

4. Juli 2016

Stellungnahme zum IESBA-Exposure Draft *Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client*

Die WPK hat mit Schreiben vom 3. Mai 2016 gegenüber dem International Ethics Standards Board for Accountants (IESBA) zu dessen geplanten Änderungen des Code of Ethics zu langjährigen Beziehungen zum Abschlussprüfungsmandanten (Exposure Draft: *Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client*) wie nachfolgend wiedergegeben Stellung genommen.

The Wirtschaftsprüferkammer (WPK) is pleased to take this opportunity to comment on the above mentioned Re-Exposure and the proposed changes to the Code of Ethics for Professional Accountants (hereinafter referred to as “the Re-ED” and “the Code”, respectively). We would like to highlight some general issues first and provide you with our responses to the Re-ED questions subsequently.

General Comments

We appreciate that IESBA has revised the provisions of its first ED issued in 2014 and is now taking a more holistic approach insofar as it also considers some of the safeguards already available to address the threats to independence that may result from a long association with an audit client. In this respect we welcome that the new proposals take external rotation and tendering as alternative safeguards into consideration to address familiarity and self-interest threats.

However, we wonder about the quite limited approach IESBA has taken in this respect by not taking into account the important key decisions made by the EU Audit Reform, including the consideration of joint audit as a potential safeguard. We regret that IESBA apparently does not view the approach taken by such an important legislator governing 31 jurisdictions (the members of the European Economic Area) as appropriate and sufficient. In our opinion the Code should not aim to be more restrictive than the provisions enacted by the European legislative authority:

1. The EU Audit Regulation (No 537/2014 of the European Parliament and of the Council of April 16, 2014, hereinafter referred to as “the EU Regulation”) does not extend the definition of the Key Audit Partner (KAP) to the Engagement Quality Control Reviewer (EQCR) and accordingly Art. 17 of the Regulation that deals with KAP rotation does not require a rotation of the EQCR.
2. Beside audit firm rotation the Regulation considers joint audit as an alternative (safeguard) to mitigate familiarity. As already mentioned, the Re-ED does not even address joint audit in this respect.
3. The EU legislator has stipulated an exhaustive definition of PIEs which includes entities listed on EU regulated markets, credit institutions and insurance undertakings, but does not differentiate between listed and non-listed PIEs. We observe that the Re-ED now distinguishes between listed and non-listed PIEs in order to introduce different rotation regimes for KAPs of respective audit clients. Any approach taken on this issue is primarily to be driven by the consideration of audit quality which in the end prohibits a distinction between listed and non-listed PIEs (cf. question 1.b). Such a distinction will also inevitably cause practical difficulties: the compliance and monitoring processes of the respective audit firms would be in need of extensive adjustment resulting in a significant increase of costs.

Furthermore, we wonder whether the application of different rule-sets can be justified from a public interest point of view, for example, where for a large non-listed insurance undertaking less restrictive rules would apply than for a small listed manufacturing company [Note: the German legislator recently adopted legislation that, whether listed or not, requires credit institutions and insurance undertakings to rotate their audit firm after 10 years whereas all listed entities that are neither credit institutions nor insurance undertakings are permitted to keep their audit firm for another 10 years, if there is a public tender for the 11th year. This said, the approach taken by IESBA would be completely different from the one taken by the German legislator, and add unnecessary complexity to the overall provisions that need to be applied in a German context.]

Overall, we consider the new approach taken by IESBA to be very detailed and rules-based which makes this section of the Code overly complex and extremely difficult to read. It may lead to such a regulatory density which would hardly be manageable by the profession. This would particularly affect SMPs and may create a competitive disadvantage for them. As explained in our comment letter of November 12, 2014 to IESBA’s first ED, such a detailed and complex approach contradicts the principles-based approach of the Code and does not achieve an appropriate balance between costs and benefits (high implementation and monitoring costs, cp. our aforementioned comment letter).

With particular reference to the EQCR, we are pleased to note from the Explanatory Memorandum (note 28) that the IESBA plans to liaise with the IAASB in the context of the latter's current initiative to review ISQC 1. Given this (pending) liaison, we would have preferred IESBA to await the results of the IAASB's assessment before making the decision to extend the cooling-off period for the EQCR. We consider the roles of the Engagement Partner (EP) and the EQCR to be distinctly different. While the EP does have the overall responsibility for the audit (engagement) and potentially gains familiarity also with the client's management and those charged with governance, the role of the EQCR is much more limited. The EQCR does not make decisions for the engagement team nor does he or she regularly meet the client. Hence the perception of familiarity and self-interest threats is in our opinion much less with the EQCR and not comparable to that of another KAP and EP in particular. There is also no evidence that the current provisions have not worked satisfactorily which would justify the extension of the cooling-off period for listed PIEs by 150%. Any change of the Code should be based on sound facts which we are not able to recognize here.

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

No. We basically questions the necessity of imposing the same or similar rules on the EQCR, i.e., cooling-off periods that are similar to those applicable to the EP and other KAPs. Whilst we do agree that the EQCR plays an important role on the audit engagement, we note, as described above, that the role of the EP is distinctly different from that of the EQCR. Due to his or her different role, the EQCR is not exposed to the same familiarity threats as other KAPs might be, nor to any other level of threat that would come close or be comparable to the threats faced by other KAPs. Hence, in our view an extension of the cooling-off period for the EQCR could hardly be justified.

In addition, we would like to point out that the proposed extension of the period to five years for the EQCR of a listed entity would result in an increase by 150%, which in our view is absolutely disproportionate. The proposed extension will create challenges for audit firms to find suitable

individuals to take on the EQCR role which may then unintentionally bear on audit quality. In particular, for small and medium sized audit firms it might become nearly impossible to cope with these challenges.

Also, we would like to point out that, after many years of discussions, the EU legislator apparently did not see any need for the EQCR to rotate as the new EU Audit Legislation did not change the concept of KAP that had been introduced in 2006 by extending its scope to the EQCR.

Furthermore, the present discussion about the precise role and responsibilities of the EQCR may likely be enriched by the outcome of the IAASB's new project on ISQC1. Therefore we would appreciate it if IESBA deferred its considerations to extend the cooling-off period for the EQCR until the comprehensive examination of the role of the EQCR has been completed by the IAASB.

(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?

No. The approach taken by IESBA seems highly problematic. In our view, any approach in this area should primarily be driven by the consideration of audit quality. This aspect of audit quality does equally apply for listed and non-listed PIEs.

As stated above, the distinct role of the EQCR does neither require nor justify to apply for the EQCR the same or even stricter cooling-off provisions than for the EP.

Overall, as already explained in our general comments, we believe that, as currently drafted, the provisions in paragraphs 290.150A and 290.150B are overly complex and will prove extremely difficult for firms of all sizes to apply in practice.

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?*

Partially yes. We are pleased to note that IESBA has revisited this matter and now tries to take a more holistic approach as described in our introductory remarks. The revised proposals basically take into account that jurisdictions might have reached a robust and effective but different approach to that in the Code.

Consequently, we appreciate the new approach stipulating provisions that allow for a reduction in the cooling-off period under certain circumstances. By means of this reduction, the substantial amount of extra work and additional economic burdens for all audit firms and auditors especially of SMPs, that otherwise would have been created, can be avoided.

This new approach is also very important against the background that the EU audit reform will cause a significant increase in the number of entities that will be treated as PIEs (for further details, please cf. our comment letter of November 12, 2014).

However, 290.150D of the Re-ED is not sufficiently clear, and may be interpreted in a way that the extension of the cooling-off period for the EQCR for listed entities may lead to odd results, e. g., as the EU legislation does not require the EQCR to rotate, it can be argued that for him or her 290.150D does not apply, and thus he or she may be subject to shorter time-on and longer cooling-off periods than the EP.

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?*

We agree only partly.

As explained above, we regret that IESBA has not sufficiently taken the EU Audit Reform in-to account. Particularly joint audits are not included as an alternative safeguard. The Basis For Conclusions and Explanatory Memorandum states that IESBA decided not to include joint audits in the proposal because "it would add unnecessary complexity" (note 82).

In our view, the consideration of joint audits would not add more complexity than the other alternatives of the new approach taken by IESBA. In addition, omitting joint audits would jeopardize the consistency with the EU Regulation.

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)?*

We highly welcome IESBA's withdrawal of its initial restrictive approach according to which the EP would have been required to cool-off if he or she has served any time as the EP during the seven year period. This approach may be regarded as mere overregulation.

On the other hand, the new approach is of such a regulatory density that is neither compatible with an international principles-based Code nor is it capable of conclusively covering the relevant cases.

Against this background, we would prefer IESBA to set up general principles along with corresponding interpretations. In addition, we would once again like to refer to Art. 17 of the EU Regulation which is much less restrictive than the IESBA proposals with respect to both the EQCR (not required to rotate) and the seven-year time on period for the EP (e. g. the time-on period commences anew after a one-year interruption).

Request for General Comments

(a) *Small and Medium Practices (SMPs)* – The IESBA invites comments regarding the impact of the proposals subject to re-exposure for SMPs.

The proposals would particularly affect SMPs significantly. SMPs have normally fewer partners able to serve as EP and EQCR. Hence the new proposals run the risk of bringing about a competitive disadvantage for them.

While the aforementioned negative effects should be outweighed by the public interest with respect to the extension of the cooling-off period to three years for the EP, the extension to five years would be a disproportionate burden for audit firms. This applies especially also for the EQCR.

(b) *Preparers (including SMEs) and users (including Those Charged with Governance and Regulators)* – The IESBA invites comments on the proposals subject to re-exposure from preparers, particularly with respect to the practical impact of those proposals, and users.

N/A.

(c) *Developing Nations* – Recognizing that many developing nations have adopted or are in the process of adopting the Code, the IESBA invites respondents from these nations to comment on the proposals subject to re-exposure, and in particular on any foreseeable difficulties in applying them in their environment.

N/A.

(d) *Translations* – Recognizing that many respondents may intend to translate the final changes for adoption in their own environments, the IESBA welcomes comment on potential translation issues respondents may note in reviewing the proposals subject to re-exposure.

In light of the high importance of the Code and its worldwide (de facto) binding effect on the profession, it might be worthwhile, as already stated in previous comment letters of the WPK, considering a translation of the Code and the present changes into the respective language of important jurisdictions by IFAC itself. This could also lead to greater acceptance and use of the Code.

We hope that our comments will be useful in finalizing the revisions to the IESBA Code.

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