

FIRM ROTATION POSITION PAPER

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A. The Background:

It has been noted that Request for Proposals (RFPs) for external audit/ assurance services from state enterprises/ state owned companies have requested audit periods ranging from three (3) to five (5) financial periods.

B. The Requirements:

There are no requirements or guidance on mandatory firm rotation (MFR) from the International Ethics Standards Board of Accountants' Code of Ethics for Professional Accountants (the IESBA Code) which is adopted by ICATT. Given that there is no guidance on MFR, what shall those charged with governance (TCWG) use when deciding when to either have the audit of the financial statements sent out to tender and/or rotate the incumbent audit firm.

C. Considerations for Guidance:

Although the IESBA Code does not address MFR, Section 540 *Long Association of Personnel (including Partner Rotation) with and Audit Client* may be used as a guide by TCWG when considering the independence threat of familiarity and self-interest that might be created from the long-standing relationships of the audit firm.

The following considerations may be taken by TCWG when assessing whether the rotation of the audit firm is required.

1. Section 540.1 requires firms to identify, evaluate and address threats to independence.

TCWG can place reliance that audit firms are required to identify, evaluate and address threats to independence which is created by familiarity with the audit client and its personnel having been on the audit engagement for a long period of time.

2. Section 540.5 requires an audit partner in a firm to not act in any roles for an audit client that is a PIE for a period of more than seven (7) years (the "time on" period).

TCWG can ensure that the audit firm is in compliance with the requirement for audit partners to rotate off the company's audit after a period of seven (7) years.

3. Section 540.3 addresses familiarity threats which might be created as a result of an individual's long association as an audit team member with the client's operations, senior management or the financial statements.

The main independence threat TCWG needs to take into consideration is the familiarity of the audit partner/s with senior management and TCWG. It needs to be determined whether senior management and TCWG have been at the entity for more than seven (7) cumulative years for the familiarity threat to be present.

4. Whether period in term, “time on” period, is a calendar year or a financial year.

- i) When audits for multiple financial years are performed at the same time (in one calendar year), for the purposes of familiarity, these multiple audits have the effect of being counted as one period/year when applying the seven (7) cumulative years “time-on” period of Section 540.5. This is also supported by the wording in Section 540.2 which states “When an individual is involved in an audit engagement over a long period of time, familiarity and self-interest threats might be created”.
- ii) Conversely, when an audit takes more than a year, the number of years it took to complete the audit will apply to the seven (7) cumulative year rule.

D. Extracts from IESBA Code:

Section 540.1 Firms are required to comply with the fundamental principles, be independent and apply the conceptual framework set out in Section 120 to identify, evaluate and address threats to independence.

Section 540.2 When an individual is involved in an audit engagement over a long period of time, familiarity and self-interest threats might be created. This section sets out requirements and application material relevant to applying the conceptual framework in such circumstances.

Section 540.5 Subject to paragraphs R540.7 to R540.9, 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 performing the engagement quality 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 R540.11 to R540.19.

Section 540.3

540.3 A1 Although an understanding of an audit client and its environment is fundamental to audit quality, a familiarity threat might be created as a result of an individual’s long association as an audit team member with:

- (a) The audit client and its operations;
- (b) The audit client’s senior management; or
- (c) The financial statements on which the firm will express an opinion or the financial information which forms the basis of the financial statements.

540.3 A2 A self-interest threat might 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. Such a threat might influence the individual’s judgment inappropriately.

540.3 A3 Factors that are relevant to evaluating the level of such familiarity or self-interest threats include:

- (a) In relation to the individual:
 - 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 an engagement team member, 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 engagement team members.
 - 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) In relation to the audit client:

- 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 organization which impact the nature, frequency and extent of interactions the individual might have with senior management or those charged with governance.

540.3 A4 The combination of two or more factors might increase or reduce the level 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.

540.3 A5 An example of an action that might eliminate the familiarity and self-interest threats created by an individual being involved in an audit engagement over a long period of time would be rotating the individual off the audit team.

540.3 A6 Examples of actions that might be safeguards to address such familiarity or self-interest threats include:

- Changing the role of the individual on the audit team or the nature and extent of the tasks the individual performs.
- Having an appropriate reviewer who was not an audit team member review the work of the individual.
- Performing regular independent internal or external quality reviews of the engagement.

E. Conclusion

The IESBA Code, which is adopted by ICATT, does not address mandatory firm rotation but it does have regulations on partner rotation for public interest entities and guidance on considerations audit firms shall consider identifying the independence threat of familiarity and self-interest that might be created from the long-standing relationships. When considering the annual reappointment of the incumbent auditor, TCWG can consider the requirements of the IESBA Code to determine if there is the existence of an independence threat of familiarity and self-interest of the audit firm. TCWG can also place reliance that all audit firms are monitored by ICATT to ensure that they are in compliance with the IESBA Code.

When assessing the familiarity threat based on the “time on” period of the relationship with the audit firm, TCWG needs to be aware that the length of the period is calendar year and not financial year/period. Additionally, consideration shall be given to the length of time senior management and TCWG are with the entity, as it pertains to the familiarity threat.