



Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client

ICAEW welcomes the opportunity to comment on the *Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client* published by IESBA on 4 February 2016, a copy of which is available from this [link](#).

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MAJOR POINTS

1. We are pleased to have the opportunity to comment on at least some of the aspects of IESBA's latest proposals to amend its Code of Ethics (the Code) in respect of long association. However, given the evident concerns expressed by many respondents to the original consultation, many of which seem not to have been addressed properly, we are surprised that this is only a partial re-exposure.
2. The Code is meant to be principles-based, with all the advantages that brings. Over time, some of the auditor independence requirements on public interest entity (PIE) audits have become more black and white, risking unintended consequences and easier circumvention. Partner rotation on PIE audits was one of those areas but at least the rules were relatively simple. Extending these requirements inevitably increases the unintended consequences and in the Boards' efforts to mitigate some of the side effects, complexity has been heaped upon complexity. Any ostensibly principles based code must have gone wrong if 18 FAQs are needed to explain 14 paragraphs in the Code.

REQUEST FOR SPECIFIC COMMENTS

Cooling-off period for the EQCR on the Audit of a PIE

Q1: 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?

3. The original IESBA proposal in 2014 was to retain the two-year off-period for EQCRs as the familiarity threat in such a role, which typically does not involve meeting personnel from the audited entity, is significantly less than that for an engagement partner (EP). We and, we note from the explanatory memorandum (EM), 'a substantial body' of other respondents supported the Board's proposals. There is no reference in the EM to any objective evidence that the current two year period presents a significant threat to independence and objectivity. The amended proposal to extend the off-period for EQCRs appears, according to the comments in the EM, to be based largely on the views of a handful of respondents that as the EQCR role is important, the off-period should be longer. We believe safeguards should be proportional to the threat, not the role: the two do not always go hand in hand.
4. Having extended the off-period, IESBA has sought to partially mitigate the practical effect on smaller firms auditing PIEs by distinguishing between the off-period for listed PIEs (5 years) and unlisted PIEs (3 years). The rationale given is that many unlisted PIEs are small and likely to be audited by small firms.
5. Accepting that this point is outside of the remit of the current project, we wonder if IESBA is trying to deal with that issue in the wrong way. Given that the Code is global, it seems likely that there are very many small listed entities. Indeed, in some countries (for example Canada and, if current proposals by the Financial Reporting Council are carried through, the UK) there are listed non-PIEs, something the Code does not present allow for. This suggests that there is a wider issue around IESBA's definition of a PIE, which the Board may wish to consider: it

does not automatically follow that the characteristics of a PIE and the characteristics of all listed entities, overlap.

6. However, in the meantime we fail, therefore, to see that the distinction achieves what it seeks to do, and it should be reversed.

Jurisdictional Safeguards

Q2: 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?

Q3: 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?

7. One of the great strengths of a principles based approach is the recognition that in particular circumstances, there can be more than one way of achieving an objective. We are comfortable, therefore, with the notion of including allowances for jurisdictional equivalents (in essence a set of alternative safeguards) in the code. However, the detailed conditions specified to apply the jurisdictional equivalent make an already complicated set of rotation requirements even more complex and rules-based. These could at least be re-written more as a set of principles.
8. It is unclear, for example, why an independent regulatory inspection regime is needed to take advantage of the alternative safeguards of a shorter on-period (ie 5 on, 3 off, rather than 7 on, 5 off, which is the default requirement).
9. In the case of the EQCR the jurisdictional equivalent has undoubtedly been introduced as another attempt to mitigate the effect of the extension to of the off-period to 5 years, that we refer to in our response to Q1 above. This further complexity adds to the indication that the extension fully to 5 years is unnecessary.

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

Q4: 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)?

10. Again, the proposals seem to add complexity to complexity. In substance, the ‘4 years in last 7 or 2 years in last 3’ rule could be rewritten as ‘the majority of the period’. The latter would be more in keeping with a principles based code.

REQUEST FOR GENERAL COMMENTS (item a only)

***Small and Medium Practices (SMPs)* – The IESBA invites comments regarding the impact on the proposals subject to re-exposure for SMPs.**

11. The extension of the ECQR off-period, albeit with a number of complex mitigations, is particularly likely to have a significant impact on smaller firms with PIE clients.
12. While the unchanged prohibition on partners during the off-period providing NAS where this could involve ‘significant or frequent interaction with senior management or those charged with governance’ is not being consulted on, we note that most respondents opposed this. The Boards’ rationale for their decision is that objectors’ reasons varied. This seems somewhat dismissive and is likely to have a more significant impact on smaller firms with PIE clients, than others.