

May 21, 2017

International Ethics Standards Board for Accountants

RE: Request for Comments on Exposure Draft *Improving the Structure of the Code of Ethics for Professional Accountants—Phase 2*

Dear Board Members:

The Auditing Standards Committee of the Auditing Section of the American Accounting Association is pleased to provide comments on the IESBA Exposure Draft *Improving the Structure of the Code of Ethics for Professional Accountants—Phase 2*.

The views expressed in this letter are those of the members of the Auditing Standards Committee and do not reflect an official position of the American Accounting Association. In addition, the comments reflect the overall consensus view of the Committee, not necessarily the views of every individual member.

We hope that our attached comments and suggestions are helpful and will assist the Board. Please feel free to contact the subcommittee chair should the Board have any questions about our comments and suggestions.

Respectfully submitted,

Auditing Standards Committee  
Auditing Section – American Accounting Association

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Comments on the  
International Ethics Standards Board for Accountant’s (IESBA) January 2017 Exposure Draft  
*Improving the Structure of the Code of Ethics for Professional Accountants – Phase 2*

In this Phase 2, IESBA is essentially modifying the structure and content of the Code to be in alignment with the “Agreed-in-Principle” documents on Structure and Safeguards released in January 2017. Accordingly, our comments are intended to provide feedback in that context.

**Comments on:** *Chapter 3 – Proposed Restructured Text of the Long Association Close-Off Document*

While research on the benefits of limiting long auditor-client associations through mandatory audit partner rotation has reached mixed conclusions (c.f., Lennox 2014; Sharma, Tanyi and Litt 2017), our comments are not intended to sway the IESBA in their decision to institute a mandatory audit partner rotation regimen. Our comments are intended to help clarify the proposed new Code.

1. We suggest that the phrase “and maintain an attitude of professional skepticism” be added after “be independent” in ¶540.1 and ¶940.1. Familiarity threats related to the audit client’s operations (¶540.4 A1(a)), financial statements (¶540.4 A1(c)), and subject matter of the assurance engagement (¶940.4 A1(b)) seem more likely the result of impaired professional skepticism as opposed to impaired independence.
2. Related to ¶540.4 A2, smaller firms are more economically dependent on their individual clients and research supports that audit firm size and audit quality are negatively related (refer to DeFond and Zhang 2014, 299, for a review of this research). We therefore recommend that the Board consider adding the following statement to the end of this paragraph: “Smaller auditing firms may be particularly vulnerable to these types of economic dependence pressures. As such, smaller firms should carefully consider their ability to maintain their independence and professional skepticism in their audits of PIEs.” Consideration should also be given to including similar wording to ¶940.4 A2
3. We believe ¶R540.6 should be modified to add the identifier “key audit partner” between “following” and “roles” in order to identify which types of individuals this paragraph addresses.

This change would also make it more consistent with the subsequent paragraphs where the phrase “key audit partner” is used.

4. We believe the IESBA should consider providing examples in ¶R540.6 (c) “Any other key audit partner role” to assist auditors and audit firms in determining the types of roles the Board is referring to here. Examples of these roles may be similar, or identical, to the restricted activities in the cooling-off period discussed in ¶R540.19. For example, is being the audit firm’s relationship partner for the client considered an “other key partner role” in ¶R540.6 (c), or just a prohibited cooling-off activity in ¶R540.19? If a partner provides non-assurance services to an audit client, is that role considered an “other key partner role” in ¶R540.6 (c), or just a prohibited cooling-off activity in ¶R540.19? Further, the Glossary of the Agreed-in-Principle document includes the following in the definition of *key audit partner*: “Depending upon the circumstances and the role of the individuals on the audit, “other audit partners” might include, for example, audit partners responsible for significant subsidiaries or divisions.” Thus, more guidance is warranted to assist in the determination of who may be considered “other” key audit partners.
5. If an auditing firm does not have sufficient qualified personnel to periodically rotate the key audit partner, we believe the firm should consider whether it is qualified to conduct the audit of a Public Interest Entity (¶R540.9). We recognize that certain circumstances may exist when the auditing firm’s qualifications are not a concern. However, we suggest that the Board consider including the following statement to the end of ¶R540.9: “Auditing firms needing to invoke this exception should carefully consider whether they have sufficient resources to conduct the audit of a public interest entity given the auditing standards requirements that auditors be competent, independent, and adequately supervise their audit engagements.”
6. We also agree with the elimination of allowing any form of partner technical consultations in the cooling-off period that was removed in the final draft of the Close-Off Document: Changes to the Code Addressing the Long Association of Personnel with an Audit or Assurance Client. Such consultations, in any form, in the cooling-off period would be disingenuous to the Board’s intent of creating a separation between the individual key audit partner and the client company.

7. In ¶540.19 A1, clarify to which “firm” the Board is referring. Is it a senior leadership position in the audit firm or the client firm? The term “Chief Executive” may be interpreted to mean an executive of the audited client firm, or a senior management position within the audit firm.
8. We believe the Board should consider including an additional item called “the assurance client’s individual(s) who is the responsible party or, if relevant, senior management” as the second item listed under ¶940.4 A1 to mirror the items listed in ¶540.4 A1. The wording in subsequent paragraphs (¶940.4 A2; ¶940.5 A1) refers to threats related to responsible individuals (or senior management, if relevant) of the assurance client, which suggests that consistency with Section 540 is warranted.

**Comments on:** *Chapter 5 – Proposed Restructured Text Relating to Independence – Other Assurance Engagements (Part 4B)*

We read Chapter 5 in light of the specific requests in Structure ED-2. We do not believe that the proposals in the ED have resulted in any unintended changes in meaning, agree that the proposals are consistent with the elements of restructuring as described in Section III of the Explanatory Memorandum, and concur with the conforming amendments arising from the Safeguards project. Regarding the effective date, we defer to the firms and regulators who have to implement the restructured Code. Therefore, we offer no specific comments on Chapter 5.

**References**

- DeFond, M., and J. Zhang. 2014. A review of archival auditing research. *Journal of Accounting and Economics* 58: 275-326.
- Lennox, C. S. 2014. Auditor tenure and rotation. In *Routledge Companion to Auditing*, edited by Hay, D., W. R. Knechel, and M. Willekens, 89-106. Abingdon, U.K.: Routledge.
- Sharma, D. S., P. N. Tanyi, B. A. Litt. 2017. Costs of mandatory periodic audit partner rotation: Evidence from audit fees and audit timeliness. *Auditing: A Journal of Practice and Theory* 36 (1): 129-149.