Audit partner-client relationship: How long is too long?

Team members and firms of audit or assurance engagements are required to be independent, both of mind and in appearance, of their clients. This is a provision of the Hong Kong Institute of CPA's *Code of Ethics for Professional Accountants*.

The code permits an individual to serve as a key audit partner of an audit engagement involving a public interest entity for seven years, after which time the individual has to cool-off for two years. Under this mechanism, a key audit partner may serve the same client 14 years out of 16 consecutive years. Some stakeholders think that this creates a threat to independence. On the other hand, other stakeholders consider that long association of personnel contributes to a high quality audit due to enhanced industry and client knowledge from the continuity.

Revisions to long association provisions

In view of the mixed views on the long association provisions, in December 2012, the International Ethics Standards Board for Accountants commenced a review of its provisions to ensure that they continue to provide robust and appropriate safeguards against the familiarity and self-interest threats arising from long association with an audit or assurance client.

In January 2017, the IESBA issued a close-off document that contains the revised long association provisions. The table on right page summarizes the key revisions and impact on practising firms.

How to implement the revised provisions?

In two years' time, practising firms are required to apply the revised long association provisions. To prepare for the change, firms are advised to understand the revised provisions and make the necessary arrangements for partner rotation on relevant PIE engagements before the provisions become effective. Below are some suggestions that a firm could consider when preparing for the new requirements.

Firm resources

The extended cooling-off period of engagement partners and engagement quality control reviewers will inevitably require more experienced or qualified senior firm resources. Firms with PIE clients should start planning for their resourcing needs. How can the firm reallocate its current resources? What type of additional resources does the firm need? Through what channel can the firm obtain additional resources? Should the firm continue to act as the auditor of its PIE clients?

Professional competence of engagement partners and engagement quality control reviewers

When considering the adequacy of qualified or experienced senior firm resources, firms are reminded that technical competence and professional skills of the individual who are qualified to act as engagement partners and engagement quality control reviewers are crucial to the engagement. HKSQC 1 *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements* and HKSA 220 *Quality Control for an Audit of Financial Statements* have set out the requirements for professional competence in engagement partners and engagement teams. HKSQC 1 also sets out the criteria for the eligibility of engagement quality control reviewers.

Expertise and knowledge of clients and the industry

Client operations and industry expertise and knowledge are important in an engagement partner and engagement quality control reviewer. The longer cooling-off periods and restrictions on what key audit personnel can undertake during cooling-off periods could result in the loss of expertise within the engagement team. Firms should therefore prepare for the transfer of client and industry knowledge within the engagement team.

When will the revised provisions be effective?

The revised provisions in the close-off document are drafted under the extant structure and drafting conventions, and are expected to be formally published as a standard under the new structure of the code. These provisions are expected to be published by the end of March 2018, and to be effective on audit engagements for financial periods beginning on or after 15 December 2018. The revised provisions on other assurance engagements will also be effective on 15 December 2018. Early adoption is permitted.

Get in touch with the Institute's Standard Setting Department (*outreachhk@hkicpa.org.hk*) if you have any questions on the revised provisions.

Key revisions to the long association provisions	Impact on practising firms
1. A strengthened partner rotation regime for audits of public interest entities, including: • From a two-year to five-year cooling-off period engagement partners; • From a two-year to three-year cooling-off period for engagement quality control reviewers; • New provisions addressing service in a combination of key audit partner roles; • A prohibition on the audit engagement team consulting with a former engagement partner or engagement quality control reviewer on a technical or industry-specific issue during the cooling-off period if that individual is also, or becomes, a technical specialist within the firm; and • Additional restricted activities during the cooling-off period, for example, the individual is prohibited from acting as a "client relationship" partner or undertake any role or activity for the provision of non-assurance services for the clients.	Expected to have a direct impact to a firm's resources, in particular, the need for more experienced or qualified senior personnel.
2. A new requirement to obtain the concurrence of those charged with governance for a key audit partner to serve: • An additional year on a PIE audit beyond the maximum seven-year time-on period where, due to unforeseen circumstances, the individual's continuity is particularly important for audit quality; and • An additional two years on a PIE audit where the individual has served an audit client as a key audit partner for six or more years and the client becomes a PIE.	An additional step required to take if a key audit partner serves for a period more than the maximum time-on period.

This article is contributed by the Institute's Standard Setting Department.