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Our ref Limited Re-exposure_Long Association of Personnel with an Audit Client.docx

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Dear Sir

Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client

KPMG welcomes the opportunity to provide comments on the aforementioned exposure draft. We have reviewed the exposure draft identified above, and our responses to the specific questions are set out below.

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*
>
> *(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?

KPMG disagrees with the proposed extension of the cooling-off period to five years for an EQCR with respect to PIEs which are listed entities and three years for an EQCR with respect to PIEs other than listed entities. There are many reasons why we disagree with this proposal:

1. The definition of a PIE in New Zealand is far broader than the definition on an international level, thus there are significantly more companies that meet the definition of a PIE in New Zealand as a portion of the total population, compared to other countries. The IESBA exposure draft states that "all PIE's are, by their nature, entities

of public interest". This statement is not true in New Zealand as there are a very large number of entities who chose to report under Tier 1, often because their parent has requested it, or in many cases because they decided to prepare full IFRS accounts in the past for any number of reasons. These entities are not of public interest.

2. There is no evidence to support that a five-year cooling off period will enhance an EQCR's independence (and the overall audit quality) more so than the two-year period already provides.

3. The EQCR is involved significantly less in an audit engagement than the EP. The EQCR role is to provide an independent view and challenge the engagement team decisions. Thus the EQCR does not create the same level of connection with the engagement and the engagement issues as the engagement team and the EP do.

   We believe the period of cooling off for an EQCR should not be equal to the period for cooling off for an EP.

4. We believe that the extended cooling-off period could lead to potential issues with a lack of experienced professionals and lesser licensed audit practitioners especially in the more specific industries.

We propose the cooling-off period remains as two years. We consider this period to be appropriate for a cooling-off as there is no evidence a further period would enhance the 'fresh look' which is trying to be achieved.

In addition, we believe the proposed changes should also consider when the client's key management personnel, finance personnel and other individuals having a key role within the audit engagement, have changed within the seven-year time-on period of the audit engagement team (i.e. if a significant portion of the audit staff has changed, or a significant portion of client's management has changed then there may be no long association).

There are other considerations which are relevant to the topic, including the fact that the NZ environment currently has different rules depending on whether the entity is a PIE, listed or an audit governed by the OAG. The differing rules already create complexity in applying rotation policies, and bring into question why differing rules exist at all. If rotation is the mechanism to mitigate familiarity and self-interest, how can there be differing periods which are acceptable to different classes of audits. Surely if you're deemed to be no longer biased by familiarity and self-interest after two years of cooling off for one entity, the same logic must be able to be applied to a different entity.

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?

KPMG agrees with the proposal to allow local regulators and standard setters the flexibility to apply a lower set of safeguards with regard to the cooling-off period.

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?

KPMG disagrees with the conditions specified in paragraph *290.150D(b).* With regard to (i), we believe that determining a time-on period shorter than 7 years will not be beneficial for the audit quality, especially for entities from specific industries which require a different set of skills and knowledge. In our view, the time-on period of 7 years is at the same time sufficient for an audit partner to obtain understanding of the client and the industry, to implement efficiency in the audit and thus be able to provide an independent and relevant view on client specific matters. We do not believe that the period of 7 years is significantly different than the proposed 5-year period. Also, many of the audit firms have their own robust policies and procedures to evaluate and maintain independence.

With regard to (ii), we believe that a mandatory firm rotation after 10 years will not be beneficial for the audit quality. There is no evidence that rotating audit firms automatically increases audit quality. In fact, during the first few years of a new audit firm's tenure their audit quality is more at risk due to the new auditor having a lessor understanding of the client. Audit partners are already being rotated to mitigate the risk of familiarity, EQCR partners are required in certain cases, therefore adding another layer of rotation (mandatory firm rotation) will only add cost, and potentially reduce audit quality. Rotating clients between companies after 10 years (in the case where the 7/3 period is applied) means that the second partner will have only 3 years served before rolling off of the engagement (which as discussed above is not a sufficient period of time for obtaining understanding of the client and the industry, and based on this – implementing client beneficial audit approach). In a combination with a new audit firm coming after the rotation (and no retained knowledge as a result) – the client will most likely experience a period of 5 consecutive years of "new auditor". In our view, this is neither efficient nor enhancing the audit quality approach.

Furthermore, in many cases the mandatory firm rotation does not actually provide an entity with more options, especially when a big listed entity wants to have a tier one audit firm as a preferred auditor and consultancy services provider. For example, if an entity has its tax services provided by a Company A, the IT advisory services provided by a Company B and the statutory audit services provided by a Company C, a mandatory firm rotation will exclude A,B and C from the possible options for a new auditor. The tax and advisory services are not required to be rotated, thus the listed entity will be reluctant to change those in order to go to A or B for a statutory audit services. In this case, the entity will be left with minimum or non-options for an audit firm choice if they wish (or a required by a legislation or a parent company decision) to stay with a tier one audit firm.

We believe the decision to change auditor or submit a request for tender should be left at the discretion of those charged with governance. Those charged with governance are best placed to assess the quality of the audit opinion provided and the work performed by the auditor. Additionally given the cost associated with the appointment of a new auditor or any retendering process they are best placed to decide if the costs to investors is offset by the benefit to be gained from any perceived improvement in audit quality.

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)?

KPMG agrees with the proposal.

I would welcome any questions you may have on this submission; should you wish to discuss further please call me on (09) 363 3663.

Yours faithfully

Darby A Healey
Partner