

AMENDMENTS TO PROFESSIONAL AND ETHICAL STANDARD 1 (REVISED)

**PROVISIONS ADDRESSING THE LONG ASSOCIATION OF PERSONNEL WITH
AN ASSURANCE CLIENT**

**Explanation of Decisions made by the NZAuASB in Finalising Amendments to
Professional and Ethical Standard 1 (Revised) Provisions Addressing the Long
Association of Personnel with an Assurance Client**

Issued February 2018

This document relates to, but does not form part of *Amendments to Professional and Ethical Standard 1 (Revised) Provisions Addressing the Long Association of Personnel with an Assurance Client* which was approved by the NZAuASB in February 2018.

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AMENDMENTS TO PROFESSIONAL AND ETHICAL STANDARD 1 (REVISED)
PROVISIONS ADDRESSING THE LONG ASSOCIATION OF PERSONNEL WITH AN ASSURANCE CLIENT
Explanation of Decisions made by the NZAuASB in Finalising the Amendments

Issued by the New Zealand Auditing and Assurance Standards Board

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BACKGROUND

1. In August 2014, the International Ethics Standard Board for Accountants (IESBA) issued an exposure draft *Proposed Changes to Certain Provisions of the Code Addressing the Long Association of Personnel with an Audit or Assurance Client* proposing to strengthen the long association provisions that apply to all assurance engagements and increase the mandatory “cooling off” period for the engagement partner on the audit of an entity that is a public interest entity (PIE). The comment period closed in November 2014.
2. In the NZAuASB’s submission to the IESBA, the Board expressed support for the project but highlighted concerns with the proposals to extend the cooling off period to five years in a jurisdiction like New Zealand, that is geographically remote with a relatively small pool of licensed auditors. The NZAuASB expressed concerns that increasing supply pressures may have a negative impact on audit quality. Similar concerns were raised by the Accounting Professional and Ethical Standards Board (APESB) in Australia.
3. In February 2016, the IESBA issued a Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client. The submission period closed in May 2016. This limited re-exposure draft addressed the length of the cooling off period for the engagement quality control reviewer (EQCR) on an audit of a PIE and circumstances where jurisdictions have established different legislative or regulatory safeguards addressing long association.
4. The NZAuASB also commented on the limited re-exposure draft expressing a preference for consistency for all public interest entities. The NZAuASB was supportive of recognising jurisdictional specific safeguards to allow for a reduction in the cooling off period. However, the Board also raised concerns that the conditions proposed were too rules-driven and would limit the use of the paragraph.
5. At the same time, the IESBA issued a basis for conclusions regarding proposals that were exposed as part of the first exposure draft which the IESBA had closed at that stage, including reaffirming that the cooling-off period for the engagement partner on an audit of a PIE should be five years.
6. In September 2016, the IESBA reached agreement on the provisions pertaining to the remaining matters that were included in the re-exposure draft, taking into account respondents’ feedback on the re-exposure draft as well as input from the Consultative Advisory Group. However further amendments were needed to address concerns raised by the Public Interest Oversight Board (PIOB).
7. In December 2016, the IESBA finalised changes to the revised provisions to respond to the PIOB concerns. A close-off document was approved by the IESBA at its December 2016 meeting with the affirmative votes of 15 out of 17 IESBA members present. One IESBA member abstained from the vote and another IESBA member voted against the document.

8. The close-off document has been prepared in accordance with the extant structure and drafting conventions of the IESBA Code. It will be used as a basis for preparing a restructured version in accordance with the revised structure and drafting conventions agreed under the project to restructure the Code of Ethics. The formal release of the revised international standard will be in the restructured form.
9. The NZAuASB's strategic approach is to adopt international standards unless it identifies compelling reasons to modify the international standards for application in New Zealand. This policy is documented in the Principles of Convergence to International Standards of the International Auditing and Assurance Standards Board and to the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA Code), which is available on the [XRB website](#).
10. The NZAuASB waited until the international process had been completed prior to deliberating on whether there was a need for compelling reason changes to be made in New Zealand. The NZAuASB exposed a New Zealand exposure draft (ED NZAuASB 2017-1) in February 2017. This exposure draft proposed to adopt the revised international requirements in New Zealand. The only compelling reason changes proposed related to continuing to align the requirements for all assurance engagements where the client is a public interest entity, as has been done pervasively throughout section 291 of PES 1 (Revised).
11. A key issue that arose in deliberating on the adoption of the amended requirements was whether the New Zealand PIE definition remained appropriate.
12. The NZAuASB also considered the impact of the transitional provision in New Zealand that permits delayed implementation of the long association provisions where law or regulation establishes a shorter cooling off period.
13. This document explains the rationale of the NZAuASB in finalising the New Zealand amendments to the Code of Ethics for Assurance Practitioners.
14. The restructured Code will also be adopted in New Zealand once it is finalised. These amendments will be issued to show how the due process requirements have been met but will not be compiled into PES 1 (Revised). They will be included in the New Zealand Code when it is issued in its restructured form.

RATIONALE FOR ADOPTING THE INTERNATIONAL REQUIREMENTS

15. The NZAuASB's strategic approach is to adopt the international standards and only, in limited circumstances, to make amendments where there are compelling reasons to do so. Any modification may not result in a standard that conflicts with, or results in lesser requirements than the international standard.
16. The international revisions to the long association provisions are a challenge for an economy the size of New Zealand. The NZAuASB is mindful that the extension of the "cooling off" period may add to auditor supply pressures, especially in the regions and in sectors where there is limited specialist expertise. However, not to adopt the

international requirements may have far worse consequences for New Zealand. While some stakeholders urged the NZAuASB not to adopt these revisions, the majority acknowledged and remained supportive of aligning the New Zealand requirements with the revised international requirements.

17. In line with the NZAuASB's strategic approach, the Board agreed to adopt the revisions in New Zealand. The Board however is committed to ensuring that the revisions do not have a negative impact on audit quality and has therefore looked for ways to reduce undue supply constraints.

RATIONALE FOR THE DEFINITION OF A PUBLIC INTEREST ENTITY IN NEW ZEALAND

18. The international Code of Ethics defines PIEs as:

- a. all listed entities; and
- b. any entity:
 - i. defined by regulation or legislation as a public interest entity; or
 - ii. for which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. Such regulation may be promulgated by any relevant regulator, including an audit regulator.

19. The IESBA has the expectation that national standard setters will adopt a definition that is appropriate for their jurisdiction.

20. The International Code also states that:

“Firms and member bodies are encouraged to determine whether to treat additional entities, or certain categories of entities, as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered include:

- a. The nature of the business, such as holding of assets in a fiduciary capacity for a large number of stakeholders. Examples may include financial institutions, such as banks and insurance companies, and pension funds;
- b. Size; and
- c. Number of employees.”

21. The definition of a PIE is significant because it largely determines which independence requirements an auditor is required to apply. The independence requirements are more stringent where the auditor is engaged to conduct an assurance engagement for an entity that is a PIE.

22. When the NZAuASB decided to revise PES 1 to align more closely with the IESBA Code in 2012, it sought feedback about and deliberated on the appropriate definition of a PIE in the New Zealand context. The NZAuASB decided to align the definition of a PIE with all those entities that report using the tier 1 financial reporting requirements under the XRB's newly-adopted accounting standards framework. The

XRB had determined and included entities in tier 1 based on whether or not such an entity was considered to have public accountability. The XRB had performed a cost benefit analysis to identify tier 1 entities. Publicly accountable entities are required to apply the highest financial reporting requirements. It was therefore agreed that it was appropriate and in the public interest that the auditor of such entities apply the most stringent independence criteria.

23. The amendments to the long association requirements brought up the question of whether the New Zealand PIE definition is fit for the purpose of those requirements. The Board sought and received feedback on this question, with particular reference to those entities which elect, but are not required, to report as tier 1 entities. The feedback received from the majority of stakeholders was that, in the context of the international changes, the New Zealand PIE definition is too broad and that “voluntary” PIEs should now be excluded from the definition.
24. The NZAuASB finds itself in agreement with that view. As a result, the NZAuASB has developed and approved amendments to the New Zealand PIE definition to exclude entities that do not meet the criteria set out in XRB A1¹, i.e., which are not considered to have public accountability but elect to report using the accounting requirements that apply to such entities. The new definition of a PIE is “any entity that meets the tier 1 criteria in accordance with XRB A1 and is not eligible to report in accordance with the accounting requirements of another tier”.
25. However, the NZAuASB remains of the view that all entities that have been determined to have public accountability, and are required to (rather than elect to) report using the tier 1 financial reporting requirements, should fall within the New Zealand PIE definition. It does not therefore propose to make any further changes to the PIE definition beyond that now being exposed.
26. The NZAuASB has considered whether this approach could leave New Zealand in a position where the long association provisions will apply more broadly than the IESBA Code intends, or than in other jurisdictions. While the IESBA Code defines a PIE only with respect to listed entities, it anticipates that each jurisdiction will determine the appropriate definition, bearing in mind that the Code also indicates what other types of entities should be encouraged to be PIEs. These include entities that hold assets in a fiduciary capacity like banks, insurance companies, pension schemes and other types of entities that, in New Zealand, are caught by the definition of a FMC reporting entity considered to have a higher level of public accountability. The IESBA Code also refers to entities that have a large number and wide range of stakeholders, and raises size as a factor to consider. The size criteria in XRB A1 have been determined based on a cost/benefit analysis of the New Zealand market.
27. In reaching its view that the PIE definition in New Zealand remains largely appropriate, the NZAuASB has been mindful that the long association revisions may raise supply challenges for the New Zealand market. It has been working closely with

¹ XRB A1, *Application of the Accounting Standards Framework*

the APESB, which is of similar view in relation to the Australian auditor supply market (but is in a position to take advantage of the transitional provision for existing laws and regulations: see below). The NZAuASB has also consulted closely with the FMA, to ensure it has a clear understanding of the impact of the exemption regime on audit requirements for some classes of PIEs. The NZAuASB is satisfied that the overall New Zealand approach, under the proposed modified PIE definition, will be fully consistent with the principles established in the international code and broadly consistent with the approach being taken in other relevant jurisdictions.

28. The NZAuASB will continue to monitor the situation going forward, including through the post-implementation review of the international changes to be conducted by the IESBA in due course, and to look for ways in which supply issues can be addressed.

RATIONALE FOR COMPELLING REASON TO ALIGN THE LONG ASSOCIATION REQUIREMENTS FOR ALL ASSURANCE ENGAGEMENTS

29. When the NZAuASB adopted the international Code in New Zealand in 2013 it was agreed that section 291, the independence section that applies to assurance engagements other than audits or reviews of financial statements, should be tightened in New Zealand to align the requirements for these other engagements with the requirements for audits and reviews. The IESBA Code has no PIE requirements with respect to other assurance engagements.
30. The NZAuASB was of the view that the threats to independence do not differ whether the subject matter of the engagement is financial statements or another subject matter. The Board considered the same approach applicable to audits and reviews is appropriate for other assurance clients, if they are PIEs. For this reason, a number of PIE requirements were included in section 291 in New Zealand, including but not limited to the long association requirements that established a 7 year time on and at that stage a 2 year cooling off period.
31. Now that the long association PIE requirements have been amended for audits and review engagements in the IESBA code, to be consistent with the view that the independence requirements should be consistent for all assurance engagements, the NZAuASB proposed to amend the New Zealand paragraphs previously included in PES 1 (Revised).
32. Stakeholders agreed that conceptually the independence requirements should be the same for all assurance engagements, but some questioned whether the compelling reason test is still met given the impact of the long association changes, and the majority were opposed to applying those changes across the board.
33. The NZAuASB decided to include the revised sections from section 290 in section 291. However, the Board will consider whether there remains a compelling reason to align the independence requirements across all assurance engagements separately as part of the project to adopt the restructured Code.

34. The Board agreed to develop additional frequently asked questions to address some implementation queries raised in response to the exposure draft.