13 May 2016

Mr. Ken Siong
Technical Director
International Ethics Standards Board for Accountants (IESBA)
International Federation of Accountants (IFAC)
529 Fifth Avenue, 6th Floor
New York, New York 10017 USA
By email: kensiong@ethicsboard.org

Dear Mr. Siong,

RE: IESBA's Exposure Draft *Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client*

Accounting Professional & Ethical Standards Board Limited (APESB) welcomes the opportunity to make a submission on the IESBA's Exposure Draft *Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client* (the Exposure Draft).

APESB is governed by an independent board of directors whose primary objective is to develop and issue, in the public interest, high-quality professional and ethical pronouncements. These pronouncements apply to the membership of the three major Australian professional accounting bodies (CPA Australia, Chartered Accountants Australia and New Zealand and the Institute of Public Accountants). In Australia, APESB issues APES 110 *Code of Ethics for Professional Accountants* (APES 110) which includes the Australian auditor independence requirements, as well as a range of professional and ethical standards that address non-assurance services.

Introductory comments

APESB commends the IESBA's efforts to enhance auditor independence by addressing familiarity and self-interest threats created by the long association of personnel with an audit client. We appreciate that the IESBA has incorporated some of our proposals to the IESBA's 2014 Exposure Draft *Proposed Changes to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client* (the 2014 Exposure Draft).

We congratulate IESBA on the proposal to consider jurisdictional safeguards in the determination of rotation requirements for Engagement Partners (EPs) and Engagement Quality Control Reviewers (EQCRs).

APESB is concerned with the IESBA's proposal to distinguish between listed Public Interest Entities (PIEs) and non-listed PIEs in the Exposure Draft. We are of the view that the long association requirements should be the same for all PIEs irrespective of whether they are listed or non-listed. Accordingly, we believe that there should be consistency in respect of the cooling-off period for EQCRs on all PIEs. This issue is discussed in more detail below.

In developing APESB's response to the Exposure Draft, we have taken into consideration feedback received from Australian stakeholders. The feedback was gathered through submissions to APESB and two roundtable events conducted by APESB in Melbourne and Sydney in March 2016.

APESB has also responded to the IESBA's general and specific questions in Appendix A.

Long Association requirements in respect of PIEs

APESB is of the view that all PIEs should be treated equally. When the concept of PIEs was introduced into the IESBA Code in July 2009, the stated intention was to classify entities that shared similar characteristics with listed entities, because there is <u>public interest</u> in applying the same auditor independence requirements to these non-listed entities.

We note that this is reflected in the definition of a PIE in the existing IESBA Code, i.e. "*An entity … for which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities."* The typical examples of these types of entities are unlisted financial institutions, insurance companies or public utilities.

APESB is of the view that any proposals to distinguish listed and non-listed PIEs undermine the very concept of a PIE as defined. We believe that the IESBA may unintentionally be setting a precedent or expectation that a similar approach may be applied to the other PIE provisions in the Code.

If there is a compelling reason for such a distinction in a jurisdiction, we are of the view that the regulator or National Standards Setter of that jurisdiction would be the appropriate body to establish such a distinction.

We recognise that the availability of suitably qualified partners to act in an EP or EQCR role in certain jurisdictions may have led to this proposal. However, invariably there are specific reasons why an entity is a PIE and must adhere to stricter auditor independence requirements compared to non-PIEs.

Recommendations

APESB's key recommendations for the IESBA's consideration are:

- to remove the proposed <u>distinction</u> between listed PIEs and non-listed PIEs in the proposed paragraphs 290.150A and 290.150B; and
- the <u>same</u> rotation requirements should be applied to EPs and EQCRs on <u>all</u> PIEs.

APESB strongly supports IESBA's proposals in respect of jurisdictional safeguards and the consideration of combination time served by an EP and EQCR before the maximum cooling-off period is enacted.

APESB's specific editorial suggestions are included in Appendix A for the IESBA's consideration.

Concluding comments

APESB acknowledges the IESBA's significant efforts in conducting surveys and stakeholder outreach in respect of this Exposure Draft.

APESB's key concern is in respect of the proposal to distinguish between listed and non-listed PIEs. We believe that if an entity is classified as a PIE due to the existence of significant public interest and wide ranging stakeholders then it should not matter whether it is listed or unlisted.

We trust you find these comments useful in your final deliberations. Should you require any additional information, please contact APESB's Technical Director, Channa Wijesinghe at channa.wijesinghe@apesb.org.au.

Yours sincerely

The Hon. Nicola Roxon
Chairman

Appendix A

APESB's Comments

APESB's responses to the specific matters raised by the IESBA in the Exposure Draft are as follows:

Specific Comments

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

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?

   APESB believes that the rotation requirements should be the same for all PIEs because PIEs have a large number and wide range of stakeholders, and there is public interest in these entities. Accordingly, APESB does not entirely agree with the IESBA's proposals.

   We note the reference to the "large numbers of small entities defined as PIEs around the world" in the IESBA's Exposure Draft. Given the definition of a PIE in the existing Code, we question whether such small entities have been correctly classified as PIEs. If they have, then the public interest in these entities must require that these entities are subject to the same independence requirements.

   We consider that, given the significance of the EQCR's role (in evaluating the significant judgements the engagement team made and the conclusions it reached in determining the opinion expressed in the report), the EQCR should be subject to similar cooling-off requirements as the EP to safeguard objectivity.

   Distinction between listed and non-listed PIEs (two-tier approach)

   APESB is concerned about the precedence the IESBA may set by distinguishing between listed and non-listed PIEs. The concept of PIEs was created by the IESBA in 2009 to group listed entities and entities that shared the same characteristics as listed entities together to ensure consistent auditor independence requirements are applied for entities that have a significant public interest.

   However, by introducing a distinction within the meaning of PIE in the Code, the IESBA may be undoing the original premise in the Code of why the definition of PIE was required in respect of auditor independence requirements.

   APESB strongly believes that the IESBA should not distinguish between listed and non-listed PIEs as by nature, they are entities of public interest.

If this is an issue in a certain jurisdiction, then we are of the view that the audit regulator or the National Standards Setter of the relevant jurisdiction are the appropriate bodies to consider whether there are compelling reasons in their jurisdiction to provide appropriate exemptions relating to PIEs. For example, we are aware that in Canada there is relief for small market capitalisation entities (i.e. reporting issuer or listed entity audit client below the market capitalisation or total assets threshold of $10 million) from the PIE auditor independence requirements.

As such, APESB is not supportive of the introduction of a distinction of PIEs between listed and non-listed entities in the IESBA Code.

Jurisdictional safeguards

APESB is strongly supportive of the introduction of the proposed jurisdictional safeguards in the Exposure Draft. This is a major achievement as overlaying the proposals with local jurisdictional rules is a complex issue, and APESB congratulates the IESBA on how they have addressed this issue in the Exposure Draft.

Whilst APESB supports the inclusion of the jurisdictional safeguards, we note that complications are likely to arise in Australia due to the introduction of the two-tier approach to PIEs.

Overlay of two-tier approach with jurisdictional safeguards

The definition of a PIE in APES 110 is specific to the Australian jurisdiction. For example, under APES 110 entities regulated by the Australian Prudential Regulatory Authority (Banking and Insurance regulator) and issuers of debt and equity instruments to the public are classified as PIEs.

The Exposure Draft proposes to introduce a two-tier approach that distinguishes a listed PIE from a non-listed PIE. However, when this two-tier approach overlays with the Australian jurisdictional safeguards (i.e. existing Australian *Corporations Act 2001* requirements in respect of the shorter 5-year time-on period for listed entities), it inadvertently results in:

- an EP on a listed PIE having a shorter 3-year cooling-off period compared to an EP on a non-listed PIE who is required to have a 5-year cooling-off period; and
- an EQCR on a listed PIE having a shorter 5-year time-on period compared to an EQCR on a non-listed PIE having a 7-year time-on period.

Consequently, in Australia, an EP or EQCR may serve on a listed PIE for longer than a non-listed PIE. For example, an EP or EQCR on a listed PIE will serve 10 years out of 13-year period (5-year time-on, 3-year cooling-off, and 5-year time-on) whereas, an EP or EQCR may only serve on a non-listed PIE for 7 years in a 12-year period (7-year time-on, 5-year cooling-off). The impact overall is that an EP or EQCR will serve a longer duration on a listed PIE engagement (77% of the time), whilst an EP or EQCR will serve a shorter duration on the non-listed PIE engagement (58% of the time).

This has inadvertently caused the IESBA's proposed rotation requirements on a non-listed PIE to be more onerous compared to a listed PIE when the Australian jurisdictional requirements are overlayed with the IESBA's proposals. Furthermore, the IESBA's proposals add complexity in monitoring the different rotation requirements for an EP and EQCR on listed PIEs and non-listed PIEs.

Stakeholders at the APESB roundtables in Australia noted that the IESBA's proposals may also inadvertently prompt firms to take action to avoid these cooling-off requirements. For example:

- firms may actively manage the rotation rules rather than allocate the most appropriate audit personnel on an engagement as many Small and Medium Practices (SMPs) may lack adequate resources to comply with the IESBA's proposals; or
- firms may 'manage' the classification of entities or certain categories of entities as PIEs unless they are defined by regulation or legislation as a PIE.

APESB considers that these actions may also adversely impact audit quality.

<u>APESB's alternative proposal</u>

Based on these unintended consequences from the combination of the two-tier approach and the jurisdictional safeguards, APESB is of the view that in the IESBA Code:

- all PIEs should be treated consistently; and
- the <u>same</u> rotation requirements should be applied to EPs and EQCRs on <u>all</u> PIEs.

APESB is also of the view that the IESBA should perform a timely post-implementation review to assess whether the IESBA's proposals are successful and whether the project's intended objectives (i.e. addressing auditor independence threats created by self-interest and familiarity) are achieved.

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?

APESB is strongly supportive of the proposal for a reduction in the cooling-off period under the conditions specified in 290.150D. We are cognizant that the IESBA has favourably considered our proposals to the 2014 Exposure Draft.

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?

APESB agrees with the conditions specified in subparagraphs 290.150D (a) and (b). We acknowledge that the IESBA has recognised jurisdictional safeguards adopted in local jurisdictions (e.g. the shorter 5-year time-on period for listed entities imposed by the Australian Corporations Act).

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)?

APESB is very supportive of the revised proposals as the IESBA has considered the length of the time served as an EP or EQCR when determining the circumstances in which the maximum cooling-off period for the EP or EQCR is triggered.

General Comments

APESB's responses to the general matters raised by the IESBA are as follows:

(a) Small and Medium Practices (SMPs)

Impact of the proposals subject to re-exposure for SMPs

APESB believes that the IESBA's proposals in the Exposure Draft in respect of the introduction of the two-tier approach that differentiates between a listed PIE from a non-listed PIE may disadvantage SMPs due to its complexity.

<u>Disproportionate impact on non-listed PIEs</u>

When the current proposals are overlayed with Australian jurisdiction safeguards, it disproportionately impacts non-listed PIE engagements as EPs and EQCRs are required to serve a shorter period on these engagements compared to listed PIE engagements. Consequently, the more stringent requirements for non-listed PIEs may force some SMPs out of the PIE audit market as SMPs may not have the necessary structures and resources in place to monitor and implement these rotation requirements.

(b) Preparers (including SMEs) and users (including Those Charged with Governance and Regulators)

Not applicable.

(c) Developing Nations

Not applicable.

(d) Translations

Not applicable.