AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
DIVISION OF PROFESSIONAL ETHICS
PROFESSIONAL ETHICS EXECUTIVE COMMITTEE
OPEN MEETING MINUTES
OCTOBER 29-30, 2015
LAGUNA BEACH, CA

The Professional Ethics Executive Committee (Committee) held a duly called meeting on October 29, 2015. The meeting convened 9 a.m. and concluded at 4:45 p.m.

Attendance:	
Samuel L. Burke, Chair	Andrew Mintzer
Carlos Barrera	Jarold Mittleider
Stanley Berman	Steven Reed
Tom Campbell	Lawrence I. Shapiro
Richard David	James Smolinski
Robert E. Denham	Laurie Tish
Anna Dourdourekas	Shelly Van Dyne* (Until 12:15 p.m.)
Janice Gray	
Greg Guin	**Not In Attendance:**
Brian S. Lynch*	Michael Brand
Bill Mann	Jana Dupree
Staff:	
Lisa Snyder, Director	Jason Evans, Sr. Technical Manager
Susan Coffey, SVP – Public Practice and Global Alliances	Liese Faircloth, Technical Manager
	Michele Craig, Technical Manager*
James Brackens, VP - Ethics & Practice Quality	Brandon Mercer, Technical Manager*
	April Sherman, Technical Manager*
Michael Buddendeck, General Counsel*	Shannon Ziemba, Technical Manager*
Ellen Goria, Sr. Manager	James West, Technical Manager*
Guests:	
Bill McKeown, KPMG	
Blake Lewis, BDO	
Jeff Lewis, Chair, Independence/Behavioral Standards Subcommittee	
Ian Benjamin, Chair, Technical Standards Subcommittee	
Dan Dustin, VP State Board Relations, NASBA	
Nancy Miller, KPMG	
Vincent DiBlanda, DT	
Sonja Araujo, PwC	
Catherine Allen, Audit Conduct	
Ray Johnson, PSU	
Eric Holbrooke, GAO*	
George Dietz, PwC*	
Edith Yaffe, E&Y*	
Joan Sterling, BDO*	
*Via Phone	

1. Transfer and Return of Client Files

Mr. Barrera presented the revised draft of the proposed new interpretation, *Transfer of Files and Return of Client Records in Sale or Transfer of Member's Practice*. He explained that based on the Committee's feedback, various edits were made to the interpretation including, a revision to the title and deletion of the requirement to "expend best efforts." The Committee agreed with these revisions.

Mr. Barrera noted that the proposal does not specifically address the case of death or incapacity of a member and the responsibilities of such member's authorized representative (e.g., executor, trustee). He offered draft language that could be included in the proposal to address this issue if the Committee believed it should be addressed. One member commented that he did not believe it would be appropriate to extend requirements to non-members. It was noted that this issue had been discussed at the AICPA/NASBA leadership meeting and a document had been drafted (currently under review by NASBA leadership) addressing this situation for state boards to post on their Web sites as guidance. The Committee discussed whether or not a question should be included in the exposure draft asking respondents whether guidance on this issue should be added to the interpretation but it was agreed that it was not necessary to include such a question. The Committee did agree, however, that it might be helpful to better understand what guidance exists on this issue at the state level as well as for other professions.

Mr. Barrera explained that the Task Force believes that notification to the client should be in writing and the proposal has been drafted with such a requirement. The Committee agreed that written notification was appropriate.

Mr. Barrera reported that no further revisions had been made to the to the *Disclosing Client Information in Connection With a Review or Acquisition of the Member's Practice* Interpretation since the last meeting.

It was moved, seconded and unanimously agreed to expose the proposed new interpretation, *Transfer of Files and Return of Client Records in Sale or Transfer of Member's Practice* to membership.

It was moved, seconded and unanimously agreed to expose the proposed revisions to the *Disclosing Client Information in Connection With a Review or Acquisition of the Member's Practice* Interpretation to membership.

2. <u>Definition of Client</u>

Mr. Mintzer provided a brief background of the Task Force's activities and that the Committee tentatively approved revised definitions of "client" and "attest client" at the July meeting. He reviewed a visual aid developed by the Task Force to recap how the proposed definitions would be applied. He explained that members would no longer need to be independent of the engaging entity unless the engaging entity meets any of the affiliate criteria or the attest entity is also the engaging party.

Mr. Mintzer explained that he believes the phrase "other than the member's employer" was removed in error from the definition of client and as such, recommends that the phrase be added back in. Specifically, he believes that the Task Force had intended on relocating the phrase within the definition but during the drafting process inadvertently eliminated it. The Committee agreed the phrase should be added back into the definition and tentatively approved the updated definition of client.

Mr. Mintzer explained that he believes there could be an unintended consequence related to the Commissions and Referral Fees Rule and the revised definition of attest client. Specifically, he explained that the rule could be read as allowing a member to have commission arrangements with an audit client when the member is not engaged by the audit client to perform the audit. He explained that to remedy this unintended consequence he recommends a sentence be added to the definition of attest client that explains that "For purposes of the Commissions and Referral Fees Rule, client includes attest client." The Committee was supportive of addressing this concern and also requested the Task Force consider whether it would be helpful to add to the definition a cross reference to the Commissions and Referral Fees Rule.

It was suggested that it was awkward and confusing to use the term attest client when the proposed definition states that an attest client is not always a client. Instead, it was suggested that the term "attest client" be replaced by the term "attest entity." Some believed that using the term "attest entity" could be confusing since (1) it is a new term while "attest client " is an established term and (2) then there would be three terms to navigate between "client", "attest entity" and "nonattest client". It was noted that the term "attest client" is still relatively new as the Code only started using it in lieu of the term "client" as part of the Codification project. It was asked if the term "attest client" was used in any of the other technical standards and in response it was noted that it is used in the international standards. The Committee directed the Task Force to replace the term "attest client" with the term "attest entity" and in the exposure draft to ask if respondents believed the term was confusing. The Committee also asked the Task Force to consider drafting a FAQ or other application guidance that would explain to members that when an attest entity is also the client, it could be referred to as an attest client.

The Committee was asked if it was necessary to include the government provision in the definition of "attest entity" or if it could be moved elsewhere such as to the independence topic. The Committee directed the Task Force to consider relocating the government provision from the "attest entity" definition.

3. <u>Council Resolution – Form of Organization and Name</u>

Ms. Snyder explained that Staff has received a number of inquiries concerning whether or not certain CPA firm ownership structures would be permitted under the *Council Resolution Concerning the Form of Organization and Name Rule* ("Council Resolution"), particularly those that involve situations where the owners of a firm include not only individuals but also ownership by a CPA firm or a grantor trust.

Ownership by CPA firm

With regard to ownership by a CPA firm, Ms. Snyder asked the Committee for its input on whether or not ownership by a CPA firm would be permissible under the Council Resolution, provided the CPA firm was owned by (a majority of) CPAs and such CPAs (and non-CPAs) were actively engaged as members of the successor firm. She stated that this issue was recently discussed by the Texas State Board Rules Committee and the Committee agreed to allow CPA firms to include corporate ownership provided the corporation is owned by CPAs of the firm. Ms. Snyder noted that in interpreting the Council Resolution, the Committee might wish to consider the meaning of "ownership" to constitute "beneficial ownership." She referred the Committee to the definition of "beneficially owned" in the AICPA Code.

The Committee discussed the issue and agreed that the Council Resolution could be interpreted to allow ownership by a CPA firm. The Committee further agreed that in determining whether a firm has complied with the requirement of "majority of ownership by CPAs," the firm should refer to the partnership or other agreements in place that set forth the beneficial ownership interests and voting rights of each CPA and non-CPA owner.

Ownership held by grantor trust

Ms. Snyder explained that for estate planning purposes, some owners of CPA firms have been advised to move their equity accounts into a living trust whereby a grantor trust is established that allows the grantor (i.e., CPA firm owner) to control and manage the trust while they are alive and thus, serve as the trustee as well as the beneficiary of the trust during their lifetime. Ms. Snyder asked the Committee for its input on whether or not ownership by a grantor trust would be permissible under the Council Resolution provided the CPA firm owner served in the capacity of trustee and beneficiary and remained actively engaged in the CPA firm. She noted that if such ownership were permitted, upon the death of the owner, the equity would need to be transferred to the firm or qualified owners within a reasonable period as set forth in paragraph five of the Council Resolution.

The Committee discussed the issue and agreed that the Council Resolution could be interpreted to allow ownership by a grantor trust and that the equity held in the trust should be attributed to the CPA firm owner for purposes of determining ownership interests. Accordingly, such ownership would be permitted provided there is a majority beneficial ownership interest by CPAs and the CPA firm owner was actively engaged as a member of the firm. The Committee was also asked to consider the scenario where the owner serves as a co-trustee of the trust with his or her non-CPA spouse and the spouse is not actively engaged in the firm's activities. The Committee agreed such an arrangement would not be permissible under the Council Resolution since it would violate the provision that all non-CPAs (e.g., spouse) be actively engaged in the firm's activities.

4. <u>Information Technology and Cloud Services</u>

Ms. VanDyne and Ms. Goria reported on the activities of the Task force. The Committee agreed that what was intended by the term, "authoritative source" was the version of the client's data or records that is used by the client. The Committee requested that the examples of hosting services included in the interpretation specifically identify if the service is considered a hosting service because the member is the "authoritative source" of the client's data or records or if the service is considered a hosting service because the member is a repository of the client's data or records. One member expressed concern that members may take possession of a client's original records even if it is just temporary custody so that the member can provide a permitted nonattest service.

The Committee then discussed whether the use of portals by members to communicate with their clients could be viewed as hosting services if information remains in the portal for some time. The example discussed was a tax return and related supporting records. One member noted that her firm discloses to tax compliance clients that the client is responsible for maintaining its books and records even if the firm chooses to send the client information through a portal. The Committee believed it would be helpful if the guidance issued includes examples of situations that the Task Force is specifically trying to address as well as examples of situations that it does not intend to address.

When discussing hosting services connected with a technology solution, it was suggested that the service might be a prohibited service under the *Information Systems Design, Implementation, or Integration* interpretation. It was also noted that it was unclear what "licensing" is intended to mean and whether the member was retained to provide hosting services or if this was another example of what hosting services would not include.

5. AICPA Codification/State Board Rules Review

Mr. Johnson reported on the results of the Records Requests Questionnaire that was distributed to state boards of accountancy in order to gain insight into the underlying reasons for any similarities and/or differences identified between the state boards' position on records requests and that of the AICPA. He explained that the Questionnaire was sent to twenty-seven state boards that had been identified as either having records requests rules that were different from the AICPA' s rules (thirteen jurisdictions) or identified as being silent on records requests relating to withholding records for non-payment of fees (fourteen jurisdictions). Seventeen of the twenty-seven state boards responded to the Questionnaire.

The Questionnaire requested input on the AICPA's position on the following provisions of the Records Requests interpretation:

- *Categorization of Records*
- *Return of Client Provided Records*
- *Withholding Client Records for Unpaid Fees*
- *Period Allowed For Returning Records*
- *Subsequent Requests for Records*
- *Working Papers*

Withholding Client Records for Unpaid Fees

Mr. Johnson noted that AICPA and NASBA had previously identified "withholding certain records due to unpaid client fees" as an issue where a significant number of state boards had a different position than that of AICPA or were silent on the issue. Mr. Johnson stated that based on the responses received, the Task Force had updated the Records Requests Research Summary prepared by the AICPA State Regulation & Legislation Team. He reported that of the fifty-five jurisdictions, thirty-six state boards allow for retention of certain records for nonpayment of fees, eight state boards remain silent on the issue and eleven state boards prohibit retention of records for nonpayment of fees. Accordingly, the state boards that allow retention of certain records for nonpayment of fees comprise sixty-five percent of the fifty-five jurisdictions whereas those that prohibit retention of records for nonpayment of fees comprise twenty percent (fifteen percent remain silent). It was further noted that those state boards that allow for retention of records for nonpayment of fees comprise sixty-one percent of the total CPAs regulated in the fifty-five jurisdictions, whereas the state boards that prohibit the retention of records for nonpayment of fees comprise thirty percent.

Mr. Johnson explained that while there is a significant minority of states that prohibit withholding certain records for nonpayment of fees, there is a clear majority of state boards that agree with the AICPA's position that allows withholding of certain records for nonpayment of fees. He explained that overall, the Task Force believes that revisiting the AICPA's guidance and potentially prohibiting retention of certain records for nonpayment of fees would be contrary to the PEEC's overall objective of uniformity of AICPA and state boards' rules and therefore, the Task Force recommends that the AICPA's guidance in the *Records Requests* interpretation on this issue should not be revisited.

Ms. Snyder noted that in discussing this issue, the Task Force also considered the rules governing attorneys regarding withholding client files due to unpaid fees. She stated that the law regarding such "retaining liens" varies significantly among the various states but case law in a majority of states allows an attorney to retain all client documents until the fees are paid. In addition, the American Bar Association's Model Rules of Professional Conduct permits an attorney to obtain a lien to secure the attorney's fees or expenses.

The Committee was asked whether or not it agreed with the Task Force's recommendation to not revisit the AICPA's position on withholding certain records due to unpaid client fees. There was unanimous agreement not to revisit the position and therefore, retain the existing guidance.

Mr. Johnson reported on the responses from state boards received on the other issues addressed in the Questionnaire and stated that based on the responses, the Task Force does not believe there is any basis to recommend that the Committee revisit any other provisions within the interpretation. The Committee did not object to any of the recommendations of the Task Force.

Mr. Johnson also noted that the Questionnaire did ask whether or not state boards would be open to reconsidering their current rules in order to conform to the AICPA rule. Overall, more than half of the state boards that provided a substantive response to the question responded "maybe" to the inquiry. Only one state responded "no" and believed that the AICPA should raise the bar and conform to the board's rules. Some state boards did not respond to this inquiry.

6. <u>IESBA Update</u>

Ms. Snyder provided highlights of the October 2015 IESBA meeting held in New York City.

Long Association of Personnel with an Audit or Assurance Client

Ms. Snyder reported that the IESBA received a brief update from the Long Association Task Force. She explained that the Board supported an increase in the cooling off period of the lead engagement partner from two years to five years for an audit of a public interest entity (PIE) but agreement had not been reached yet on the cooling off period for the engagement quality control review (EQCR) partner. She noted that the IESBA's Consultative Advisory Group (CAG) supported a cooling-off period of five years for the EQCR partner whereas others believe a three year cooling-off period is appropriate. Ms. Snyder also explained that the Board is considering providing an alternative to elements of the partner rotation requirements for PIE audits in the Code where jurisdictions have established different regulatory safeguards, or a package of safeguards, to address threats created by long association; and activities that can be performed by the rotated partner with respect to the client during the cooling-off period. The IESBA will consider a final draft of the proposed provisions at its November/December 2015 meeting, and vote on whether to re-expose the changes to the Code on specific issues.

Structure of the Code

Ms. Snyder reported that the IESBA considered a revised draft of "Tranche I" and a first-read draft of "Tranche II" of the draft Exposure Draft. The IESBA continued to broadly support the direction of the restructuring. She noted that the IESBA discussed, among other matters: the approach to describing the relevance of application material in the Code versus requirements and articulation of the linkage between independence and objectivity. The IESBA will consider

a revised draft of Tranches I and II at its November/December 2015 meeting for possible exposure.

Review of Safeguards in the Code
Ms. Snyder reported that the IESBA considered a first-read draft of the proposed revised provisions in extant Section 100, *Introduction and Fundamental Principles* and Section 200, *Introduction* (Part B – Professional Accountants in Public Practice) of the Code as they relate to safeguards. Topics discussed included: a proposed revised description of the concept of "safeguards;" re-characterization of certain examples of safeguards in extant Section 200 as conditions in the work environment, within a firm or within an entity's systems and procedures that may affect the level of threats to compliance with the fundamental principles; a proposed description for the concept of a "reasonable and informed third party;" and "stepping back" to evaluate the continued effectiveness of safeguards in the light of changed circumstances or new information concerning threats. The IESBA will consider a revised draft of the proposed Sections 100 and 200 at its November/December 2015 meeting for possible exposure.

Review of Part C of the Code – Phase I
Ms. Snyder reported that the IESBA considered significant comments received on proposed revised Section 370 included in the Exposure Draft, *Proposed Changes to Part C of the Code Addressing Presentation of Information and Pressure to Breach the Fundamental Principles.* Topics discussed included: how to evaluate and respond to pressure to breach the fundamental principles, including in a conflict of interest situation; whether the proposed guidance should distinguish between "senior" professional accountants in business (PAIBs) and other PAIBs; and the adequacy of the guidance in Section 300 in highlighting the greater expectations of "senior" PAIBs. The IESBA agreed to consider revised drafts of Sections 300, 320 and 370 by conference call and then possibly adopt final standards at its November/December 2015 meeting.

Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations (NOCLAR)
Ms. Snyder reported that the IESBA received a preliminary update on significant comments from respondents to the Exposure Draft, *Responding to Non-Compliance with Laws and Regulations*. The IESBA will consider a full analysis of the comments received on the Exposure Draft at its November/December 2015 meeting.

7. Entities Included in State and Local Government Financial Statements

Ms. Miller explained that while the Task Force still has many issues to discuss, the preliminary thinking of the Task Force is that it would like to retain the "making reference to another auditor's report" exception (making reference exception) that exists today. She explained that another exception the Task Force has discussed is the possibility of not having to remain independent of an immaterial fund or component unit unless the member knows or has reason to believe a significant threat exists. If the member knows or has reason to believe a significant threat exists, then Ms. Miller explained the Task Force is considering that the member would likely need to evaluate the situation using the conceptual framework. She emphasized that the notion of "knows or has reason to believe" would not require the member to "search" for possible threats.

Ms. Miller explained that to test the preliminary conclusion that members do not have to remain independent of an immaterial fund or component unit unless the member knows or has reason to believe a significant threat exists, a subgroup of the Task Force applied

examples to situations where a covered member or firm had a direct financial interest in discreetly presented component units. Discreetly presented component units were used since these entities have the most distance from the primary government, that is, the primary government has the least amount of fiscal responsibility over these entities. Ms. Miller explained that the subgroup was not able to conclude that the immateriality of a discreetly presented component unit was a sufficient safeguard by itself and so she believes that it is unlikely that the Task Force will be able to conclude that a blanket exception for immaterial funds and component units is workable. For the February Committee meeting, the Task Force expects to work through all the examples and bring a recommendation for downstream entities to the Committee.

Ms. Miller also explained that there are a number of entities in the state and local environment that do not use GASB GAAP (e.g., tribal entities that need audits because they receive federal funding but exclude certain entities that don't receive any federal funding and entities that use cash basis). She explained that the Task Force has briefly discussed what state and local entities members should be independent of when GASB GAAP is not used by the primary government, and hopes to have a recommendation for the Committee at its next meeting.

Ms. Miller concluded by explaining that the Task Force has been unable to identify why the extant interpretation contains an exception for the "making reference" provision when certain individuals are in a key positon and as such, may recommend it be removed.

8. Minutes of the Professional Ethics Executive Committee Open Meeting

It was moved, seconded and unanimously agreed to approve the minutes of the July 2015 open meeting

9. Commissions and Contingent Fees Task Force

Ms. Tish explained that the Task Force reviewed the commissions and referral fees rules of 18 states and identified that 12 of those states require disclosure be in writing. In addition, 10 of the 12 states call for specific information to be included in the written disclosure; however, the specific information required to be disclosed varied by states.

Ms. Tish explained that the Task Force discussed the merits of both issues; whether the disclosure should be in writing and if so, should the written disclosure include specific information. Ultimately, the Task Force believed that requiring disclosure be in writing would result in enhanced transparency since it would bring the arrangement to the client's attention and could also assist in avoiding misunderstandings. Ms. Tish explained that with respect to the disclosure of specific information, while the Task Force thought there was some merit to identifying the party involved with the commission or referral fee and the amount paid, depending upon the situation, other information may also be important. Accordingly, she explained the Task Force is recommending that the required disclosure be in writing and only encourage that significant terms be included since this will bring the arrangement to the client's attention and allow the client to inquire as to additional specifics if he or she is interested.

After some discussion, it was agreed the proposed interpretation should be silent as to what terms should be included in the written documentation and instead, the Committee should draft non-authoritative guidance such as FAQs or examples of draft documentation for members.

It was moved, seconded and unanimously agreed to expose the revised interpretation to membership.

Ms. Tish then explained that back in 2006, the Committee agreed that the current prohibition period associated with receiving contingent fees was inconsistent with the way other financial relationships are treated in the Code of Conduct (i.e., under the independence rules) and since contract terms can be amended prior to completion of a professional service, the Committee agreed it would be appropriate to provide for a "cure" for new attest engagements (e.g., where a nonattest client requests that the member perform an audit and the member received a contingent fee from such client during the period covered by the financial statements). She further explained that the recommended basis provided by the prior Task Force was that when performing an engagement for a contingent fee, the primary threat to a member's independence and objectivity is the financial self-interest threat. Under the *Independence* Rule of the AICPA Code, a member need only be independent *during the period of the professional engagement* for purposes of financial interests/relationships with an attest client. She explained that the prior Task Force believed that any threat to a member's independence (or objectivity) would be eliminated once the financial interest is disposed of (i.e., the financial relationship is terminated or otherwise settled) and therefore, provided such disposition occurs prior to the performance of any attest procedures or formal agreement to perform the attest engagement, independence would not be considered impaired. Using this conceptual basis, the former Task Force believed that if the contingent fee relationship was terminated (e.g., paid in full or fixed in price) prior to the period of the professional engagement, there would be no threat to the member's independence or objectivity.

Ms. Tish explained that the Committee tabled this issue in 2006 because at the time, there were no other revisions that needed to be made to either the commissions or contingent fees rules nor was there a planned membership ballot that such a revision to the rules could be included in. Ms. Tish explained that while the Task Force believes the prior Task Force's conclusions had merit, unless there are other reasons to amend the rules it recommends this issue remain tabled. The Committee agreed to table this issue since there were no other planned revisions to any of the rules in the Code.

10. **Exposure Draft – Maintaining the Relevance of the Uniform CPA Examination**
    For informational purposes only.

11. **Conceptual Framework Toolkits**
    For informational purposes only.

12. **Electronic Records**
    For informational purposes only.

13. **IESBA Suspected Noncompliance with Laws and Regulations Exposure Draft**
    For informational purposes only.

14. **PEEC Planning Subgroup**
    For informational purposes only.