only an engagement partner.
The reason is that only the term "an engagement partner" is used, but an engagement partner is not clearly defined as "an individual **who has most influence** on the outcome of the audit" in the proposed provisions, although the fourth line from the top of page 11 in the paragraph for "*Which KAPs Should be Subject to a Longer Cooling-Off Period?"* in the *Explanatory Memorandum* of the exposure draft, states that "The engagement partner is the individual in the firm who is responsible for the engagement and its performance and **who has most influence** on the outcome of the audit."

The definition of "Engagement Partner" stipulated in the Code is "The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body." Therefore, it is not understood that an engagement partner is an individual **who has most influence** on the outcome of the audit when only an engagement partner is mentioned in the proposed provisions. In Japan, in particular, we define a lead audit engagement partner **(i.e., *Hitto-Gyomu-Shikko-Shain*)** as an individual **who has most influence** on the outcome of the audit and define engagement partners as key audit partners other than an individual **who has most influence** on the outcome of the audit **(i.e., *Gyomu-Shikko-Shain*) respectively in Japanese**. Accordingly, translation issues and misinterpretations will arise if only an engagement partner is stated in English.

For the reasons above, we propose the following sentence be inserted in order to clarify that an individual **who has most influence** on the outcome of the audit is subject to the revised provisions stated in the *Explanatory Memorandum*:

"290.150A In respect of an audit of a public interest entity, an individual shall not be a key audit partner for more than seven years. After such time:

- An individual who has acted as the engagement partner at any time during the seven year period shall not be a member of the engagement team or provide quality control for the audit engagement for five years; and
- Any other key audit partner shall not be a member of the engagement team or provide quality control for the audit engagement for two years.

If there is more than one engagement partner on the engagement team, an engagement partner who has most influence on the outcome of the audit in the engagement partners is subject to a five year cooling-off period requirement. "

Question 6

If the cooling-off period is extended to five years for the engagement partner, do respondents agree that the requirement should apply to the audits of all PIEs?

We do not agree that the requirement should apply to the audits of all PIEs. Under the current situation, the requirement should not apply to the audits of all PIEs, but only listed entities.

Listed entities are entities that could significantly and extensively affect public interests if familiarity and self-interest threats arise from long association with them since listed entities could influence a broad range of stakeholders across multiple jurisdictions due to the globalization of security markets.

In addition, listed entities are not only the entities commonly designated as PIEs in many jurisdictions, but also the entities which are clearly and specifically stipulated in the definition* of the Code.

In contrast, the range of PIEs other than listed entities is not necessarily the same among jurisdictions. This is because the entities that need to be regulated, and, thus are designated by regulators in each jurisdiction, are defined as PIEs based on different conditions and circumstances, such as legal, economic, social needs specific to each jurisdiction.
Certain entities other than listed entities could significantly and extensively affect public interests if familiarity and self-interest threats arise from long association with them. Those entities include, for example, non-listed financial institutions and insurance companies. However, under the current situation, the requirement should apply only to the audits of listed entities since the Code designates only listed entities as the most narrowly defined PIEs that are acceptable at a global level.

Further to the above proposal, going forward, in order to specify entities that could significantly and extensively affect public interest, we also propose revising the definition of PIEs to clearly stipulate specific entities in addition to listed entities, which should be designated as global PIEs. The IESBA should undertake research and a benchmarking exercise on the range of PIEs in each jurisdiction in order to revise the definition of PIEs.

Therefore, based on the current situation, since the Code applies as the global code, the extended cooling-off requirement (five years) should apply only to the audits of listed

entities which are commonly designated as PIEs and after the definition of PIEs is revised, the extended cooling-off requirement should apply to the audits of all PIEs.

> * Public interest entity
>
> (a) A listed entity; and
>
> (b) An entity:
>
> (i) Defined by regulation or legislation as a public interest entity; or
>
> (ii) For which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. Such regulation may be promulgated by any relevant regulator, including an audit regulator.

Question 7

Do respondents agree with the cooling-off period remaining at two years for the EQCR and other KAPs on the audit of PIEs? If not, do respondents consider that the longer cooling-off period (or a different cooling-off period) should also apply to the EQCR and/or other KAPs?

We support this revision.
A two year cooling-off period is appropriate because the KAP other than the EP has less influence than the EP who has most influence on the outcome of the audit and the significance of the familiarity threats created by the long association of the EQCR with the audit client is relatively low.

In addition, although the EQCR plays an important role in an audit, because the EQCR is responsible for quality control in an audit engagement, the significance of the familiarity threats created by the long association of the EQCR with the audit client is relatively low since the EQCR does not directly conduct the audit, or make decisions for the engagement team on behalf of an engagement partner and, in addition, does not meet the client. Therefore, a two year cooling-off period is appropriate.

We request that you clarify the definition of EQCR, including his/her responsibility and role by providing examples or additional explanations related to the term “an individual whose primary responsibility is to be consulted within a firm.” which is stipulated in the first bullet point starting with “Consult with” in paragraph 290.150B. The reason is that the term “an individual whose primary responsibility is to be consulted within a firm” is not consistent with “the individual responsible for the engagement quality

control review" stipulated in the definition of "Key Audit Partner" in the Code and, therefore, it is not clear that those have the same meaning.

Question 8

Do respondents agree with the proposal that the engagement partner be required to cool-off for five years if he or she has served any time as the engagement partner during the seven year period as a KAP?

We support this revision. This is an effective way to apply consistently and systematically.

We request that you clarify the exceptional case described as follows:
In the case where an EP is away from an audit engagement for certain reasons, and such a period exceeds five years during a seven year time-on count, we understand the EP fulfills the five year cooling-off even though the EP did not intend to take a cooling-off period, and, as such, when the EP returns to the engagement, the time-on count starts fresh as year 1 from this year.

Example:

Year 1 – EP time-on
Years 2 to 6 – EP not involved in the audit engagement
Year 7 – EP time-on, the time-on count starts fresh as year 1 from this year

It is expected that an individual who was an EP with less than seven year time-on cannot be involved in an audit engagement as an EP due to, for example, illness or injury, and such a period could become multiple years. We propose providing more guidance by inserting an illustration as below to explain how an EP counts the time-on period in an exceptional case:
The illustration on page 15 in the *Explanatory Memorandum* is a good example.

Illustration:

	x1	x2	x3	x4	x5	x6	x7	x8	x9	x 10	x11
EP	5	6	7	X	X	X	X	X	1	2	3
				5 year cooling-off					Fresh start		
EP	1	XX	XX	X	X	X	1	2	3	4	5
		5 year cooling-off					Fresh start after 5 year cooling off				
EP	3	X	X	X	X	X	1	2	3	4	5
		5 year cooling-off					Fresh start after 5 year cooling-off				
EP	5	XX	6	7	X	X	X	X	X	1	2
					5 year cooling-off					Fresh start	

- X ：Scheduled cooling-off period.
- XX：Indicates a year in which an individual is not a member of the engagement team due to, for example, serious illness, where he or she has served as the engagement partner and will serve as the engagement partner after the individual returns to the engagement.

Question 9

Are the new provisions contained in 290.150C and 290.150D helpful for reminding the firm that the principles in the General Provisions must always be applied, in addition to the specific requirements for KAPs on the audits of PIEs?

We support this revision. These new provisions are useful for audit firms to recognize the threats created even by a time-on period of less than seven years or threats created by the long association of a member of the audit team other than the KAP with the audit client. This is because the threats could be significant even if the time-on period is less than seven years and the threats could be created by the long association of a member of the audit team other than KAP with the audit client.

Question 10

After two years of the five-year cooling-off period has elapsed, should an engagement partner be permitted to undertake a limited consultation role with the audit team and audit client?

We support this revision.

Question 11

Do respondents agree with the additional restrictions placed on activities that can be performed by a KAP during the cooling-off period? If not, what interaction between the former KAP and the audit team or audit client should be permitted and why?

We support this revision. The proposed provisions are useful because the activities, including interaction between the former KAP and the audit team or audit client, are prohibited during the cooling-off period in order to reduce the significance of the threat.

Question 12

Do respondents agree that the firm should not apply the provisions in paragraphs 290.151 and 290.152 without the concurrence of TCWG?

We support this revision.

Section 291

Question 13

Do respondents agree with the corresponding changes to Section 291? In particular, do respondents agree that given the differences between audit and other assurance engagements, the provisions should be limited to assurance engagements "of a recurring nature"?

We support this revision. This is because the threat created by the long association does not arise in relation to assurance engagements other than assurance engagement "of a recurring nature."

Impact Analysis

Question 14

Do respondents agree with the analysis of the impact of the proposed changes? In the light of the analysis, are there any other operational or implementation costs that the IESBA should consider?

We support this revision with the exception of the following:
The impact of the proposed effective date is not described. However, it should be clearly described and explained. The proposed effective date is too early to apply the revised provisions to our jurisdiction in a practical manner because of the reasons expressed in the introductory paragraph of this comment letter.
Therefore, we propose that the provisions in paragraphs 290.150A and 290.150B be effective for the audits of financial statements for years beginning on or after December 15, **2019**.

Request for General Comments

(a) *Small and Medium Practices (SMPs)*
This revision significantly affects SMPs.
We received a large number of comments from JICPA members who belong to SMPs in Japan. Those are unfavorable comments expressing significant concern regarding the extended cooling-off requirement for EPs (five years cooling-off period) in the proposed provisions.
Many SMPs in Japan audit listed companies and the number of these firms exceed 150 firms. Currently, all these SMPs are subject to the seven year time-on and two year cooling-off requirement for all KAPs including EPs as described in the introductory paragraph of this comment letter.

SMPs emphasize that they need considerably more time to respond to the proposed rotation requirements for the following specific reasons:

a. They have partners to fulfill the current rotation requirement but do not have enough partners to meet the proposed more stringent rotation requirement.

b. The plan for rotating partners will be complex mainly because two different cooling-off periods (five years for EPs and two years for other KAPs) will be dealt with.

c. They need considerable time to prepare for the implementation since it is necessary to identify EPs, deal with them separately from other KAPs, subsequently develop a rotation plan for EPs, and, in addition, reorganize organizational structure if these proposed provisions are finalized as proposed. This is because they operate and establish organizational structures, including the number of partners and rotation plan, in order to fulfill the current rotation requirement of seven year time-on period and two year cooling-off period which are applicable to all key audit partners.

Moreover, we also received unfavorable comments that the cooling-off period for EPs should remain at two years as required by the current provision for the following reasons:

a. There is no evidence indicating that audit failures were caused by the two year cooling-off period.

b. Certain activities are permitted for EPs in the proposed provisions; however, the cooling-off period should remain at two years with no permitted activities related to an audit client during the cooling-off period in order to eliminate the threat or reduce it to an acceptable level.

Other than the above, as commented for question 6, the entities subject to the proposed provisions should be limited to listed entities.

(b) *Preparers (including SMEs) and users (including Regulators)*
Not applicable.

(c) *Developing Nations*
Not applicable.

(d) *Translations*
English is not the official language in Japan, thus, it is inevitable to translate the Code from English to Japanese in an understandable manner. For this reason, we pay close attention to the wording used in the Code in respect of whether it is translatable and comprehendible when translated.

For example, the meaning of "year" which is used for a rotation requirement is not clear in terms of whether it means one fiscal period or 12 months. If it means one fiscal period, it could be less than 12 months, for example, 6 months.
In addition, there are issues in respect of the translation related to our comments about clarification of "an individual **who has most influence"** for question 5 and inconsistency of the EQCR definition for question 7.

In Japan, in particular, we define a lead audit engagement partner as an individual **who has most influence** on the outcome of the audit and define engagement partners as key audit partners other than an individual **who has most influence** on the outcome of the audit **in Japanese**. Accordingly, translation issues and misinterpretations will arise if only an engagement partner is stated in English.

Furthermore, regarding the comment on EQCR definition for question 7, translation issues and misinterpretations will also arise if there are different expressions although the same meaning is intended. We propose using the same expression or wording if the same meaning is intended.

(e) *Effective date*
As described in the introductory paragraph and comments for question 14 in this comment letter, we propose that the provisions in paragraphs 290.150A and 290.150B be effective for the audits of financial statements for years beginning on or after December 15, **2019**.

We hope that our views will be of assistance to the IESBA.

Sincerely yours,

Mineo Kanbayashi
Executive Board Member - Ethics Standards
The Japanese Institute of Certified Public Accountants