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# EXPOSURE DRAFT

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BREACH OF AN INDEPENDENCE INTERPRETATION

PROPOSED INTERPRETATION OF THE

AICPA PROFESSIONAL ETHICS DIVISION

**June 16, 2014**

**Comments are requested by September 16, 2014**

**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](mailto:lsnyder@aicpa.org)**

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June 16, 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 September 16, 2014. 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/2014JuneBr  
eachesExposureDraftCommentLetters.aspx](http://aicpa.org/InterestAreas/ProfessionalEthics/Community/ExposureDrafts/Pages/2014JuneBr<br/>eachesExposureDraftCommentLetters.aspx).

All comments received will be considered by the PEEC at its November 12-13, 2014 meeting.

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

Sincerely,

Wes Williams, *Chair*  
*AICPA Professional Ethics Executive Committee*

Lisa A. Snyder, *Director*  
*AICPA Professional Ethics Division*

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## **Explanation of Proposals**

The PEEC is exposing for comment revised ET section 91 *Applicability*, and new Interpretation No. 101-20, “Breach of an Independence Interpretation,” under Rule 101, *Independence* (AICPA, *Professional Standards*, ET sec. 101 par. .22), which provides guidance to members in public practice concerning a breach of an independence interpretation.

### *Breach of an Independence Interpretation*

Rule 101, *Independence*, states that a member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by council. A breach of an interpretation of the *Independence* rule would require a member’s firm to resign from an attest engagement regardless of the consequences of the breach. The PEEC believes that the public interest is not served if a firm is forced to resign from an attest engagement due to a breach of an independence interpretation if the consequences of the breach are such that they do not affect the attest engagement team’s integrity, objectivity, and professional skepticism. Under such circumstances, the PEEC believes the public interest is better served by robust guidance to assist members in evaluating the impact of the independence breach and determining whether the firm should resign from the attest engagement or whether actions could be taken to satisfactorily address the consequences of the breach. Thus, the PEEC developed the proposed interpretation, which provides guidance to assist members in evaluating and addressing the consequences of a breach of an independence interpretation.

The proposed guidance clearly states that it is not always possible to address the consequences of a breach of an independence interpretation and even if a member follows the proposed guidance and believes to have satisfactorily addressed the consequences of a breach, that does not preclude a potential investigation or enforcement action. In addition, in order for the provisions of the proposed interpretation to be able to address the consequences of a breach of an independence interpretation, the firm must have established policies and procedures designed to provide it with reasonable assurance that the firm, its personnel, and, when applicable, others subject to independence requirements, maintain independence when required. This would include policies and procedures designed to provide the firm with reasonable assurance that it is notified of breaches of an independence interpretation and to enable it to take appropriate actions to resolve such situations.

The proposed interpretation states that no action can be taken to satisfactorily address the consequences of a breach when the threat to independence resulting from the breach is significant such that the attest engagement team’s integrity, objectivity, and professional skepticism are compromised. The PEEC believes that due to the significance of the threats to the attest engagement team’s integrity, objectivity, and professional skepticism, there is a rebuttable presumption that no action may satisfactorily address a breach when the breach is committed by the lead attest engagement partner or an individual in a position to influence the attest

engagement, or when the breach is known to any other partner or partner equivalent who fails to ensure the breach is promptly communicated to an appropriate individual within the firm.

When a breach is identified, the member should communicate the breach to an appropriate individual within the firm, for example, an individual with responsibility for the policies and procedures relating to independence or the attest engagement partner (the “responsible individual”). The PEEC believes that once alerted, the responsible individual should be required to evaluate the significance of the breach, as it may be such that the member who identified the breach is not in a proper position to perform the necessary steps required to fulfill the provisions of the interpretation. Depending upon the significance of the breach, it may be necessary to terminate the attest engagement or it may be possible to take action that satisfactorily addresses the consequences of the breach. When determining if satisfactory action could be taken to address the breach, among other specific factors, the responsible individual must consider whether a reasonable and informed third party would be likely to conclude that the attest engagement team’s integrity, objectivity, and professional skepticism would not be compromised. The PEEC believes that consideration of the views of an “informed third party” is an appropriate measure in determining if the breach can be satisfactorily addressed. If it is determined that satisfactory action can be taken, then the responsible individual must discuss the breach, and the actions he or she proposes to take to address the breach with those charged with governance. The specific matters to be discussed are outlined within the proposed interpretation. Those charged with governance must be satisfied that the actions to be taken to address the breach are appropriate and satisfactorily address the consequences of the breach in order for the firm to continue the attest engagement.

The proposed guidance requires the responsible individual to document certain factors involving the breach, including the communication to those charged with governance. The PEEC believes that a breach of an independence interpretation is of great significance and thus, documentation of the breach, actions taken, and matters discussed should be required.

#### *ET Section 91*

Proposed Interpretation No. 101-20 addresses breaches of an independence interpretation. The PEEC agreed to include guidance concerning breaches of all other provisions of the AICPA Code of Professional Conduct (the code) within ET section 91, *Applicability*. The guidance requires the member to evaluate the significance of the breach and take action to satisfactorily address the breach. In doing so, the member is required to consider whether a reasonable and informed third party would likely conclude that the member is able to comply with the code. The PEEC believes that these robust requirements are the core of proposed Interpretation No. 101-20 without the additional requirements that are specific to independence. Consistent with proposed Interpretation No. 101-20, a member’s determination that the member has satisfactorily addressed the consequences of the breach would not preclude an investigation or enforcement action concerning the underlying breach of the code.

In developing the proposed guidance, the PEEC has considered the new ethics standards issued by the International Ethics Standards Board for Accountants (IESBA) in March 2013 related to addressing a breach of a requirement of the IESBA Code of Ethics for Professional Accountants (IESBA code). The PEEC believes the proposed interpretation is substantially consistent with the guidance contained in the IESBA code related to breaches of the IESBA independence provisions, and any differences are necessary to make the proposed interpretation relevant to AICPA members practicing in the United States.

### **Effective Date**

PEEC does not believe that a delayed effective date for transition purposes is necessary. Accordingly, PEEC proposes that, if adopted, the proposed interpretation and revisions to ET section 91, *Applicability*, apply to breaches identified on or after the effective date, which will be the last day of the month in which the interpretation and revisions to ET section 91 are published in the *Journal of Accountancy*. However, see request for specific comments below.

### **Request for Specific Comments**

Although PEEC welcomes comments on all aspects of these proposals, it specifically requests feedback on the following:

Do you believe that a delayed effective date is necessary? If so, please explain why you believe additional time to implement the proposed interpretation and revisions to ET section 91 would be necessary and how much time you believe would be adequate.

## **Text of Proposed Revised Applicability ET Section 91**

*(Additions appear in boldface italic, and deletions are ~~stricken~~.)*

### **ET Section 91 – Applicability**

**As adopted January 12, 1988, unless otherwise indicated**

**.01** The bylaws of the AICPA require that members adhere to the rules of the Code of Professional Conduct. Members must be prepared to justify departures from these rules.

**.02** *Interpretation Addressing the Applicability of the AICPA Code of Professional Conduct.* For purposes of the applicability section of the code, a member is a member, an associated member, or an international associate of the AICPA [[sec. 92 par.21](#)].

1. The Rules of Conduct that follow apply to all professional services performed except
  - a. when the wording of the rule indicates otherwise
  - b. that a member who is practicing outside the United States will not be subject to discipline for departing from any of the rules stated herein as long as the member's conduct is in accord with the rules of the organized accounting profession in the country in which he or she is practicing. However, when a member's name is associated with financial statements under circumstances that would entitle the reader to assume that U.S. practices were followed, the member must comply with the requirements of rules 202, *Compliance With Standards* [[sec. 202 par. 01](#)], and 203, *Accounting Principles* [[sec. 203 par. 01](#)].
  - c. a member who is a member of a group engagement team (see the clarified SAS *Special Considerations—Audits of Group Financial Statements [Including the Work of Component Auditors]*) will not be subject to discipline if a foreign component auditor (accountant) departed from any of the ethics requirements stated herein with respect to the audit or review of group financial statements or other attest engagement, as long as the foreign component auditor's (accountant's) conduct, at a minimum, is in accord with the ethics and independence requirements set forth in the International Ethics Standards Board for Accountants' (IESBA's) Code of Ethics for Professional Accountants, and the members of the group engagement team are in compliance with the rules stated herein.
  - d. a member who is a member of a network firm (as defined in [paragraph .24 of section 92, Definitions](#)) will not be subject to discipline if a firm within the network (as defined in [paragraph .23 of section 92](#)) that is located outside the United States (foreign network firm) departed from any of the ethics requirements stated herein, as long as the foreign network firm's conduct, at a minimum, is in accord with the ethics and independence requirements set forth in the IESBA's Code of Ethics for Professional Accountants.

2. A member shall not knowingly permit a person, whom the member has the authority or capacity to control, to carry out on his or her behalf, either with or without compensation, acts that, if carried out by the member, would place the member in violation of the rules. Further, a member may be held responsible for the acts of all persons associated with him or her in public practice whom the member has the authority or capacity to control.
3. A member (as defined in [paragraph .21 of section 92](#)) or a covered member (as defined in [paragraph .07 of section 92](#)) may be considered to have his or her independence impaired, with respect to a client, as the result of the actions or relationships of certain persons or entities, as described in rule 101, [[sec. 101 par. 01](#)], and its interpretations and rulings, whom the member or covered member does not have the authority or capacity to control. Therefore, nothing in this section should lead one to conclude that the member's or covered member's independence is not impaired solely because of his or her inability to control the actions or relationships of such persons or entities.

***.03 Interpretation No. 101-20 under ET Section 101, Independence, contains guidance with which a member should comply with if the member identifies a breach of an independence provision of the code. If a member identifies a breach of any other provision of this Code, the member should evaluate the significance of the breach and its impact on the member's ability to comply with the rules of the code. The member should take whatever actions may be available, as soon as practicable, to satisfactorily address the consequences of the breach. The member should determine whether to report the breach, for example, to those who may have been affected by the breach, a professional body, relevant regulator or oversight authority. In making the evaluation and in determining what actions should be taken, the member should exercise professional judgment and take into account whether a reasonable and informed third party, weighing the significance of the breach, the action to be taken, and all the specific facts and circumstances available to the member at that time, would be likely to conclude that the member is able to comply with the rules of the code. A member's determination that the member has satisfactorily addressed the consequences of the breach will not, however, preclude an investigation or enforcement action concerning the underlying breach of the code and the member should be prepared to justify such determination.***

## **Text of Proposed New Interpretation No. 101-20—Breach of an Independence Interpretation**

### ***Introduction***

AICPA bylaws require members to comply with the *Independence* rule. This interpretation provides guidance to assist members in evaluating and addressing the consequences of a breach of an independence interpretation and the impact on the attest engagement team's integrity, objectivity, and professional skepticism so the member or member's firm can determine if the consequences of a breach can be satisfactorily addressed. This interpretation also provides specific steps and actions the member should take when the member becomes aware that a breach of an independence interpretation has occurred. However, a member's determination that he or she has satisfactorily addressed the consequences of a breach of an independence interpretation will not preclude an investigation or enforcement action. In any case, the member should be prepared to justify such determination.

### ***Required Policies and Procedures Established by the Firm***

In order for the consequences of an independence breach by a member or the member's firm to be able to be addressed by the provisions of this interpretation, the firm must have established policies and procedures designed to provide it with reasonable assurance that the firm, its personnel, and, when applicable, others subject to independence requirements, maintain independence when required. The policies and procedures should enable the firm to communicate its independence requirements to its personnel and, when applicable, others subject to them; to identify and evaluate circumstances and relationships that create threats to independence; and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards or, if effective safeguards cannot be applied, withdrawing from the engagement. These policies and procedures should be designed to provide the firm with reasonable assurance that it is notified of breaches of independence requirements and to enable it to take appropriate actions to resolve such situations.

### ***Breaches Resulting in Significant Threats***

In situations where a partner or professional employee of the firm intentionally and knowingly breaches an independence interpretation or breaches an independence interpretation due to ignorance or negligence, and the threat to independence resulting from the breach is significant such that the attest engagement team's integrity, objectivity and professional skepticism are compromised, the consequences of the breach would not be able to be addressed by the provisions of this interpretation as no actions could be taken to satisfactorily address the consequences of breach.

In other situations, where either of the following conditions exist, there is a rebuttable presumption that the breach would not be able to be addressed by the provisions of this interpretation as the threats to the attest engagement team's integrity, objectivity, and professional skepticism would be considered so significant that no actions could be taken to satisfactorily address the consequences of breach:

- a. A partner or professional employee that committed the breach is either the lead attest engagement partner or an individual in a position to influence the attest engagement; or
- b. The breach is known to any other partner or partner equivalent who fails to ensure the breach is promptly communicated to an appropriate individual within the firm as described in this interpretation.

(See the “Unsolicited Financial Interests” section of Interpretation No. 101-15, “Financial Relationships” [ET section 101.17], for guidance on unsolicited financial interests.)

### ***Identifying and Communicating a Breach***

When a 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, for example, an individual or individuals with responsibility for the policies and procedures relating to independence, or the attest engagement partner (the “responsible individual”).

The responsible individual should report the breach to those who need to take appropriate action and, where appropriate, to relevant network firms. The responsible individual should be satisfied that the interest or relationship that caused the breach has been terminated, suspended, or eliminated and address the consequences of the breach. A consequence of a breach may be that termination of the attest engagement is necessary.

### ***Evaluating the Significance of a Breach***

The responsible individual should evaluate the significance of the breach and its impact on the attest engagement team’s integrity, objectivity, and professional skepticism and the ability to issue an attest report. The significance of the breach will depend on factors such as the following:

- a. The nature and duration of the breach
- b. The number and nature of any previous breaches with respect to the current attest engagement
- c. Whether a member of the attest engagement team had knowledge of the interest or relationship that caused the breach
- d. Whether the individual who caused the breach is a member of the attest engagement team or another individual for whom there are independence requirements
- e. The role of the individual if the breach relates to a member of the attest engagement team
- f. The impact of the service, if any, on the accounting records or the amounts recorded in the attest client’s financial statements if the breach was caused by the provision of a professional service
- g. The extent of the self-interest, advocacy, undue influence, or other threats created by the breach

### ***Addressing the Consequences of a Breach***

Depending upon the significance of the breach, it may be necessary to terminate the attest engagement or it may be possible to take action that satisfactorily addresses the consequences of the breach. Certain breaches described in this interpretation are not able to be addressed by the provisions of this interpretation. For all other breaches, the responsible individual should

determine whether satisfactory action can be taken and is appropriate in the circumstances. In making this determination, the responsible individual should exercise professional judgment and take into account whether a reasonable and informed third party, weighing the significance of the breach, the action to be taken, and all the specific facts and circumstances available to the member at that time, would be likely to conclude that the attest engagement team's integrity, objectivity, and professional skepticism would be compromised and therefore whether independence is impaired.

Examples of actions that the responsible individual may consider include the following:

- a. Removing the relevant individual from the attest engagement team
- b. Conducting an additional review of the affected attest work or re-performing that work to the extent necessary, in either case using different personnel
- c. Recommending that the attest client engage another firm to review or re-perform the affected attest work to the extent necessary
- d. Engaging another firm to evaluate the results of the nonattest service or having another firm re-perform the nonattest service to the extent necessary to enable it to take responsibility for the service if the breach relates to a nonattest service that affects the accounting records or an amount that is recorded in the financial statements

### ***Communicating With Those Charged with Governance***

If the responsible individual determines that action cannot be taken to satisfactorily address the consequences of the breach, the responsible individual should inform those charged with governance as soon as practicable and take the steps necessary to terminate the attest engagement in compliance with any applicable legal or regulatory requirements relevant to terminating the attest engagement. Where termination is not permitted by law or regulation, the responsible individual should comply with any reporting or disclosure requirements.

If the responsible individual determines that action can be taken to satisfactorily address the consequences of the breach, the responsible individual should discuss the breach and the action taken or proposed to be taken with those charged with governance as soon as practicable. The matters to be discussed should include the following:

- a. The significance of the breach, including its nature and duration
- b. How the breach occurred and how it was identified
- c. The action taken or proposed to be taken and the responsible individual's rationale for why the action will satisfactorily address the consequences of the breach and enable the firm to issue the attest report
- d. The conclusion that, in the responsible individual's professional judgment, the integrity, objectivity, and professional skepticism of the attest engagement team has not been compromised and the rationale for that conclusion
- e. Any steps that the responsible individual has taken or proposes to take to reduce or avoid the risk of further breaches occurring

The responsible individual should communicate in writing with those charged with governance all matters discussed in accordance with the paragraph above and obtain the concurrence of those

charged with governance that action can be, or has been, taken to satisfactorily address the consequences of the breach. The communication shall include a description of the firm's policies and procedures relevant to the breach designed to provide it with reasonable assurance that independence is maintained and any steps that the firm has taken, or proposes to take, to reduce or avoid the risk of further breaches occurring. If those charged with governance do not concur that the action satisfactorily addresses the consequences of the breach, the responsible individual should take the steps necessary to terminate the attest engagement, where permitted by law or regulation, in compliance with any applicable legal or regulatory requirements relevant to terminating the attest engagement. Where termination is not permitted by law or regulation, the responsible individual should comply with any reporting or disclosure requirements.

### ***Breaches Relating to Previously Issued Reports***

If the breach occurred prior to the issuance of the previous attest report, the responsible individual should comply with this section in evaluating the significance of the breach and its impact on the attest engagement team's objectivity, integrity, and professional skepticism and its ability to issue an attest report in the current period. The responsible individual should also consider the impact of the breach, if any, on the attest engagement team's integrity, objectivity, and professional skepticism in relation to any previously issued attest reports, and the possibility of withdrawing such attest reports in accordance with professional standards, and discuss the matter with those charged with governance.

### ***Documentation***

The responsible individual should document the breach, the action taken, key decisions made and all the matters discussed with those charged with governance and any discussions with a professional body, relevant regulator, or oversight authority. When the firm continues with the attest engagement, the matters to be documented should also include the conclusion that, in the responsible individual's professional judgment, the integrity, objectivity, and professional skepticism of the attest engagement team have not been compromised and the rationale for why the action taken satisfactorily addressed the consequences of the breach such that the firm could issue an attest report.