

Proposed Amendments to Long Association of Personnel with an Audit or Assurance Client requirements in APES 110 *Code of Ethics for Professional Accountants*

Prepared and issued by
Accounting Professional & Ethical Standards Board Limited

EXPOSURE DRAFT 01/17
ISSUED: February 2017

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Commenting on this Exposure Draft

This Exposure Draft, *Proposed Amendments to Long Association of Personnel with an Audit or Assurance Client requirements in APES 110 Code of Ethics for Professional Accountants*, was developed and approved by the Accounting Professional & Ethical Standards Board Limited (APESB).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by 7 April 2017.**

Comments should be addressed to:

The Chairman
Accounting Professional & Ethical Standards Board Limited
Level 11, 99 William Street
Melbourne Victoria 3000
Australia

APESB would prefer that respondents express a clear overall opinion on whether the proposed amendments, as a whole, is supported and that this opinion be supplemented by detailed comments, whether supportive or critical, on any matter. APESB regards both critical and supportive comments as essential to a balanced view of the proposed amendments.

Respondents are asked to submit their comments electronically through the APESB website, using the link <http://www.apesb.org.au/apesb-exposure-drafts-open-for-comment>.

Please submit comments in both a PDF and Word file. All comments will be considered a matter of public record and will ultimately be posted on the website www.apesb.org.au.

APESB prefers that comments are submitted via its website. However, if there are practical difficulties, comments can also be sent to sub@apesb.org.au or mailed to the address noted above.

Obtaining a copy of this Exposure Draft

This Exposure Draft is available on the APESB website: www.apesb.org.au. Alternatively, any individual or organisation may obtain one printed copy of this Exposure Draft without charge until **7 April 2017** by contacting:

Accounting Professional & Ethical Standards Board Limited
Level 11
99 William Street
Melbourne Victoria 3000
Australia
E-mail: enquiries@apesb.org.au
Phone: (03) 9670 8911
Fax: (03) 9670 5611

Reasons for issuing Exposure Draft 01/17

APESB proposes to amend APES 110 *Code of Ethics for Professional Accountants* (“the Code”) to incorporate changes on Long Association of Personnel with an Audit or Assurance Client (Long Association) requirements proposed by the International Ethics Standards Board for Accountants (IESBA) to the international *Code of Ethics for Professional Accountants*.

Key requirements and guidance in Exposure Draft 01/17

This Exposure Draft sets out the proposed amendments to Long Association requirements for Members in Public Practice involved in Audit or Assurance Engagements, as outlined in Section 290 *Independence – Audit and Review Engagements* (Section 290) and Section 291 - *Independence – Other Assurance Engagements* (Section 291).

Audits of Public Interest Entities (PIE)

Section 290 reflects the proposed amendments to Long Association requirements for Members in Public Practice involved in PIE audits.

A significant amendment relates to recognition of jurisdictional law or regulation that imposes cooling-off periods for Engagement Partners in PIE audits that may be shorter than the proposed Code provisions (see paragraph 290.163). Under the proposed jurisdictional provision, where legislation or regulation requires a cooling-off period of less than 5 years for an Engagement Partner of PIE audits, the cooling-off period of 5 years may be reduced to the higher of that period or 3 years.

This applies to the Australian jurisdiction in circumstances where applicable law (such as the *Corporations Act 2001*) or regulation prescribes cooling-off periods shorter than the proposed Code requirements (see paragraphs AUST290.163.1 and AUST290.163.2), as follows:

- Where legislative or regulatory requirements prescribe a minimum cooling-off period of 2 years for an Engagement Partner in PIE audits, the minimum cooling-off period under the proposed Code provisions will be 3 consecutive years.
- Under the proposed requirements however where an Audit Client, in accordance with law or regulation, has extended an Engagement Partner’s time-on period to 7 years, the required cooling-off period will be 5 consecutive years.

The extant requirements in Section 290 for audits of PIEs are compared with the proposed requirements in the table below, including the impact of the application of the *Corporations Act 2001* (“the Act”) to the proposed requirements:

| Role | Existing Code with the Act | | Proposed Code | | Proposed Code with the Act | |
|---|----------------------------|---------------------|-----------------|---------------------|----------------------------|---------------------|
| | Time-on (years) | Cooling off (years) | Time-on (years) | Cooling off (years) | Time-on (years) | Cooling off (years) |
| Engagement Partner | 5** | 2 | 7 | 5 | 5** | 3 |
| Engagement Quality Control Review Partner | 5** | 2 | 7 | 3 | 5** | 3 |
| Other Key Audit Partners | 7 | 2 | 7 | 2 | 7 | 2 |

** Assuming that the Engagement Partner or Engagement Quality Control Review Partner only serves a 5-year time-on period.

Transition of alternative cooling-off period established by legislation or regulation

A transitional provision that specifies a sunset to the alternative cooling-off period requirements in paragraph 290.163 is proposed, to specify that it will only apply for audits of financial statements for periods beginning prior to 15 December 2023.

Other Matters

Proposed amendments also include:

- enhancements to general provisions in both Section 290 and Section 291; and
- inclusion of the definition of “Professional Bodies” to make the Code consistent with other APESB pronouncements.

Proposed Operative Date

The proposed operative date for the revised Long Association provisions is 15 December 2018. This will be applied to the Section 290 and Section 291 as follows:

- Section 290 - effective for audits of Financial Statements for periods beginning on or after 15 December 2018.
- Section 291 - effective on 15 December 2018.

Earlier adoption of these provisions will be permitted.

Request for Specific Comments

Transition of alternative cooling-off period established by legislation or regulation

Transitional Provisions will include a proposed sunset to the alternative cooling off period permitted under legislation or regulation that will have effect for audits of Financial Statements for periods beginning prior to 15 December 2023. This aims to facilitate the transition to a required cooling-off period of 5 consecutive years in jurisdictions where the legislative body or regulator has specified a cooling-off period of less than five consecutive years.

APESB requests that respondents consider this matter and its impact in the Australian context and provide specific comments.

Amendments to Long Association of Personnel with an Audit or Assurance Client requirements in APES 110 *Code of Ethics for Professional Accountants*

ISSUED: [DATE]

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TRANSITIONAL PROVISIONS

2 DEFINITIONS

[AUST] Professional Bodies means the Chartered Accountants Australia and New Zealand, CPA Australia and the Institute of Public Accountants.

[Other terms defined in Definitions remain unchanged.]

PART B - MEMBERS IN PUBLIC PRACTICE

SECTION 290

INDEPENDENCE - AUDIT AND REVIEW ENGAGEMENTS

[Paragraphs 290.1 – 290.147 of extant Section 290 remain unchanged.]

Long Association of Personnel (including Partner Rotation) with an Audit Client

General Provisions

290.148 Familiarity and self-interest threats, which may impact an individual's objectivity and professional scepticism, may be created and may increase in significance when an individual is involved in an Audit Engagement over a long period of time.

Although an understanding of an Audit Client and its environment is fundamental to audit quality, a familiarity threat may be created as a result of an individual's long association as a member of the Audit Team with:

- The Audit Client and its operations;
- The Audit Client's senior management; or
- The Financial Statements on which the Firm will express an Opinion or the financial information which forms the basis of the Financial Statements.

A self-interest threat may be created as a result of an individual's concern about losing a longstanding client or an interest in maintaining a close personal relationship with a member of senior management or Those Charged with Governance, and which may inappropriately influence the individual's judgement.

290.149 The significance of the threats will depend on factors, individually or in combination, relating to both the individual and the Audit Client.

(a) Factors relating to the individual include:

- The overall length of the individual's relationship with the client, including if such relationship existed while the individual was at a prior Firm.
- How long the individual has been a member of the Engagement Team, and the nature of the roles performed.
- The extent to which the work of the individual is directed, reviewed and supervised by more senior personnel.

- The extent to which the individual, due to the individual's seniority, has the ability to influence the outcome of the audit, for example, by making key decisions or directing the work of other members of the Engagement Team.
- The closeness of the individual's personal relationship with senior management or Those Charged with Governance.
- The nature, frequency and extent of the interaction between the individual and senior management or Those Charged with Governance.

(b) Factors relating to the Audit Client include:

- The nature or complexity of the client's accounting and financial reporting issues and whether they have changed.
- Whether there have been any recent changes in senior management or Those Charged with Governance.
- Whether there have been any structural changes in the client's organisation which impact the nature, frequency and extent of interactions the individual may have with senior management or Those Charged with Governance.

290.150 The combination of two or more factors may increase or reduce the significance of the threats. For example, familiarity threats created over time by the increasingly close relationship between an individual and a member of the client's senior management would be reduced by the departure of that member of the client's senior management and the start of a new relationship.

290.151 The significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an Acceptable Level. Examples of such safeguards include:

- Rotating the individual off the Audit Team.
- Changing the role of the individual on the Audit Team or the nature and extent of the tasks the individual performs.
- Having a Member in Public Practice who was not a member of the Audit Team review the work of the individual.
- Performing regular independent internal or external quality reviews of the engagement.
- Performing an Engagement Quality Control Review.

290.152 If a Firm decides that the threats are so significant that rotation of an individual is a necessary safeguard, the Firm shall determine an appropriate period during which the individual shall not be a member of the Engagement Team or provide quality control for the Audit Engagement or exert direct influence on the outcome of the Audit Engagement. The period shall be of sufficient duration to allow the familiarity and self-interest threats to Independence to be eliminated or reduced to an Acceptable Level. In the case of a Public Interest Entity, paragraphs 290.153 to 290.168 also apply.

Audits of Public Interest Entities

290.153 In respect of an audit of a Public Interest Entity, an individual shall not act in any of the following roles, or a combination of such roles, for a period of more than seven cumulative years (the "time-on" period):

(a) The Engagement Partner;

- (b) The individual appointed as responsible for the Engagement Quality Control Review; or
- (c) Any other Key Audit Partner role.

After the time-on period, the individual shall serve a “cooling-off” period in accordance with the provisions in paragraphs 290.155 – 290.163.

290.154 In calculating the time-on period, the count of years cannot be restarted unless the individual ceases to act in any one of the above roles for a consecutive period equal to at least the cooling-off period determined in accordance with paragraphs 290.155 to 290.157 as applicable to the role in which the individual served in the year immediately before ceasing such involvement. For example, an individual who served as Engagement Partner for four years followed by three years off can only act thereafter as a Key Audit Partner on the same Audit Engagement for three further years (making a total of seven cumulative years). Thereafter, that individual is required to cool off in accordance with paragraph 290.158.

Cooling-off Period

290.155 If the individual acted as the Engagement Partner for seven cumulative years, the cooling-off period shall be five consecutive years.

290.156 Where the individual has been appointed as responsible for the Engagement Quality Control Review and has acted in that capacity for seven cumulative years, the cooling-off period shall be three consecutive years.

290.157 If the individual has acted in any other capacity as a Key Audit Partner for seven cumulative years, the cooling-off period shall be two consecutive years.

Service in a combination of Key Audit Partner roles

290.158 If the individual acted in a combination of Key Audit Partner roles and served as the Engagement Partner for four or more cumulative years, the cooling-off period shall be five consecutive years.

290.159 If the individual acted in a combination of Key Audit Partner roles and served as the Key Audit Partner responsible for the Engagement Quality Control Review for four or more cumulative years, the cooling-off period shall, subject to paragraph 290.160(a), be three consecutive years.

290.160 If an individual has acted in a combination of Engagement Partner and Engagement Quality Control Review roles for four or more cumulative years during the time-on period, the cooling-off period shall be:

- (a) Five consecutive years where the individual has been the Engagement Partner for three or more years; or
- (b) Three consecutive years in the case of any other combination.

290.161 If the individual acted in any other combination of Key Audit Partner roles, the cooling-off period shall be two consecutive years.

Service at a Prior Firm

290.162 In determining the number of years that an individual has been a Key Audit Partner under paragraphs 290.153 to 290.154, the length of the relationship shall, where relevant, include time while the individual was a Key Audit Partner on that engagement at a prior Firm.

Position where Alternative Cooling-Off Period for Engagement Partners is Established by Law or Regulation

290.163 Where a legislative body or regulator (or organisation authorised or recognised by such legislative body or regulator) has established a cooling-off period for an Engagement Partner of less than five consecutive years, the higher of that period or three years may be substituted for the cooling-off period of five consecutive years specified in paragraphs 290.155, 290.158 and 290.160(a) provided that the applicable time-on period does not exceed seven years.

AUST290.163.1 Subject to AUST290.163.2, in Australia, the provisions of paragraph 290.163 apply to circumstances where legislation or a regulator prescribes a time-on period of shorter than seven years during which an individual is permitted to be Engagement Partner in the audits of Public Interest Entities.¹

AUST290.163.2 Where the Audit Client has exercised an option, in accordance with legislation or regulation, to extend the Engagement Partner's time-on period to seven years, the cooling-off period shall be five consecutive years as specified in paragraphs 290.155, 290.158 and 290.160(a).

Restrictions on Activities During the Cooling-off Period

290.164 For the duration of the relevant cooling-off period, the individual shall not:

- (a) Be a member of the Engagement Team or provide quality control for the Audit Engagement;
- (b) Consult with the Engagement Team or the client regarding technical or industry-specific issues, transactions or events affecting the Audit Engagement (other than discussions with the Engagement Team limited to work undertaken or conclusions reached in the last year of the individual's time-on period where this remains relevant to the audit);
- (c) Be responsible for leading or coordinating the Firm's Professional Services to the Audit Client or overseeing the Firm's relationship with the Audit Client; or
- (d) Undertake any other role or activity not referred to above with respect to the Audit Client, including the provision of non-assurance services, that would result in the individual:
 - (i) Having significant or frequent interaction with senior management or Those Charged with Governance; or
 - (ii) Exerting direct influence on the outcome of the Audit Engagement.

The provisions of this paragraph are not intended to prevent the individual from assuming a leadership role in the Firm, such as that of the Senior or Managing Partner.

¹ Refer to s324DA of the *Corporations Act 2001* which has more restrictive Audit Partner rotation requirements for Listed Entities in Australia.

Other Matters

290.165 There may be situations where a Firm, based on an evaluation of threats in accordance with the general provisions above, concludes that it is not appropriate for an individual who is a Key Audit Partner to continue in that role even though the length of time served as a Key Audit Partner is less than seven years. In evaluating the threats, particular consideration shall be given to the roles undertaken and the length of the individual's association with the Audit Engagement prior to an individual becoming a Key Audit Partner.

290.166 Despite paragraph 290.153 - 290.161, Key Audit Partners whose continuity is especially important to audit quality may, in rare cases due to unforeseen circumstances outside the Firm's control, and with the concurrence of Those Charged with Governance, be permitted to serve an additional year as a Key Audit Partner as long as the threat to Independence can be eliminated or reduced to an Acceptable Level by applying safeguards. For example, a Key Audit Partner may remain in that role on the Audit Team for up to one additional year in circumstances where, due to unforeseen events, a required rotation was not possible, as might be the case due to serious illness of the intended Engagement Partner. The Firm shall discuss with Those Charged with Governance the reasons why the planned rotation cannot take place and the need for any safeguards to reduce any threat created.

[Paragraphs 290.151 of extant Section 290 has been deleted as content is addressed in paragraphs 290.148 and 290.149.]

290.167 When an Audit Client becomes a Public Interest Entity, the length of time the individual has served the Audit Client as a Key Audit Partner before the client becomes a Public Interest Entity shall be taken into account in determining the timing of the rotation.² If the individual has served the Audit Client as a Key Audit Partner for a period of five cumulative years or less when the client becomes a Public Interest Entity, the number of years the individual may continue to serve the client in that capacity before rotating off the engagement is seven years less the number of years already served. If the individual has served the Audit Client as a Key Audit Partner for six or more cumulative years when the client becomes a Public Interest Entity, the partner may continue to serve in that capacity with the concurrence of Those Charged with Governance for a maximum of two additional years before rotating off the engagement.

290.168 When a Firm has only a few people with the necessary knowledge and experience to serve as a Key Audit Partner on the audit of a Public Interest Entity, rotation of Key Audit Partners may not be an available safeguard. If an independent regulator³ in the relevant jurisdiction has provided an exemption from partner rotation in such circumstances, an individual may remain a Key Audit Partner for more than seven years, in accordance with such regulation, provided that the independent regulator has specified other requirements which are to be applied, such as the length of time that the Key Audit Partner may be exempted from rotation or a regular independent external review.

² Refer to s324DA of the *Corporations Act 2001* which has more restrictive Audit Partner rotation requirements for Listed Entities in Australia.

³ Refer to s342A of the *Corporations Act 2001* which specifies that the Australian Securities and Investment Commission may grant extensions.

[Paragraphs 290.154 – 290.228 of extant Section 290 remain unchanged but renumbered as paragraphs 290.169 – 290.242.]

Paragraphs 290.243 to 290.499 are intentionally left blank.

[Paragraphs 290.500 – 290.514 of extant Section 290 remain unchanged.]

SECTION 291

INDEPENDENCE—OTHER ASSURANCE ENGAGEMENTS

[Paragraphs 291.1 – 291.136 of extant Section 291 remain unchanged.]

Long Association of Personnel with an Assurance Client

291.137 Familiarity and self-interest threats, which may impact an individual's objectivity and professional scepticism, maybe created and may increase in significance when an individual is involved on an Assurance Engagement of a recurring nature over a long period of time.

A familiarity threat may be created as a result of an individual's long association with:

- The Assurance Client; or
- The subject matter and subject matter information of the Assurance Engagement.

A self-interest threat may be created as a result of an individual's concern about losing a longstanding Assurance Client or an interest in maintaining a close personal relationship with the Assurance Client or a member of senior management and which may inappropriately influence the individual's judgement.

291.138 The significance of the threats will depend on factors, considered individually or in combination, such as:

- The nature of the Assurance Engagement.
- How long the individual has been a member of the Assurance Team, the individual's seniority on the team, and the nature of the roles performed, including if such a relationship existed while the individual was at a prior Firm.
- The extent to which the work of the individual is directed, reviewed and supervised by more senior personnel.
- The extent to which the individual, due to the individual's seniority, has the ability to influence the outcome of the Assurance Engagement, for example, by making key decisions or directing the work of other members of the Engagement Team.
- The closeness of the individual's personal relationship with the Assurance Client or, if relevant, senior management.
- The nature, frequency and extent of interaction between the individual and the Assurance Client.
- Whether the nature or complexity of the subject matter or subject matter information has changed.
- Whether there have been any recent changes in the individual or individuals who are the responsible party, or if relevant, senior management.

291.139 The combination of two or more factors may increase or reduce the significance of the threats. For example, familiarity threats created over time by the increasingly close relationship between

an individual and the Assurance Client would be reduced by the departure of the person who is the responsible party and the start of a new relationship.

291.140 The significance of any threats shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce them to an Acceptable Level. Examples of such safeguards in relation to a specific engagement include:

- Rotating the individual off the Assurance Team.
- Changing the role of the individual on the Assurance Team or the nature and extent of the tasks the individual performs.
- Having a Member in Public Practice who is not a member of the Assurance Team review the work of the individual.
- Performing regular independent internal or external quality reviews of the engagement.
- Performing an Engagement Quality Control Review.

291.141 If a Firm decides that the threats are so significant that rotation of an individual is a necessary safeguard, the Firm shall determine an appropriate period during which the individual shall not be a member of the Engagement Team or provide quality control for the Assurance Engagement or exert direct influence on the outcome of the Assurance Engagement. The period shall be of sufficient duration to allow the familiarity and self-interest threats to be eliminated or reduced to an Acceptable Level.

[Paragraphs 291.138 – 291.157 of extant Section 291 remain unchanged but renumbered as paragraphs 291.142 – 291.161.]

TRANSITIONAL PROVISIONS

The Code is subject to the following transitional provisions:

[Paragraphs 1 – 6 of extant Transitional Provisions remain unchanged.]

Long Association of Personnel with an Audit Client or Assurance Client

7. The long association provisions (including partner rotation) have been strengthened to stipulate specific requirements for Key Audit Partners. The new provisions set out in paragraphs 290.148 – 290.168 are effective for audits of Financial Statements for periods beginning on or after 15 December 2018 and paragraphs 291.137 - 291.141 are operative on 15 December 2018. Early adoption of these amendments is permitted.
8. The alternative jurisdictional partner rotation requirements set out in paragraph 290.163 shall have effect only for audits of Financial Statements for periods beginning prior to 15 December 2023. This will facilitate the transition to the required cooling-off period of five consecutive years for Engagement Partners in those jurisdictions where the legislative body or regulator (or organisation authorised or recognised by such legislative body or regulator) has specified a cooling-off period of less than five consecutive years.