



Our Ref.: C/EC

10 May 2016

Ken Siong  
Technical Director  
International Ethics Standards Board for Accountants  
529 Fifth Avenue, 6th Floor  
New York, NY 10017  
The United States of America

Dear Sir,

**International Ethics Standard Board for Accountants Exposure Draft on Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client**

The Hong Kong Institute of Certified Public Accountants is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We are grateful for the opportunity to provide you with our comments on this Exposure Draft.

We acknowledge that the engagement quality control reviewer ("EQCR") plays an important role in an audit engagement. While we agree that extending the cooling-off period for the EQCR for audit of public interest entities could provide an effective "fresh look" on the audit engagement, we are also concerned that the proposals would pose further pressure on firm resources and reduce the availability of individuals suitably qualified to act in this role. This would lead to potential adverse consequences for audit quality, which might not be in the public interest.

We are mindful that the benefits of such a "fresh look" must be appropriately balanced with the costs of having stringent rotation requirements. In this regard, we believe that it is crucial to analyse how the different rotation requirements would interact and how the entire package of safeguards would impact audit quality. We, therefore, recommend that the IESBA reconsiders the proposals with caution and ensure that the rotation requirements are both robust and balanced.

Our responses to the questions raised in the Exposure Draft are set out in the Appendix for your consideration.

If you have any questions regarding the matters raised in our comment letter, please contact Eky Liu, Associate Director of the Standard Setting Department ([eky@hkicpa.org.hk](mailto:eky@hkicpa.org.hk)).

Yours faithfully,

Chris Joy  
Executive Director

CJ/EL  
Encl.



### **Detailed comments on IESBA Exposure Draft on *Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client***

#### **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 of 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 acknowledge that the EQCR plays an important role in an audit engagement. However, in order to maintain his/her objectivity as an EQCR, the EQCR does not usually interact with the audit client management. Therefore, the level of familiarity threat created by the EQCR's long association with audit client is less than that created by the engagement partner ("EP").

The IESBA's final conclusion on the extension of cooling-off period for the EP to five years and the additional restrictions on activities that the rotating partners could undertake during the cooling-off period would already pose practical challenges to firms of all sizes. The pressure on firm resources would even be more intense if the EQCR has to be subject to the same longer cooling-off period as that of the EP. We are concerned that this proposal not only would further reduce the availability of individuals who are senior and experienced to act in this role, but also result in loss of knowledge and expertise (especially on highly specialized industries). This would, in turn, lead to potential adverse consequences for audit quality, which might not be in the public interest.

We note that the IESBA acknowledges the potential difficulties faced by smaller firms and proposes a shorter cooling-off period of three years for the EQCR of non-listed public interest entities ("PIEs"). However, it is not clearly explained in the Explanatory Memorandum how this three-year cooling-off period is determined and why such differential approach only applies in the rotation of EQCR. We also consider that such proposal is too complex to apply and effectively adopt.

We are mindful that the benefit of a "fresh look" must be appropriately balanced with the costs of having stringent rotation requirements. In this regard, we believe that it is crucial to analyse how the different rotation requirements would interact and how the entire package of safeguard would impact audit quality. In the light of the above, we recommend the IESBA reconsiders the proposals with caution and ensure that the rotation requirements are both robust and balanced.



**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?**

**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?**

In Hong Kong, we do not have local legislations or regulations that impose additional requirements to address threats created by long association with audit client. Therefore, we do not have direct responses to Questions 2 and 3.

**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)?**

We agree in principle that a key audit partner ("KAP") should be subject to the longer cooling-off period if he or she has served as the EP of an audit for a majority of the seven-year time-on period. We consider that "four or more years" fairly and reasonably represents a majority of the seven-year time-on period.

However, we have reservation about the second criterion (i.e. at least two out of the last three years) to be used in determining which cooling-off period applies when a KAP has served in a combination of roles during the time-on period. We do not think that merely a two-year role as the EP in the last three years of the time-on period should warrant a much longer cooling-off period. We consider that this criterion adds unnecessary complexity to the rotation requirements.

Consider the following scenarios in relation to the cooling-off period for the KAP of PIEs:

Scenario	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Cooling-off period
1	EP	KAP	KAP	EP	EP	KAP	KAP	2 consecutive years
2	EP	KAP	KAP	KAP	EP	EP	KAP	5 consecutive years

Both partners in the above scenarios served as the EPs for 3 years. Because the partner in the second scenario served as the EP for "two out of the last three years", he or she is subject to a cooling-off period which is 3 years more than the partner in the first scenario. However, there seems to have little justification for the longer cooling-off



period for the partner in the second scenario.

Accordingly, we recommend that the IESBA retains only the first criterion (i.e. four or more years) in determining whether longer cooling-off period applies when a KAP has served in a combination of roles during the time-on period. We also suggest to emphasize that firms are required to evaluate the significance of threats according to the general provisions and determine, based on firm's evaluation of threats, whether the longer cooling-off period applies even if the KAP has served less than 4 years as the EP during the time-on period.

**~ End ~**