

December 10, 2012

Lisa A. Snyder, CPA
Director, Professional Ethics Division
AICPA
1211 Avenue of the Americas, 19th Floor
New York, NY 10036-8775

Re: June 29, 2012 PEEC Exposure Draft of an Omnibus Proposal, *Proposed Revised and New Interpretations and Proposed Deletion of Ethics Ruling:*

- **Proposed Revised Interpretation No. 101-3, *Nonattest Services,*” under Rule 101, *Independence***
- **Proposed New Interpretations No. 501-11 and 502-6, both of which are entitled *Use of the CPA Designation, Under Rules 501, Acts Discreditable, and 502, Advertising and Other Forms of Solicitation***
- **Proposed Deletion of Ethics Ruling No. 65, *Use of the CPA Designation by Member Not in Public Practice, Under Rule 102, Integrity and Objectivity* [ET 191.130-.131]**
- **Proposed Deletion of Ethics Ruling No. 38, *CPA Title, Controller of Bank, Under Rule 501* [ET 591.075-.076]**
- **Proposed Deletion of Ethics Ruling No. 78, *Letterhead: Lawyer—CPA, Under Rule 502* [ET 591.155-.156]**

Dear Ms. Snyder:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to represent the views of local and regional firms on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective.

TIC has reviewed the ED and is providing the following comments for your consideration.

GENERAL COMMENTS

TIC is very supportive of the proposed changes involving the activities (such as financial statement preparation) that will be reclassified to nonattest services and the new paragraph that provides guidance on the cumulative effect on independence when members provide nonattest services. TIC also concurs with the proposed deletion of the above Ethics Rulings, since they will be replaced with new guidance.

However, TIC takes exception to certain revisions made to the Internal Audit Assistance Services section of the ED since they do not solve the issues that TIC raised in its comment letter on the February 28, 2011 Omnibus Proposal. In particular, the ED lacks sufficient guidance to distinguish ongoing evaluations from separate evaluations and seems to over-emphasize frequency of performance of separate evaluations when assessing a member's independence. TIC also disagrees with the editorial change that is proposed for the section on Performance of Nonattest Services Relating to the Financial Statement Period Prior to the Period of the Professional Engagement.

SPECIFIC COMMENTS

Proposed Revised Interpretation No. 101-3, *Nonattest Services,*” under Rule 101, *Independence*

Performance of Nonattest Services Relating to the Financial Statement Period Prior to the Period of the Professional Engagement

TIC does not support deleting the “and” conjunction in paragraph b of the list of conditions that must be met for a member to remain independent when performing nonattest services immediately prior to being engaged to also perform attest services for the same client. TIC believes omission of the conjunction could be interpreted as allowing a member to meet only one of the conditions listed to maintain independence under the circumstances.

TIC understands that the conjunction was deleted to conform to an editorial convention which assumes that all items in a list are required unless otherwise indicated. However, PEEC should not assume that this editorial convention will be universally understood. TIC therefore recommends the following editorial change to the introductory sentence that precedes the list of conditions, if the conjunction “and” is to be deleted from the list of conditions:

A member's independence would not be impaired if the member performed nonattest services that would have impaired independence during the period covered by the financial statements, provided that all of the following conditions are met...

[The proposed additions are underlined.]

Cumulative Effect on Independence When Providing Nonattest Services

TIC fully supports this amendment.

Activities Related to Attest Services

TIC agrees that *financial statement preparation, cash-to-accrual conversions, and reconciliations* are separate nonattest services that should not be considered activities related to attest services.

See the Internal Audit Assistance Services section below for TIC's comments on monitoring activities that may have a dual purpose as activities related to attest services.

Internal Audit Assistance Services

TIC agrees with the conclusion in the ED that internal audit assistance services that result in the practitioner assuming management responsibilities, such as monitoring activities that involve ongoing evaluations of the client's internal control, should be automatic impairments to independence when performed for an attest client. TIC also agrees that members need to exercise professional judgment to determine if separate evaluations performed for an attest client would impair independence. Although the proposed amendments attempt to provide additional guidance for members to make such judgments, TIC believes additional improvements are necessary because:

- The ED fails to draw a clear line between the definitions of ongoing evaluations v. separate evaluations.
- The guidance on separate evaluations places too much emphasis on frequency of performance in the assessment of impairment.

Ongoing v. Separate Evaluations

The ED draws upon some of the terminology from the Committee of Sponsoring Organizations of the Treadway Commission (COSO) Internal Control—Integrated Framework (the COSO framework) to describe ongoing evaluations and separate evaluations. However, TIC believes the definitions in the ED are insufficient and should include more guidance that would better differentiate the two evaluations. In addition, one of the proposed amendments is somewhat inconsistent with the principles contained in the COSO framework (as presented in the September 2012 post-public-exposure version).

TIC believes additional guidance is important for two reasons. If a clearer line between ongoing and separate evaluations can be established, members can more readily understand which internal audit assistance services result in an automatic impairment to independence v. those that are subject to further interpretation and assessment. An improved understanding of PEEC's intent with respect to this section could promote significantly greater consistency in the application of the Interpretation.

The COSO framework does not specifically define either term (although the Framework does provide some guidance about the respective attributes of each term). It is important to note that the COSO framework is not attempting to draw a fine line between the terms. Both types of evaluations are acceptable activities to help management assess whether internal controls are present and functioning. However, PEEC has concluded that there is a clear difference between the two types of evaluations in terms of their potential effect on a member's independence. The ED intends to draw a line between ongoing

evaluations, which would impair a member's independence, and separate evaluations, which may or may not impair independence, depending on the circumstances.

TIC believes the descriptions for each term should be expanded so that they are more closely aligned with the guidance in the COSO framework. The term "ongoing evaluations" would be defined as the routine and recurring monitoring activities of an organization that are performed on a very timely basis generally as an integral part of "live" transaction processing (i.e., real-time monitoring). A member performing real-time monitoring activities for a client has effectively assumed management's responsibility on a day-to-day basis for the proper functioning of one or more aspects of the client's internal control system.

Separate evaluations would be defined as ad hoc monitoring activities that are performed outside of the normal transaction processing cycle, generally with respect to completed transactions, by objective management personnel, internal audit, or external parties. These evaluations vary in scope and frequency depending on the circumstances.

Another point of confusion with the COSO framework concepts exists within the second bullet on page 12 of the ED, which states that the following activity, if performed as part of an internal audit assistance engagement, would impair independence:

- *Performing frequent separate evaluations on the effectiveness of a significant control such that the member is, in effect, performing ongoing evaluations.*

According to the COSO framework, performing frequent separate evaluations may be an indication that the entity should identify ways to enhance its ongoing evaluations, but the two types of evaluations are not the same (no matter how frequently separate evaluations are performed). Therefore, TIC believes the ED should not imply that a crossover to ongoing evaluations is possible simply by performing more frequent separate evaluations. This implication adds unnecessary complexity and seems contradictory to the proper assessment of separate evaluations.

Frequency of Performance

The ED implies that frequency of performance of separate evaluations is, in and of itself, the most significant threat to a member's independence. TIC believes this emphasis, intended or not, is misplaced and may lead to significant inconsistencies in practice. Frequency of performance, taken out of context, is not suitable as a determining factor because each member will have a different perception of how frequency should be defined. For example, assuming all other factors (such as the significance of controls being tested, the nature and extent of testing, and management's assumption of responsibility for the work performed) being equal, some members may assume that performing separate evaluations quarterly is acceptable whereas other members may believe that any monitoring activity performed more frequently than annually is an unacceptable threat to independence. An appropriate boundary for frequency of performance can be assessed only in the context of other factors, not in isolation.

In particular, the second bullet on page 12 (cited above) seems to overemphasize the importance of frequency of performance in the evaluation of separate evaluations and downplays other important considerations.

The second bullet on page 12 fails to mention that the first consideration is whether the member has assumed management's responsibilities in the performance of the separate evaluations. (TIC understands and supports the assertion that independence is automatically impaired whenever a member assumes any management responsibility, regardless of frequency.) TIC believes the second bullet on page 12 of the ED should be very clear that the frequency of the member's performance is relevant only for those separate evaluations for which management is assuming responsibility for the proper functioning of internal controls.

If management is assuming full responsibility for the separate evaluations performed by the member (in accordance with the criteria in Interpretation 101-3), TIC believes the significance, scope, nature and extent of the internal controls subject to the separate evaluations, along with the frequency of the separate evaluations, needs to be evaluated concurrently and weighted appropriately to assess whether a member's independence has been impaired. The weight placed on frequency of performance will vary depending on the number and significance of the controls tested and the extent of the testing. TIC therefore recommends that the first full paragraph on page 11 be revised to eliminate language that equates frequent separate evaluations with ongoing evaluations and to emphasize the importance of weighing all factors appropriately in the assessment of independence.

Based on all of the above concerns, TIC recommends revising the second bullet on page 12 as follows:

- *Performing separate evaluations, which, in the member's judgment, pose a self-review threat that cannot be overcome based on the concurrent and appropriately weighted evaluation of the significance of the controls tested, the scope, nature and extent of the testing and the frequency of testing, even if management is accepting responsibility for the services performed and the other general requirements of the Interpretation are met.*

Dual-Purpose Engagements

Certain TIC members perform internal audit assistance services that serve a dual purpose in financial statement audits of community banks. These members consider, and often specifically structure the engagement to perform these evaluations as extended audit procedures, and all work performed is included in the working paper file for the financial statement audit. Depending on the circumstances, TIC believes such extended audit procedures could be considered part of the attest service. Further clarification is needed within the ED to help members understand when separate evaluations represent a

separate nonattest service v. part of an attest service (i.e., continuous financial statement auditing) and not subject to Interpretation 101-3.

Reference to AT 501 Engagements

The third bullet on page 12 seems to be written in the context of an engagement performed under Statement on Standards for Attestation Engagements No. 15 (Section AT 501), *An Examination of an Entity's Internal Control Over Financial Reporting That is Integrated With an Audit of Its Financial Statements*. However, this standard is not referenced within the bullet. TIC believes referencing AT 501 is necessary to be consistent with the related paragraph on page 13.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

A handwritten signature in black ink that reads "Karen Kerber". The signature is written in a cursive style with a large initial "K".

Karen Kerber, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees