



via e-mail to: lsnyder@aicpa.org

Lisa A. Snyder
Director, Professional Ethics Division
AICPA Professional Ethics Executive Committee
1211 Avenue of the Americas
New York, NY 10036-8775

September 11, 2014

Re: Breach of an Independence Interpretation – Proposed Interpretation of the AICPA Professional Ethics Division – June 16, 2014

Dear Ms. Snyder:

PricewaterhouseCoopers LLP ("PwC") appreciates the opportunity to provide comments on the AICPA Professional Ethics Executive Committee's ("PEEC") June 16, 2014 proposal relating to a breach of an independence interpretation. We provide the following specific comments and suggestions with respect to proposed new Interpretation No. 101-20, *Breach of an Independence Interpretation* ("Interpretation 101-20"), under Rule 101, *Independence*.

Deliberate and Unintentional Breaches

Proposed Interpretation 101-20 provides (see the 1st paragraph under *Breaches Resulting in Significant Threats*) that the consequences of a breach could not be addressed and the attest engagement team's integrity, objectivity, and professional skepticism would be compromised in situations where a significant threat to independence is caused by a partner or professional employee of the firm who:

- intentionally and knowingly breaches an independence interpretation, *or*
- breaches an independence interpretation due to ignorance or negligence.

The two scenarios described above address all possible causes of breaches of independence: those breaches that result from intentional acts, and those that do not. PEEC should reconsider the need to include this language in the interpretation given that it does not differentiate, in any meaningful way, between the two possibilities. Further, the significance of a breach and its impact on the attest engagement team's integrity, objectivity, and professional skepticism are the only relevant factors that the member needs to take into consideration when determining if the breach can be addressed by the provisions of proposed Interpretation 101-20. Although consideration as to whether the breach was intentional or not would be relevant for purposes of evaluating any disciplinary action to be taken against the member, it is not a factor in evaluating an independence impairment, and therefore need not be addressed by this interpretation.

Use of the auditor's professional judgment

Proposed Interpretation 101-20 provides (see the 2nd paragraph under *Breaches Resulting in Significant Threats*) that there is a "rebuttable presumption" that an independence breach would not be able to be addressed if the breach is: 1) committed by either the lead attest engagement partner or an individual in a position to influence the attest engagement, or 2) known to any other partner or partner equivalent who fails to ensure that the breach is promptly communicated to an appropriate individual within the firm. The rebuttable presumption only implicitly invokes the auditor's professional judgment in making a determination regarding whether the presumption can or cannot be overcome. This provision should



clarify that a member is permitted to exercise and apply his or her professional judgment in the specific circumstances to determine what, if any, actions can or cannot be taken to address the consequences of a breach of independence, irrespective of which individual(s) committed the breach and whether the breach was known to anyone else in the firm.

Communicating a breach to an appropriate individual within the firm

As noted in the preceding paragraph, proposed Interpretation 101-20 provides (see the 2nd paragraph under *Breaches Resulting in Significant Threats*) that there is a rebuttable presumption that the independence breach would not be able to be addressed if the breach is known to any other partner or partner equivalent who fails to ensure that the breach is promptly communicated to an appropriate individual within the firm. A failure to promptly communicate an independence breach to the appropriate individuals within the firm does not give rise to an independence impairment in and of itself, as it also does not cause the attest engagement team's integrity, objectivity, and professional skepticism to be compromised. This is a cause for concern particularly where the actual independence violation is not deemed to be significant and could otherwise, if not for this proposed provision, be satisfactorily addressed by certain actions after discussion with those charged with governance, as appropriate. For example, where a partner does not promptly report a breach within the firm, even if the breach is not deemed to be significant and is subsequently reported by another individual, the firm may be placed in a position where it must withdraw or withhold its attest report because, under the proposed interpretation, the firm is technically not independent and cannot take any actions to address the breach. PEEC should carefully consider the unintended consequences that may arise as a result of adopting this particular provision as proposed.

Communicating breaches "as soon as practicable"

Proposed Interpretation 101-20 requires that, when an independence breach is identified, the member should, in accordance with his or her firm's policies and procedures, promptly communicate the breach to an appropriate individual within the firm. If, upon evaluating the significance of the breach and its impact on the attest engagement team's integrity, objectivity, and professional skepticism, the responsible individual determines that action cannot be taken to satisfactorily address the consequences of the breach, the responsible individual is required to inform those charged with governance at the attest client *as soon as practicable* and take the steps necessary to terminate the attest engagement. Similarly, if the responsible individual determines that action can be taken to satisfactorily address the consequences of the breach, proposed Interpretation 101-20 requires that the responsible individual discuss the breach and the action taken or proposed to be taken with those charged with governance *as soon as practicable*.

The phrase "as soon as practicable" can be interpreted to mean "promptly," "as soon as time permits," "in the least time possible," or even "immediately." As written, the proposed interpretation leaves this phrase open to interpretation such that some might infer it to mean any number of differing time frames, if the circumstances allow. In order to eliminate any potential ambiguity, proposed Interpretation 101-20 should define "as soon as practicable" and provide clarification around what specific timing PEEC envisions for communicating breaches to those charged with governance.

PEEC should consider permitting members to establish (in consultation with those charged with governance, as appropriate) an alternate timing for reporting and discussing independence breaches that are not deemed to be significant. As proposed, Interpretation 101-20 would require *any* breach of an independence interpretation, regardless of significance, to be communicated to those charged with governance as soon as practicable. If the responsible individual determines (by applying the criteria set out in the proposed interpretation) that an independence breach is not significant and that action can be taken to satisfactorily address the consequences of the breach, proposed Interpretation 101-20 should allow the responsible individual to discuss the breach and the action he/she proposes to take with those charged with governance in accordance with the timeline and protocols agreed with those charged with



governance. PEEC should provide members with the flexibility and latitude to establish protocols and a timetable for communicating independence breaches that are not deemed to be significant based on the member's professional judgment as well as the views of those charged with governance regarding which matters should be reported and when. The appropriate timing and content of reporting, including when certain types of breaches that are not deemed to be significant should be communicated by the member (and even whether minor breaches need to be reported at all) is a determination that is best left to those charged with governance, with input from the member. From a practical standpoint, those charged with governance at the attest client may meet infrequently throughout the year. Accordingly, this may not afford the member an opportunity to discuss every independence breach with all of those charged with governance "as soon as practicable" and obtain their concurrence that action can be, or has been, taken to satisfactorily address the consequences of the breach. Alternatively, those charged with governance may see little value in the immediate reporting of breaches to the auditor's independence that are not deemed to be significant. As worded, the proposal would diminish the ability of those charged with governance to make decisions regarding how to adequately handle the auditor's breaches of independence by establishing a pre-determined timetable for communicating those breaches instead of allowing those charged with governance to establish their own timetable, one that best suits their particular facts and circumstances.

It is of interest to note that, in response to the International Ethics Standards Board for Accountants' ("IESBA") exposure draft addressing breaches, the PEEC submitted a comment letter recommending that IESBA incorporate a clause that would allow those charged with governance and the firm to exercise professional judgment to establish a protocol for the reporting of certain breaches. The comment letter recognized that those charged with governance may determine that they do not wish to be notified of trivial and inconsequential breaches that have little or no bearing on the firm's objectivity. Accordingly, PEEC recommended that IESBA adopt a standard that would provide those charged with governance with the ability to establish an appropriate policy that sets a threshold for the reporting of certain breaches of the IESBA *Code of Ethics for Professional Accountants* ("IESBA Code"). Now that PEEC is proposing its own breaches standard, it would seem reasonable for the Committee to take a similar approach as that suggested to IESBA. In fact, we would recommend that PEEC converge with IESBA in this respect and adopt a provision similar to that included in paragraph 290.46 of the IESBA Code, which explicitly states that those charged with governance may establish an alternative timing for the auditor to report less significant breaches:

If the firm determines that action can be taken to satisfactorily address the consequences of the breach, the firm shall discuss the breach and the action it has taken or proposes to take with those charged with governance. The firm shall discuss the breach and the action as soon as possible, *unless those charged with governance have specified an alternative timing for reporting less significant breaches.* [emphasis added]

It is a wholly sensible approach to provide the member and those charged with governance with the latitude to discuss and agree on protocols that allow the two parties to determine when independence breaches that are not deemed to be significant should be communicated.

Proposed effective date

If proposed Interpretation 101-20 is not modified to allow for reporting of independence breaches that are not deemed to be significant and that can be (or have been) satisfactorily addressed on an alternate timetable (versus "as soon as practicable"), once adopted, the Interpretation should not take effect immediately. The effective date should be delayed for some period of time to allow members to properly implement changes to their systems, processes, procedures, and/or policies to enable them to comply with the requirements of Interpretation 101-20. This would be consistent with, for example, the approach taken by IESBA when it adopted its own breaches standard, which did not take effect until April 1, 2014, one full year after issuance.



We would be pleased to discuss our comments and to answer any questions that you or the PEEC may have. Please contact Michael Deniszczuk (201-521-4239) regarding our submission.

Yours sincerely,

PricewaterhouseCoopers LLP

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