
EXPOSURE DRAFT

FIRM MERGERS AND ACQUISITIONS

PROPOSED INTERPRETATION

AICPA PROFESSIONAL ETHICS DIVISION

December 10, 2014

Comments are requested by May 15, 2015

Prepared by the AICPA Professional Ethics Executive Committee for comments from persons interested in independence, behavioral, and technical standards matters.

Comments should be addressed to Lisa A. Snyder, Director of the Professional Ethics Division, at lsnyder@aicpa.org

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December 10, 2014

This exposure draft contains important proposals for review and comment by the AICPA's membership and other interested parties regarding pronouncements for possible adoption by the Professional Ethics Executive Committee (PEEC). The text and an explanation of the proposed pronouncements are included in this exposure draft.

After the exposure period is concluded and the PEEC has evaluated the comments, the PEEC may decide to publish one or more of the proposed pronouncements. Once published, the pronouncements become effective on the last day of the month in which they are published in the *Journal of Accountancy*, unless otherwise stated in the pronouncements.

Your comments are an important part of the standard-setting process; please take this opportunity to comment. Responses must be received at the AICPA by May 15, 2015. All written replies to this exposure draft will become part of the public record of the AICPA and will be available at <http://aicpa.org/InterestAreas/ProfessionalEthics/Community/ExposureDrafts/Pages/CommentLettersFortheDecember2014ProfessionalEthicsDivisionExposureDraft.aspx>.

All comments received will be considered by the PEEC at a subsequent meeting.

Please send comments to Lisa A. Snyder, director of the Professional Ethics Division, via e-mail at lsnyder@aicpa.org

Sincerely,

Samuel L. Burke, *Chair*
AICPA Professional Ethics Executive Committee

Lisa A. Snyder, *Director*
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Explanation for the Proposed “Firm Mergers and Acquisitions” Interpretation

The PEEC is exposing for comment a new interpretation, “Firm Mergers and Acquisitions,” [1.220.020] under the “Independence Rule” [1.200.001]. The proposal provides guidance to members in situations where independence with respect to an attest client may become impaired as a result of a firm merger or acquisition. The guidance would apply when either (1) a member's firm merges with or acquires another firm or entity or all or part of the business thereof or (2) a member's firm, or all or part of the business thereof, is merged with or acquired by another firm. The proposal focuses on two types of relationships that could impair independence: employment or association with an attest client and the provision of nonattest services that would impair independence (prohibited nonattest services).

Employment or Association With an Attest Client

The proposal requires certain safeguards to be in place in order for independence to be maintained when a partner or professional employee of one firm is employed by or associated with an attest client of the other firm as a result of the merger or acquisition. Such safeguards require that the partner or professional employee terminate the relationship prior to the effective date of the merger or acquisition and be prohibited from participating on the attest engagement team or being in a position to influence the attest engagement if the engagement covers any period in which the partner or employee was employed or associated with the attest client. The partner or employee must also comply with any applicable safeguards under the provisions of the “Former Employment or Association With an Attest Client” interpretation regarding disassociation from an attest client, such as the safeguard that requires any “covered member” to cease participation in the attest client's employee benefit plans.

The PEEC also believes that in order to safeguard independence, a responsible individual within the firm (for example, an individual with responsibility for the policies and procedures relating to independence) should assess the prior relationship that the partner or professional employee had with the attest client as well as the position that the individual will hold at the firm to determine if threats are at an acceptable level. If threats are determined not to be at an acceptable level, the responsible individual will need to be satisfied that safeguards are applied that will eliminate or reduce threats to an acceptable level.

The PEEC has concluded that in certain circumstances, threats to independence will not be at an acceptable level. Specifically, in situations where the partner or professional employee will have interaction with the attest engagement team or where the attest engagement team will evaluate work performed by the partner or professional employee while he or she was employed or associated with the attest client, additional safeguards must be applied. Under such circumstances, an individual within the firm with the appropriate stature, expertise and objectivity must review the subsequent attest engagement, prior to issuing the attest report, to determine whether the attest engagement team maintained integrity, objectivity, and as appropriate, professional skepticism.

Another safeguard that will need to be applied relates to communication between the firm and those charged with governance at the attest client. Specifically, the proposal requires that the

nature of the relationship and any safeguards that were applied be discussed with those charged with governance and that such discussion take place as soon as practicable under the circumstances but before issuing the attest report. The proposal also encourages that the substance of the discussion be documented.

Nonattest Services

As noted, the proposal also provides independence guidance in situations where one firm provided prohibited nonattest services to an attest client of the other firm. The PEEC believes that the significance of the threats differ depending upon whether the prohibited nonattest services were provided by the “acquiring firm” with respect to an attest client of the acquired firm or by the “acquired firm” with respect to an attest client of the acquiring firm. In determining which firm would be considered the “acquiring firm” for purposes of the interpretation, the proposal refers members to the guidance contained in *FASB Accounting Standards Codification* (ASC) 805-10-55 paragraphs 11–18, among other sources.

In situations where the acquiring firm provided prohibited nonattest services to an attest client of the acquired firm during the period of the professional engagement or the period covered by the financial statements, the PEEC believes that the threats created would be so significant that they could not be reduced to an acceptable level. Specifically, in such situations, the acquired firm’s attest client would become an attest client of the acquiring firm (that is, the surviving firm) upon the merger or acquisition and any prohibited nonattest services performed by the acquiring firm for such an attest client would impair independence if the attest engagement were to continue.

Alternatively, when the acquired firm provided the prohibited nonattest services to an attest client of the acquiring firm during the period of the professional engagement or the period covered by the financial statements, the PEEC believes the acquiring firm’s independence will not be impaired provided certain steps are taken. One step is for the acquired firm to either terminate the prohibited nonattest services or modify the nonattest services such that the services will no longer be considered to impair independence. Another step is for the firm to perform an evaluation to determine if threats are either at an acceptable level or can be reduced to an acceptable level by the application of safeguards. The extent of the evaluation performed would be based on whether or not the prohibited nonattest services will be attributable to the acquiring firm. The nonattest services will be considered attributable to the acquiring firm if the acquiring firm will assume responsibility (that is, be held liable or accountable, or both) for the results of the prohibited nonattest services performed by the acquired firm.

In evaluating the significance of any threats, the proposal provides various factors that should be considered and where threats are determined not to be at an acceptable level, the proposal provides examples of possible safeguards to be applied. In cases where no safeguards exist that can eliminate or reduce threats to an acceptable level, independence would be impaired.

The proposed guidance also requires a responsible individual within the firm to discuss with those charged with governance the nature of any prohibited services performed that are subject to the above evaluation, along with any safeguards applied, and encourages documentation of such discussion.

Effective Date

PEEC does not believe that a delayed effective date for transition purposes is necessary. Accordingly, PEEC proposes that the interpretation be effective the last day of the month in which the interpretation is published in the *Journal of Accountancy*. As such, the interpretation would apply to mergers and acquisitions with effective dates on or after the effective date the interpretation.

Request for Specific Comments

Although comments are welcome on all aspects of the proposal, the PEEC specifically requests feedback regarding the following:

1. The PEEC is proposing that, in situations where the acquiring firm provided prohibited nonattest services to an attest client of the acquired firm during the period of the professional engagement or the period covered by the financial statements, the threats created would be so significant that they could not be reduced to an acceptable level and, therefore, independence would be impaired. Do you agree with this conclusion or would an evaluation of threats and application of safeguards be a more appropriate approach, similar to the guidance for instances where the acquired firm performed prohibited nonattest services to an attest client of the acquiring firm?
2. Paragraph .07b of the proposal requires an evaluation of the threats to be performed on the basis of the attribution of the results of the nonattest services to the acquiring firm (that is, whether the acquiring firm will assume responsibility for such services) when prohibited nonattest services were provided by the acquired firm to an attest client of the acquiring firm. Is this guidance sufficiently clear?
3. Is the effective date for the proposal appropriate or is a transition period necessary? If a transition period is necessary, please explain why and indicate what time period would be sufficient.

Text of Proposed “Firm Mergers and Acquisitions” Interpretation

1.220.040 Firm Mergers and Acquisitions

01. When (1) a *member's firm* merges with or acquires another *firm* or entity or all or part of the business thereof (acquired firm), or (2) a *member's firm*, or all or part of the business thereof, is merged with or acquired by another *firm* (acquiring firm), *threats* to compliance with the “[Independence Rule](#)” [1.200.001] may exist as a result of employment or association with, or the provision of nonattest services to, an *attest client* of the acquired or acquiring firm.
02. When determining which *firm* is the acquirer, *members* should consider, the guidance contained in FASB ASC 805-10-55 paragraphs 11–18, among other sources.

Employment or Association with an Attest Client

03. If a *partner* or professional employee was formerly employed by or associated with an entity as a director, officer, employee, promoter, underwriter, voting trustee, trustee of any pension or profit sharing trust of the entity, or in any capacity equivalent to that of a member of management and that entity becomes an *attest client* through a merger or acquisition, *threats* will be at an *acceptable level* and *independence* will not be *impaired* provided all of the following *safeguards* are met:
 - a. The *partner* or professional employee terminates the relationship with the *attest client* (for example, resigns as a director) prior to the effective date of the merger or acquisition.
 - b. The *partner* or professional employee does not participate on the *attest engagement team* and is not an *individual in a position to influence the attest engagement* for the *attest client* when the *attest engagement* covers any period that includes his or her former employment or association with that *attest client*.
 - c. The applicable disassociation *safeguards* in paragraph .04 of the “[Former Employment or Association With an Attest Client](#)” interpretation [1.277.010] are implemented prior to the effective date of the merger or acquisition.
 - d. As soon as practicable under the circumstances but before issuing the attest report, a responsible individual within the *firm* assesses the prior relationship of the *partner* or professional employee with the *attest client*, as well as the position he or she holds at the *firm*, to determine if *threats* are created that are not at an *acceptable level*. If the responsible individual determines that *threats* are not at an *acceptable level*, he or she should be satisfied that *safeguards* are applied to eliminate or reduce the *threats* to an *acceptable level*. *Threats* will not be at an *acceptable level* if
 - i. the *partner* or professional employee will have interaction with members of the *attest engagement team* regarding the *attest client* or
 - ii. the *attest engagement team* is placed in a position of evaluating the *partner* or professional employee’s representations and work while he or she was employed or associated with the *attest client*.

In such situations, an individual within the *firm* with the appropriate stature, expertise and objectivity should review the subsequent *attest engagement* prior to

issuing the attest report to determine whether the *attest engagement team* maintained integrity, objectivity, and as appropriate, professional skepticism.

- e. As soon as practicable under the circumstances but before issuing the attest report, the nature of the relationship and any *safeguards* that were applied are discussed with *those charged with governance*. Documentation of the substance of the discussion with *those charged with governance* is encouraged.

Nonattest Services

04. Nonattest services provided to an entity that becomes an *attest client* through a merger or acquisition may create self-review, management participation, and advocacy threats to the *member's* compliance with the “*Independence Rule*” [1.200.001]. Specifically, *threats* may exist if during the *period of the professional engagement* or the period covered by the *financial statements*, nonattest services that would otherwise *impair independence* (prohibited nonattest services) under the interpretations of the “Nonattest Services” subtopic [1.295] are performed by

- a. the acquiring firm, with respect to an *attest client* of the acquired firm or
- b. the acquired firm, with respect to an *attest client* of the acquiring firm.

Prohibited Nonattest Services Provided by Acquiring Firm

05. If the acquiring firm provided prohibited nonattest services to an *attest client* of the acquired firm during the *period of the professional engagement* or the period covered by the *financial statements*, *threats* to compliance with the “*Independence Rule*” [1.200.001] will not be at an *acceptable level* and cannot be reduced to an *acceptable level* by the application of *safeguards*. Accordingly the acquiring firm’s *independence* will be *impaired* with respect to the *attest client*.

Prohibited Nonattest Services Provided by Acquired Firm

06. If the acquired firm provided prohibited nonattest services to an *attest client* of the acquiring firm prior to the financial statement period covered by the acquiring firm’s next attest report, the acquiring firm’s *independence* would not be *impaired*.

07. If the acquired *firm* provided prohibited nonattest services to an *attest client* of the acquiring firm during the *period of the professional engagement* or the period covered by the *financial statements*, the acquiring firm’s *independence* would not be *impaired*, provided that

- a. the acquired firm terminates the prohibited nonattest services (or modifies the service offerings such that they would not *impair independence*) prior to the effective date of the merger or acquisition.
- b. an evaluation of the *threats* is performed and *threats* are determined to be at an *acceptable level* or reduced to an *acceptable level* by the application of *safeguards*. The evaluation should be conducted on the basis of the attribution of the results of the nonattest services to the acquiring firm. That is
 - i. if the nonattest services can be attributed to the acquiring firm because the acquiring firm will assume responsibility for the results of the nonattest

- services, the evaluation should assess all prohibited nonattest services that the acquired firm performed for the *attest client* during the financial statement period to be covered by the acquiring firm's next attest report.
- ii. If the nonattest services cannot be attributed to the acquiring firm, the evaluation should assess all prohibited nonattest services that the acquired firm performed for the *attest client* during the period in which the merger or acquisition was pending (that is, from the commencement of negotiations through the effective date of the merger or acquisition).
08. In evaluating the significance of any *threats*, consideration should also be given to the following:
- a. Whether the nonattest service is attributed to the acquiring firm and whether the work performed or its results will be subject to attest procedures.
 - b. The significance of the results of the nonattest service to the *attest client's financial statements*.
 - c. The extent to which the *attest client* and its management were involved in overseeing the nonattest services performed (including making any significant judgments and decisions with respect to the nonattest services) and whether the *attest client* and its management possessed the suitable skill, knowledge and/or experience to oversee such services.
 - d. Whether the nonattest services involved the assumption of a management responsibility.
09. If the *member* concludes that the *threats* to *independence* are not at an *acceptable level*, the *member* should apply *safeguards* to reduce *threats* to an *acceptable level*.
10. Examples of *safeguards* include the following:
- a. An individual not associated with the nonattest engagement reviews the nonattest services work performed.
 - b. Another *firm* performs an *attest engagement* on the subject matter of the nonattest service.
 - c. Another *firm* re-performs the nonattest service to the extent necessary for it to take responsibility for that service.
 - d. Different *partners* and engagement teams (from those who performed the nonattest services) perform the *attest engagement*.
- If no *safeguards* exist that will eliminate or reduce the *threats* to an *acceptable level*, *independence* will be *impaired*.

Communications With Those Charged With Governance

11. As soon as practicable under the circumstances but before issuing the *attest* report, a responsible individual within the *firm* should discuss the nature of the prohibited nonattest services performed by the acquired firm that are subject to evaluation in paragraph .07b and any *safeguards* applied with *those charged with governance*. Documentation of the substance of the discussion with *those charged with governance* is encouraged.

Other Interests in and Relationships With an Attest Client

12. This Interpretation addresses only *threats* to *independence* that may arise as a result of a merger or acquisition relating to employment or association with, or the provision of nonattest services to, an *attest client*. However other interests in, and relationships with, an *attest client* may also result in *threats* to compliance with the “[Independence Rule](#)” [1.200.001] or other rules during a merger or acquisition. Accordingly, *members* should take whatever pre-merger actions are necessary to be satisfied that the *firm* is in compliance with all relevant rules prior to the effective date of the merger or acquisition.

Effective Date

13. This interpretation is effective the last day of the month that it is published in the *Journal of Accountancy*.