

**May 9, 2016**

## **IFAC Small and Medium Practices (SMP) Committee Response to the International Ethics Standards Board for Accountants (IESBA) Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client**

### **INTRODUCTION**

The SMP Committee is pleased to respond to the IESBA (the Board) on this Limited Re-exposure Draft (ED).

The SMP Committee is charged with identifying and representing the needs of its constituents and, where applicable, to give consideration to relevant issues pertaining to small-and medium-sized entities (SMEs). The constituents of the SMP Committee are small-and medium-sized practices (SMPs) who provide accounting, assurance and business advisory services principally, but not exclusively, to clients who are SMEs. Members of the SMP Committee have substantial experience within the accounting profession, especially in dealing with issues pertaining to SMEs, and are drawn from IFAC member bodies from 18 countries from all regions of the world.

### **GENERAL COMMENTS**

The SMP Committee has been grateful for the opportunity to provide comments on the Long Association project in advance of the IESBA Board's meetings and submitted a [response](#) to the August 2014 Exposure Draft in which we raised concerns that the proposals may place unreasonable constraints on SMPs and have significant unintended consequences. The basis of conclusions regarding the proposals that were previously exposed was helpful to be included as background to this ED.

We believe that the role of the engagement quality control reviewer (EQCR) is quite distinct from the role of the Engagement Partner (EP) such that the independence and familiarity threats created by long association of the EQCR are significantly less. In our opinion, the cooling-off period for the EQCR does not need to be subject to same restrictions as the new provisions for the EP. We consider that any increase in objectivity that might be achieved by extending the cooling-off period for the EQCR would not materially benefit audit quality, but will, in combination with rotation of the EP, instead likely adversely impact the effectiveness and efficiency of audits. In addition, we are concerned that SMPs may be disproportionately affected by the proposals due to their more limited availability of individuals able to perform the EQCR role. We encourage the Board to re-consider these proposals.

Notwithstanding that the SMP Committee did not agree with the extension of the cooling-off period to five years for the engagement partner on the audit of PIEs, we support the proposal to allow for a reduction in the cooling-off period for EPs on audits of PIEs to three years under the conditions specified. We also agree with the proposed principles to be used in determining whether the longer cooling-off period applies when a partner has served a combination of roles during the seven-year time-on.



## SPECIFIC COMMENTS

We have outlined our responses to each question (*in italics*) in the ED below.

### **Length of the Cooling-off Period for the EQCR**

1. *Do respondents agree that the IESBA's proposal in paragraphs 290.150A and 290.150B regarding the cooling-off period for the EQCR for audits of PIEs (i.e., five years with respect to listed entities and three years with respect to PIEs other than listed entities) reflects an appropriate balance in the public interest between:*

- (a) Addressing the need for a robust safeguard to ensure a "fresh look" given the important role of the EQCR on the audit engagement and the EQCR's familiarity with the audit issues; and*
- (b) Having regard to the practical consequences of implementation given the large numbers of small entities defined as PIEs around the world and the generally more limited availability of individuals able to serve in an EQCR role?*

*If not, what alternative proposal might better address the need for this balance?*

We maintain our view that the role of the EQCR is quite distinct from the role of the EP such that the independence and familiarity threats created by long association of the EQCR are significantly less. Therefore, the cooling-off period for the EQCR does not need to be subject to same restrictions as the EP for listed PIEs or increased to three years with respect to non-listed PIEs.

In our view, any increase in objectivity that might be achieved by extending the cooling-off period for the EQCR would not materially benefit audit quality, but will, in combination with rotation of the EP, instead likely adversely impact the effectiveness and efficiency of audits. We believe that a combined loss of knowledge of a client and the in-depth understanding of the risks for an audit will compromise audit quality, which is clearly not in the public interest.

We are concerned that the extension of the cooling-off period for the EQCR may create a competitive disadvantage for SMPs that audit PIEs and listed entities, which is more prevalent in some jurisdictions than in others. As noted in the Explanatory Memorandum, many national definitions of PIEs encompass small non-listed entities<sup>1</sup>, which are often audited by SMPs, who therefore may be disproportionately affected by the proposals due to the practical challenges of having more limited availability of individuals able to perform the EQCR role.

There is a risk that the proposals could further exacerbate the market dominance of the largest accounting firms and lead to further erosion of competition and choice in the audit market for listed entities. Competition and choice tend to drive quality and innovation in audit market, and as such are in the public interest.

The SMP Committee is also concerned about the added degree of complexity in applying the provisions given the resulting different cooling-off periods applicable to the EP, EQCR and Other KAPs on the audits

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<sup>1</sup> Please see the Federation of European Accountants (FEE) survey [Definition of Public Interest Entities \(PIEs\) in Europe](#) which demonstrates the wide diversity of definitions of PIEs applicable across European Countries.



of listed PIE entities and PIEs that are not listed entities. Determining which individual audit partners are subject to the provisions of the Code is likely to be challenging in practice.

The Explanatory Memorandum notes that a “substantial body” of respondents to the original ED supported the proposal that the cooling-off period remain at two years for the EQCR on the audit of PIEs and only “some respondents” were of the view that the cooling-off period should be longer than two years. It is important the proposals are practical, do not impose undue complexity and that any changes to the Code are based on a thorough impact analysis and are supported by robust evidence and research.

We strongly encourage the Board to re-consider the combined impact on SMPs of the proposed cooling-off period for the EQCR with the matters already agreed and that are not subject to re-exposure.

### **Jurisdictional Safeguards**

2. *Do respondents support the proposal to allow for a reduction in the cooling-off period for EPs and EQCRs on audits of PIEs to three years under the conditions specified in paragraph 290.150D?*
3. *If so, do Respondents agree with the conditions specified in subparagraphs 290.150D(a) and (b)? If not, why not, and what other conditions, if any, should be specified?*

The SMP Committee supports the proposal to allow for a reduction in the cooling-off period for EPs on audits of PIEs to three years under the conditions specified. We agree that if a jurisdiction, after following appropriate due process, has reached a robust but different solution to that reached in the Code, it would be reasonable and in the public interest for the Code to recognize an alternative, while maintaining a minimum set of requirements. This flexibility will foster acceptance of the Code as it will allow it to work in conjunction with, as opposed to in competition, to well-established national and/ or regional requirements.

We suggest the IESBA minimize the risk of confusion by making it clearer that this particular requirement does not need to be implemented in all jurisdictions. A regulator may have determined a different set or combination of safeguards to those required in the Code and requirement 290.150D could be interpreted as an additional provision as it is currently worded.

We agree with the conditions specified in subparagraphs 290.150D (a) and (b).

### **EP or EQCR for Part of the Seven-Year Time-on Period**

4. *Do respondents agree with the proposed principle "for either (a) four or more years or (b) at least two out of the last three years" to be used in determining whether the longer cooling-off period applies when a partner has served in a combination of roles, including that of EP or EQCR, during the seven-year time-on period (paragraphs 290.150A and 290.150B)?*

We agree with the proposed principle for either (a) four or more years or (b) at least two out of the last three years to be used in determining whether the longer cooling-off period applies when a partner has served a



combination of roles during the seven-year time-on. The revised proposal is a more proportional response as it would not require a KAP to be subject to a longer cooling-off period just because the KAP had stepped into an EP or EQCR role for one year.

However, we are concerned that the practical application of the provisions may not be straightforward. We therefore support the proposed IESBA Staff Questions & Answers (Q&A) publication, which will be helpful to be issued with the final pronouncement to facilitate implementation of the provisions. We recommend that this includes specific situations that might affect SMPs, to assist with the practical application of the requirements.

### **Effective date**

As we have previously communicated to the IEBSA, keeping up with new regulations and standards has been consistently ranked as one of the top challenges facing SMPs<sup>2</sup>. This supports the need for a stable platform for the Code. We would prefer that the Board do not make piecemeal changes to the Code and give due consideration to whether it would be practical for these revisions to be introduced as part of other significant changes resulting from other current projects. Practitioners need time to understand the changes, assess how they are affected and to put measures in place to enable them to comply. The impact on SMPs resources of this process can be particularly onerous as they do not have the same level of in-house resources available at larger firms.

### **CONCLUDING COMMENTS**

We hope the IESBA finds this letter helpful in finalizing the changes to certain provisions of the Code addressing the long association of personnel with an audit or assurance client. In turn, we are committed to helping the Board in whatever way we can to build upon the results of this ED. Please do not hesitate to contact me should you wish to discuss matters raised in this submission.

Sincerely,

A handwritten signature in black ink, appearing to read 'Giancarlo Attolini', written over a horizontal line.

Giancarlo Attolini

Chair, SMP Committee

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<sup>2</sup> Please see the [2015 IFAC Global SMP Survey Results](#)