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12 November 2014

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,

IESBA Exposure Draft on Proposed Changes to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client

The Hong Kong Institute of Certified Public Accountants (HKICPA) is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We welcome the opportunity to provide you with our comments on this Exposure Draft. Our responses to the questions raised in the Exposure Draft are set out in the Appendix for your consideration.

We support the IESBA's initiative to reconsider the requirements to address familiarity and self-interest threats created by using the same senior personnel on an audit engagement over a long period of time. Having said that, we are also mindful that the proposals may bring practical concerns to firms of all sizes. The proposed requirements re extension of cooling-off period for the engagement partner of a PIE audit to five years may create significant difficulties for small and medium-sized practices (SMPs) because of the limited ability to rotate amongst partners. Even for larger practices, the proposed extension is an excessive response as it may result in the loss of expertise of engagement partners, in particular in respect of highly specialised industries or sectors. The proposed prohibition for rotating a partner who may provide non-assurance professional services to the audit client may also significantly impact the business of SMPs.

If you have any questions regarding the matters raised in our comment letter, please contact Ambrose Wong, our Associate Director of Standard Setting at ambrose@hkiipa.org.hk.

Yours faithfully,

Chris Joy
Executive Director

SR/AW

Encl.



Hong Kong Institute of CPAs

Comment on IESBA Exposure Draft on Proposed Changes to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client

General Provisions

Question 1

Do the proposed enhancements to the general provisions in paragraph 290.148 provide more useful guidance for identifying and evaluating familiarity and self-interest threats created by long association? Are there any other safeguards that should be considered?

Question 2

Should the General Provisions apply to the evaluation of potential threats created by the long association of all individuals on the audit team (not just senior personnel)?

We consider the proposed enhancements to the general provisions in paragraph 290.148 would provide useful guidance for identifying and evaluating familiarity and self-interest threats created by long association.

We agree in principle that any audit team member could be associated with an audit client for long enough to create threats to independence. Having said that, we believe that in general the significance of the threat created by junior audit team members is much less than for senior members as they are not typically involved in making key audit decisions or influence the outcome of the audit.

Question 3

If a firm decides that rotation of an individual is a necessary safeguard, do respondents agree that the firm should be required to determine an appropriate time-out period?

We agree that firms should be required to determine an appropriate time-out period when applying the safeguard of rotating the individual off the audit team under paragraph 290.149A.



Rotation of Key Audit Partners (KAPs) on Public Interest Entities (PIEs)

Question 4

Do respondents agree with the time-on period remaining at seven years for KAPs on the audit of PIEs?

Question 5

Do respondents agree with the proposal to extend the cooling-off period to five years for the engagement partner on the audit of PIEs? If not, why not, and what alternatives, if any, could be considered?

We agree it is appropriate for the time-on period to remain at seven years for KAPs on the audit of PIEs.

Although we do not have a strong objection to extend the cooling-off period to five years, we note that this proposal would be of a concern to audit firms, including both sizeable and smaller firms, on the loss of knowledge possessed by a senior member of the firm who was required to rotate off.

Our constituents from the SMP sector consider the proposal would pose considerable difficulties for SMPs because of the limited ability to rotate amongst partners. SMP constituents also believe that the proposal would erode the choice in the audit market for PIEs. The IESBA may wish to consider whether this potential outcome is consistent with its original intention behind the proposal and whether the costs of the proposed extension of a cooling-off period outweigh benefits.

Question 6

If the cooling-off period is extended to five years for the engagement partner, do respondents agree that the requirement should apply to the audits of all PIEs?

We do not have any comment on this question.

Question 7

Do respondents agree with the cooling-off period remaining at two years for the Engagement Quality Control Reviewer (EQCR) and other KAPs on the audit of PIEs? If not, do respondents consider that the longer cooling-off period (or a different cooling-off period) should also apply to the EQCR and/or other KAPs?

We agree that it is appropriate for the cooling-off period to remain at two years for the EQCR and other KAPs on the audit of PIEs. Despite the fact that the EQCR and/or other KAPs play an important role in an audit, they do not usually participate in the engagement proper or make final executive decisions on the audit overall. Their familiarity threat created by long association with the audit client in this regard is typically less than that applying to engagement partners.



Question 8

Do respondents agree with the proposal that the engagement partner be required to cool-off for five years if he or she has served any time as the engagement partner during the seven year period as a KAP?

We have concerns on the proposal that the engagement partner be required to cool-off for five years if he or she has served any time as the engagement partner during the seven year period as a KAP.

There are situations in which a KAP, other than the engagement partner, will not have the same relationship or contact with client senior management as would the engagement partner, nor will they be in a position to significantly influence the outcome of the entire audit as compared with the engagement partner. For example, if an audit partner responsible for a significant subsidiary has been a KAP for the group audit for five years, and becomes the overall engagement partner for the group audit in the sixth year, this KAP might not have been in a position to develop a close relationship with senior management of the group during the first five years as the audit partner responsible for the audit of the significant subsidiary.

We note from the Exposure Draft that this provision has been chosen as being the least complex option and one which will enhance the perception of stakeholders in the audit process. We acknowledge the importance to ensure effective implementation of requirements, however we also have concerns that creating a significantly restrictive requirement to avoid such "complexity" may not be the appropriate approach. We recommend that the IESBA should reconsider the proposed requirement and express it in such a way that the objectives of the requirement are met and also that audit firms are not required to rotate an engagement partner off so soon when in reality no familiarity threat has likely arisen.

Question 9

Are the new provisions contained in 290.150C and 290.150D helpful for reminding the firm that the principles in the General Provisions must always be applied, in addition to the specific requirements for KAPs on the audits of PIEs?

We consider the new provisions contained in 290.150C and 290.150D are helpful for reminding firms that the principles in the general provisions must always be applied, in addition to the specific requirements for KAPs on the audits of PIEs.

Question 10

After two years of the five-year cooling-off period has elapsed, should an engagement partner be permitted to undertake a limited consultation role with the audit team and audit client?

We agree that an engagement partner should be permitted to undertake a limited consultation role with the audit team and audit client after two years of the five-year cooling-off period has lapsed as proposed under paragraph 290.150B. While it is important to establish a cooling off period to address any threats to independence, such timeframes should not unreasonably restrict the most appropriate individuals with the technical skills from being available to consult with engagement teams on particular



issues relevant to their area of expertise. We believe the potential impact to audit quality resulting from restricting access to the special expertise that such individual possesses would outweigh any residual familiarity or self-interest threat remaining after two years, as such threats would have diminished following limited contact with the engagement team and audit client.

Question 11

Do respondents agree with the additional restrictions placed on activities that can be performed by a KAP during the cooling-off period? If not, what interaction between the former KAP and the audit team or audit client should be permitted and why?

We agree in principle that the rotated partner should be prohibited from exerting undue influence on the outcome of the audit engagement during the cooling-off period.

Having said that, our constituents from the SMP sector consider that the current proposal is overly excessive in prohibiting the rotated partner from leading or coordinating the firm's non-assurance professional services (i.e. services requiring accountancy or related skills performed by an accountant including accounting, taxation, management consulting and financial management services) for the PIE audit client. Those constituents alternatively recommend to address the threat by applying additional safeguards (for example: requiring engagement quality control review on the audit). Those constituents also believe that the rotated partners should be permitted to interact with the client during the cooling-off period, given the interaction would solely be in relation to the non-assurance professional services being provided and the rotated partner does not exert direct influence on the outcome of the audit engagement.

It is stated in the explanatory memorandum that "the IESBA considered the principle that during the cooling-off period the outgoing partner should not exert direct influence over the engagement team or the outcome of the audit, though it is not the intention of the IESBA to prevent the outgoing partner from assuming a leadership role in the firm such as that of Senior or Managing Partner".

Question 12

Do respondents agree that the firm should not apply the provisions in paragraphs 290.151 and 290.152 without the concurrence of Those Charged With Governance (TCWG)?

Under paragraphs 290.151 and 290.152 firms are required to obtain concurrence from TCWG to apply the limited exception provisions. We consider audit firms should be permitted to exercise professional judgment when considering to apply the limited exception provisions without the need to obtain agreement or pre-clearance from TCWG. We recommend to require firms to inform TCWG on the application of the limited exception provisions as part of their regular ISA 260 reporting to TCWG.



We also consider that firms should be required to put in place internal safeguards to reduce the threat to an acceptable level when applying the limited exception provisions under the proposed paragraphs 290.151 and 290.152. An example of such acceptable safeguards may include requiring engagement quality control review on the audit engagement to ensure objectivity and professional skepticism are upheld by the audit team.

Section 291

Question 13

Do respondents agree with the corresponding changes to Section 291? In particular, do respondents agree that given the differences between audit and other assurance engagements, the provisions should be limited to assurance engagements "of a recurring nature"?

We agree with the corresponding changes to Section 291 and also consider that the provisions should be limited to assurance engagements "of a recurring nature" given the differences between audit and other assurance engagements.

Impact Analysis

Question 14

Do respondents agree with the analysis of the impact of the proposed changes? In the light of the analysis, are there any other operational or implementation costs that the IESBA should consider?

We consider the proposed changes will increase compliance costs for audit firms. They will need to maintain more extensive partner rotation plans to ensure appropriate succession planning. The proposed extension of the cooling-off period and the prohibition to provide other professional services by the rotated engagement partner will significantly affect the SMP sector in particular as they generally have a smaller number of partners to rotate amongst.

~ End ~