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Dear Mr Siong

Exposure Draft – 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 supportive of the objective of the proposals to strengthen the current provisions to enhance auditor independence. However, we believe IESBA should go further in strengthening the provisions so as to address perceptions issues and enhance confidence in audit.

The allowed period of ‘time-on’ as a key audit partner

We believe that it is helpful that the period for which key audit partners can act as such is consistent, whether they are the engagement partner, engagement quality control reviewer or other partner making key decisions or judgments. However, we believe that IESBA has reached the wrong conclusion that it is not appropriate to reduce the current period from seven years to five.

The Explanatory Memorandum identifies that “a number of larger jurisdictions have restricted the time-on period to five years for the engagement partner and the individual responsible for the engagement quality control review (EQCR) on the audits of listed companies. The International Organization of Securities Commissions (IOSCO) had also indicated that the IESBA should review the time-on period “given the shorter regulatory requirement in many jurisdictions. A five year rotation period would ensure that a fresh mind is brought to the audit more frequently and reduce any familiarity threat.””

The Explanatory Memorandum notes that some regulators (including ourselves) provide for increasing the time-on period from five to seven years in certain circumstances on the grounds of preserving audit quality. However, this is intended to apply in exceptional circumstances and does not provide an argument that seven years is therefore acceptable as a general base period. Further, IESBA’s allowance, albeit in rare cases, that a key audit partner can serve an additional year, takes the maximum time-on period under the IESBA Code up to eight years.

We are concerned that the proposed changes to the Code appear to reflect a compromise to address perceived practical issues in some, particularly smaller, jurisdictions. We strongly recommend IESBA reconsider this – to serve the public interest, and alleviate concerns about threats to auditor independence and objectivity, ethical principles for auditors of PIEs should not be subject to compromise. The arguments IESBA puts forward against reducing

the time-on period do not appear to be borne out by the practical experience in those jurisdictions where a shorter period is in place. It is also not clear as to the basis for IESBA's statement that "Such increased frequency of rotation is not likely to bring about meaningful incremental benefits ... to the confidence in the independence of the auditor."

The 'time-off' period

We support the proposal to increase the 'time-off' period for engagement partners to 5 years. However, we do not agree that it is appropriate to have a lesser period of time-off for other key audit partners, especially the EQCR. At the IESBA National Standards Setters meeting in July this year, which we attended, we recall that representatives generally called for a no return period of five years for the EQCR. It was also noted at that meeting that the rules were 'complex' in having different periods for different categories of partners.

While other key audit partners "will generally have a lesser ability to influence the audit" they nonetheless do have some ability to influence, and self-interest and familiarity threats do arise. We believe it is difficult to support the proposition in effect that such threats are always sufficiently less to justify to third parties the shorter time-off period. Accordingly, we recommend that the required time-off period for all key audit partners should be 5 years. This would be a less complex arrangement and would be easier for stakeholders not directly involved in audit to understand. We believe this would better address perception issues and enhance confidence in audit, and is also consistent with having the same allowed 'time-on' period for all key audit partners.

This is also more consistent with the IESBA proposal that a key audit partner who has served "at any time" within the time-on period as engagement partner, even if only one year, should be required to have a time-off period of 5 years. While it may be expected to be more likely that a key audit partner who changes role would become the engagement partner at the end of the period, it is possible that they could have served as the engagement partner for one year at the start before moving to another, less responsible, role on the audit (e.g. reflecting changes within the firm and to allow more time on other audits). Under the current IESBA proposals, such a partner who had served as a key audit partner, other than engagement partner, for the six years immediately before rotating off would be required to have a time-off period of five years, while another partner, who had served as a key audit partner, other than engagement partner, for seven years, would be required to have a time-off period of only two years. IESBA says it proposes this model as it is easier to apply. However, we believe that the whole position could be made easier to understand, especially for third parties, if consistent periods of time-on and time-off were applied to all key audit partners regardless of the specific role served.

Involvement with the audit during the 'time-off' period

To address fully concerns of threats to objectivity, there should be no involvement at all with the audit during the time-off period, other than responding to queries concerning previously completed audits the partner was involved with. At the IESBA National Standards Setters meeting we recall that there was also a strong sense that, in the time-off period, the individual should have no involvement with the audited entity at all ("off means off").

Accordingly, we believe that in principle someone who has acted as a key audit partner should not be able to be consulted by the audit team on technical or industry-specific issues in respect of the audited entity at any time during the time-off period. This would strengthen in particular the safeguards against familiarity threats. Also, without this condition it is possible that the partner's objectivity could be threatened, or perceived to be threatened, if they were to resume the role of a key audit partner after the time-off period, with both familiarity and self-review threats a possibility. However, we recognise that in exceptional cases a firm may have few partners with relevant technical or industry-specific expertise and, if such a prohibition were to be extended to those in an internal technical consultation

role, it could be difficult to implement in those cases without risking audit quality. Accordingly, if a prohibition on providing technical or industry-specific advice in relation to the audited entity for the entirety of the 'off-period' is not established, we recommend that further safeguards should be required when a former key audit partner provides such advice. These could include, for example, ensuring that (i) the key audit partner should have no other involvement with the audit or the audited entity, (ii) any advice given should be specifically subject to engagement quality control review, and (iii) if advice is given on matters material to the financial statements, the former key audit partner should not resume the role of a key audit partner until such time as a reasonable and informed third party would conclude that the partner's independence and objectivity is not impaired (for example, their 'off-period' should recommence whenever they conclude the giving of such advice).

We strongly support the proposals that during the time-off period the rotated partner should not act as 'relationship partner' for the client, and should not undertake any other role, including the provision of non-audit services, that would result in:

- Significant or frequent interaction with senior management or those charged with governance; or
- An ability to exert direct influence on the outcome of the audit engagement.

We agree that these provisions should not prevent an individual from assuming a senior leadership role in the firm and it is helpful to clarify this.

Obtaining the concurrence of those charged with governance

We agree that if, in rare circumstances, it is considered appropriate to extend, by a limited amount, the total time-on period served, this should require the approval of those charged with governance. Ordinarily this should be the audit committee or persons serving an equivalent role.

Yours sincerely



Nick Land

Director of the FRC and Chairman of the FRC's Audit & Assurance Council

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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.