FRC Financial Reporting Council

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3 May 2016

Dear Mr Siong,

Exposure Draft – Limited re-exposure of proposed changes to the Code addressing the long association of personnel with an audit or assurance client

The Financial Reporting Council (FRC) welcomes the opportunity to comment on the proposed changes to the Code of Ethics for Professional Accountants (the Code) set out in the above exposure draft. We are disappointed that concerns we raised in our response of 12 November 2014 to the previous exposure draft on long association have not be addressed. However, as requested, in this response we are not repeating comments made previously.

We believe that the proposals in this exposure draft introduce inappropriate compromises and unnecessary complexity and appear to be designed to accommodate extant requirements in some jurisdictions that are less stringent than the requirements IESBA originally proposed. The extent of the complexity is highlighted by the proposed IESBA Staff Questions and Answers. Such complexity is likely to detract from any perception that a principle-basis has been applied and undermine confidence in the effectiveness of the requirements.

Cooling-Off Period for the EQCR on the Audit of a Public Interest Entity

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 [Public Interest Entities] 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?

No. We believe that the cooling-off period for the EQCR should be five years for all PIEs. Under the IESBA definition, non-listed PIEs include those entities that are defined by regulation or legislation as a PIE, and those entities for which the audit is required by regulation or legislation to be <u>conducted in compliance with the same independence requirements that apply to the audit of listed entities</u>. The approach proposed in the exposure draft reflects a position where all non-listed PIEs are in effect deemed to be of less public interest than listed PIEs - this is inconsistent with the definition of a PIE and is likely to be confusing for stakeholders. There may, for example, be many credit institutions that are non-listed PIEs

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that could be considered to be of greater public interest than many small listed entities.

In jurisdictions where the IESBA Code is adopted, this approach will require legislators and regulators to determine whether they agree that non-listed entities they have designated as PIEs are to be treated differently to listed PIEs and, if not, to introduce law or regulation to override the IESBA position. This is unhelpful for national legislators and regulators and also risks undermining confidence in the Code.

We appreciate that the large numbers of small entities defined as PIEs can give rise to practical issues, particularly for smaller firms with few partners. However, the reliefs that IESBA is proposing are unnecessary as these concerns have already been recognized in the auditing standards. The IAASB recognises this in the International Standard on Quality Control 1 and addresses it in paragraph A50 of the application material for that standard.

> *It may not be practicable, in the case of firms with few partners, for the engagement partner not to be involved in selecting the engagement quality control reviewer. Suitably qualified external persons may be contracted where sole practitioners or small firms identify engagements requiring engagement quality control reviews. Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews. Where the firm contracts suitably qualified external persons, the requirements in paragraphs 39-41 and guidance in paragraphs A47-A48 apply.*

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?*

No. We do not agree that the specified conditions - an independent regulatory inspection regime and either a mandated time on period shorter than seven years or mandatory firm rotation / retendering at least every ten years – justify reducing the cooling-off period for key audit partners.

One of the significant threats that rotation of key audit partners is intended to address is the familiarity threat, where close personal relationships are developed with the audited entity's personnel. Rotation of firms does not address that threat at the level of the individual partner unless it serves to reduce the partner's involvement with the entity to the same extent as the requirements imposed directly on individuals. Also, mandatory retendering without mandatory rotation, as would be possible under 290.150D, may provide no additional safeguard in relation to threats related to individual key audit partners. An independent regulatory inspection regime contributes to general oversight and quality control but could not, in our view, be relied upon to help mitigate threats such as familiarity, particularly given that several years can elapse between inspections of audits of a particular entity.

The IESBA should determine what, in principle, it believes is the appropriate cooling-off period required (we support five years) and implement that in the Code. We do not believe it would be appropriate to compromise that position in order to seek to obtain acceptance in jurisdictions that may view less stringent requirements as appropriate.

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?*

See above – we do not agree with the proposal or with the conditions specified.

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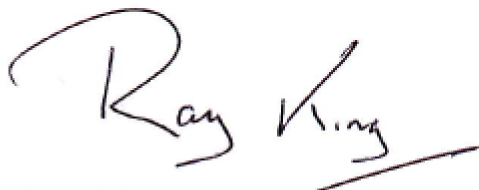
Service in a Combination of Roles during the Seven-year Time-on Period

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)?*

No. We believe that a partner who has served the maximum permitted time-on period, including as the engagement partner, EQCR or combination of those roles should be required to cool-off for the full five year period. The familiarity threat that arises is not diminished by the partner serving part of the time-on period as a key audit partner other than engagement partner or EQCR.

Yours sincerely.



Ray King
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About the FRC
The Financial Reporting Council is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. We promote high standards of corporate governance through the UK Corporate Governance Code. We set standards for corporate reporting and actuarial practice and monitor and enforce accounting and auditing standards. We also oversee the regulatory activities of the actuarial profession and the professional accountancy bodies and operate independent disciplinary arrangements for public interest cases involving accountants and actuaries.

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