Think Ahead ACCA

Limited re-exposure of proposed changes to the Code addressing the long association of personnel with an audit client

An exposure draft issued by the International Ethics Standards Board for Accountants

Comments from ACCA

May 2016

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ACCA welcomes the opportunity to comment on the proposals issued by the International Ethics Standards Board for Accountants (the IESBA). The ACCA Global Forum for Ethics has considered the matters raised, and the views of its members are represented in the following.

OVERALL COMMENTS

We support the objectives of this IESBA project and agree that the enhancements to the Code of Ethics for Professional Accountants (The Code) that are not subject to re-exposure will provide a more robust framework for dealing with the long association of personnel with an audit client. However, we note that the decisions made by the IESBA in respect of the matters not subject to re-exposure have largely been based on the 'broad support' of respondents.[1] We urge the IESBA to carefully consider the qualitative nature of responses received, and more clearly articulate its decision-making process when setting out its basis for conclusions to the current exposure draft.

We note that audit quality and the importance of having adequate resources in audit firms continue to be emphasised in the exposure draft. We also welcome the strengthened general provisions which apply to all individuals on the audit team, not just senior personnel. These general provisions must be regarded as valuable guidance in support of the application of the conceptual framework approach.

The provisions on long association are rules-based and we believe these sit better within a separate set of independence standards rather than a high level Code of ethical principles. In our response to the IESBA consultation on *Improving the Structure of the Code of Ethics for Professional Accountants – Phase 1*, we advocate the complete separation of the independence standards (C1 and C2) from the Code. We believe that the Code should primarily focus on behaviours, and prescriptive standards should be clearly set apart.

We welcome the IESBA's decision to require a cooling-off period of five years for an engagement partner (EP) on the audit of a public interest entity (PIE).[2] We also welcome the recognition of 'jurisdictional safeguards' which allows a relaxation in the cooling-off period for EPs where alternative national or regional requirements exist.

In our original response to the IESBA consultation on the *Proposed Changes to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client* we advocated convergence in the default cooling-off periods for EPs, engagement quality control reviewers (EQCRs) and other key audit partners (KAPs) as this would aid clarity. While we remain supportive of this approach, we note that the IESBA has determined to make no change to the two-year cooling-off period for a KAP and is reconsidering the cooling-off period for an EQCR.

We believe the proposal to implement different lengths of cooling-off period depending on the category of KAP involved in an audit introduces a layer of requirements which adds further complexity to the existing provisions for long association. We remain concerned over the ability of small start-ups, unsophisticated companies and the smaller accounting firms to engage with these proposed changes. The unintended negative consequences of such provisions are likely to outweigh the benefits, which are founded more on the public perspective than the need to maintain objectivity in practice.

[1] Exposure draft paragraphs 20, 22, 26, 46, 60 and 70

[2] The definition of a PIE includes entities defined as such by regulation or legislation, as well as listed entities.

The length of the cooling-off periods for an EP, an EQCR and a KAP must strike a balance between robust independence standards and the practical consequences of implementation such as audit quality and cost. Due regard must be paid to the principle of proportionality. Aligning the cooling-off periods for each category of KAP involved in an audit would also minimise the need to introduce complex requirements relating to situations where an individual has served in a combination of roles during the seven-year time-on period.

We question the validity of the resources argument when considering whether the cooling-off period should be two, three or five years. While we acknowledge that resources and the cost to companies and SMPs are important, we believe (as does the IESBA) that the public interest is paramount. We also note that complexity was cited as a reason for not including joint audits in the proposals, and we support this.

If the cooling-off period for other KAPs is to remain at two years, we would advocate a cooling-off period for an EQCR of two years for the sake of clarity and consistency.[3] In such circumstances, a shorter cooling-off period of two years for an EQCR would not impact audit quality, and would be consistent with the cooling-off period for a KAP. We also believe that the IESBA should seek to avoid the additional complexity that would exist with different cooling-off periods for an EQCR with respect to listed PIEs and other PIEs. If a two-year cooling-off period was considered unacceptable in respect of an AQCR, we would advocate a compromise that balances the cooling-off period for all EQCRs and other KAPs at three years.

We question the status of, and need to issue, the proposed IESBA Staff Questions and Answers (Q&A) publication with the final pronouncement in order to facilitate implementation of the provisions for long association. The need for a Q&A would indicate a lack of clarity in the proposals, and it could undermine the Code itself.

The overriding consideration in finalising the provisions relating to long association must be achieving the right balance between safeguarding objectivity (for which the visibility of independence is a proxy) and maintaining audit quality (which might be enhanced by continuity within the audit team). Objectivity is a state of mind or an attitude to be adopted; independence cannot be absolute, and so has most relevance in terms of appearances.

Overall, it is difficult to see how a more complex set of provisions on long association will add anything to safeguarding objectivity and improving audit quality. Excessive and complex provisions present a barrier to understanding, implementation and enforcement, and can result in unintended breaches. As a guiding rule, we would advocate simplicity, consistency and clarity, so that the provisions for dealing with the long association of personnel on an audit or assurance client are easily understood by all audit firms.

[3] We note that the case for retailing a two-year cooling-off period for other KAPs has not been made out in paragraphs 21 to 23 of the exposure draft.

SPECIFIC ISSUES

In this section of our response, we answer the four questions set out in the consultation paper section *Request for Specific Comments*.

Cooling-Off Period for the EQCR on the Audit of a PIE

Question 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 recognise and agree that the EQCR plays an important role in ensuring audit quality is maintained in an engagement by providing an independent evaluation of the key judgements made. The role of the EQCR is particularly important in high-risk areas and the assessment of whether the related audit procedures and documentation support the audit conclusions reached. However, the EQCR is not a decision-maker and has little or no client contact.

The current proposals for the cooling-off period for the EQCR on the audit of a PIE would be difficult to monitor and add more complexity to the provisions. We question the proposed distinction between listed and non-listed PIEs and the rationale for introducing a different length of cooling-off period for EQCRs involved in audits of these entities. The differentiation between PIEs based on whether they are listed or not may not necessarily indicate a need to strengthen the independence of the EQCR. More relevant considerations would be whether there is a larger number of stakeholders in the entity, and the nature of their interests. It is difficult to define the public interest, and even if some jurisdictions have quite small PIEs, most will have an effective definition of a PIE, and that should be sufficient. We advocate simplicity, consistency and clarity, so that the provisions are easily understood and can be implemented by all audit firms.

In our original response, we advocated convergence in the default cooling-off periods for EPs, EQCRs and other KAPs as this aids clarity, and we remain supportive of this approach. While we acknowledge that having all key audit personnel always rotating off an audit at the same time would be problematic, aligning the cooling-off periods does not necessarily mean this would be the case. The most challenging year is the first year of cooling-off for an EQCR. But once a new EQCR is in place there are benefits from retaining them as such for an effective period.

However, we note that the IESBA has determined a cooling-off period of five years for an EP and two years for a KAP.[4] If the cooling-off period for a KAP is to remain at two years, we would advocate a cooling-off period for an EQCR of two years, aligning it to a KAP for clarity and consistency. We believe that, in such circumstances, a shorter cooling-off period of two years for an EQCR would not impact on audit quality.

We also believe that the IESBA should seek to avoid the additional complexity that would exist with different cooling-off periods for an EQCR with respect to listed PIEs and other PIEs. As acknowledged in paragraph 18 of the exposure draft with regard to EPs, a substantial body of respondents to the earlier consultation 'commented that all PIEs are, by their nature, entities of public interest; that there was no previous distinction between listed and non-listed PIEs; and that applying the change in the provision to all PIEs would provide clarity, consistency and stability'. However, if a two-year cooling-off period for all EQCRs was considered unacceptable, we would advocate a compromise that balances the cooling-off period for all EQCRs and other KAPs at three years.

If resourcing issues are identified and attributed to the equalisation of cooling-off periods, we would encourage the IESBA to explore alternative approaches to mitigating the familiarity threat while addressing these issues. For example, an alternative proposal might be to allow the EQCR to remain for (up to) another two years if the EP is also due to rotate off the engagement.

Jurisdictional Safeguards

Question 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?

In our original response, we supported extending the cooling-off period to five years for an EP on the audit of all PIEs (listed and non-listed). However, we expressed concerns as to how the five-year cooling-off period for an EP might be implemented in some jurisdictions where alternative requirements may exist.

We therefore welcome the recognition of 'jurisdictional safeguards' which allows a relaxation in the cooling-off period where alternative national or regional requirements exist. We support the proposal to allow a reduction in the cooling-off period for EPs on the audit of PIEs to three years where an independent standard setter, regulator or legislative body has evaluated the specific threats and determined alternative safeguards are more appropriate.

With regard to EQCRs, we refer to our response to Question 1 above in which we advocate a cooling-off period of two or three years, so long as the requirements for EQCRs are aligned with the requirements for KAPs.

Question 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?

We refer to our response to Question 2 above. If the cooling-off period for EQCRs was aligned to that of KAPs, paragraph 290.150D would only be relevant to EPs. We agree with the conditions specified in subparagraphs 290.150D (a) and (b), as they relate to an EP. Smaller

[4] We note that the case for retailing a two-year cooling-off period for other KAPs has not been made out in paragraphs 21 to 23 of the exposure draft.

firms may have resource issues when a need to rotate staff arises, but the length of the cooling-off period does not aggravate this to any great extent.

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

Question 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)?

The complexity within proposed paragraphs 290.150A and 290.150B highlights the problems that arise from an over-prescriptive approach to independence and objectivity, and the potential costs relating to a lack of clarity. If a KAP was EP at any time within the time-on period, he or she is likely to have a perceived status (with the client and within the firm), which makes the complicated provisions proposals irrelevant.

In our original response we expressed concern that the requirement for an EP to cool-off for five years if they have served any time during the seven-year time-on period as a KAP seemed unreasonable. Instead, we advocated a default cooling-off period of five years for all audit partners in conjunction with a risk-based approach. If the IESBA were to adopt this approach, it would not be necessary to introduce complex requirements relating to service in a combination of roles during the seven-year time-on period.

GENERAL COMMENTS

ACCA has developed this response following an internal due process involving SMPs, preparers (including SMEs) and users, those in developing nations, and those who will use the Code in translation. This input, such as from our Global Forum for Ethics, has informed the whole of this response. However, we would make the following observations.

Small and Medium Practices (SMPs)

We believe that the IESBA should consider the operational aspects for SMPs – particularly those that audit PIEs – and the companies they audit. Resource limitations within such firms could frustrate their ability to interpret the detailed requirements, as well as implement them using personnel of the required knowledge and experience.

There are also costs associated with tracking compliance with the independence requirements. The independence records relating to specific partners, audit staff and PIEs would result in higher costs and complicated planning procedures, and these problems would be exacerbated by variances in the rotation requirements of different jurisdictions and the independence standards.

In addition to our concerns that complicated provisions for long association will give rise to inadvertent breaches, we are also concerned about further concentration in the PIE audit market due to SMPs no longer having the resources to ensure compliance. This arises solely from complexity, rather than potentially long cooling-off periods.

While this exposure draft recognises the difficulties faced by SMPs, especially with regard to ‘limited resources’, we remain concerned that the smaller accounting firms, small start-ups and unsophisticated companies may have a difficult time engaging with, and dealing with, these

changes. As a guiding rule, we would advocate a ‘think small first’ approach, so that minimum requirements in respect of long association are applicable to all firms, but enhanced safeguards are put in place where greater threats are perceived, or where there is a clear public interest rationale.

Preparers (including SMEs) and users (including those charged with Governance and Regulators)

See our response in respect of SMPs above.

Developing Nations

Member bodies in different parts of the world operate within a range of cultural environments, and clarity and conciseness are important in this respect. If complicated provisions are to remain within the revised Code, the IESBA will be required to provide detailed guidance to aid consistency of understanding and interpretation across all the IFAC member organisations.

Translations

In our opinion the proposals should be clear, consistent and logical. While we are not aware of any potential translation issues, the IESBA should remain alert to this in proposing further changes to the existing wording.