Ethics interpretations and other guidance are promulgated by the executive committee of the Professional Ethics Division to provide guidelines about the scope and application of the rules but are not intended to limit such scope or application. Publication in the Journal of Accountancy constitutes notice to members. A member who departs from these guidelines shall have the burden of justifying such departure in any disciplinary hearing.

The Professional Ethics Executive Committee (PEEC) has adopted the following:

- Revised interpretations under the “Independence Rule” (ET sec. 1.200.001)
  — “Leases” (ET sec. 1.260.040)
  — “Client Affiliates” (ET sec. 1.224.010)

- New interpretation under the “Confidential Client Information Rule” (ET sec. 1.700.001)
  — “Disclosing Information in Connection with a Quality Review” (ET sec. 1.700.110)
Text of Revised “Leases” Interpretation
(Additions are in boldface italic, and deletions are in strikethrough)

1.260.040 Leases

.01 When a covered member enters into or has a leasing agreement with an attest client during the period of the professional engagement, the self-interest, familiarity, and undue influence threats to the covered member’s compliance with the “Independence Rule” [1.200.001] may exist. would be at an acceptable level and independence would not be impaired if all the following safeguards are met:

a. The lease meets the criteria of an operating lease (as described in GAAP).
b. The terms and conditions set forth in the lease agreement are comparable with other leases of a similar nature.
c. All amounts are paid in accordance with the lease terms or provisions.


New or Renegotiated Leases

.02 Threats to compliance with the “Independence Rule” [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards, and independence would be impaired, if a covered member has a lease that meets the criteria of a capital lease (as described in GAAP). Accordingly, independence would be impaired because the lease would be considered to be a loan with an attest client. This paragraph excludes a lease that is in compliance with the “Loans and Leases With Lending Institutions” interpretation [1.260.020] of the “Independence Rule.” [Prior reference: paragraphs .182–.183 of ET section 191]

If a covered member who is an individual on the attest engagement team, an individual in a position to influence the attest engagement, or the firm enters into a lease or renegotiates terms of an existing lease with an attest client during the period of the professional engagement, threats to compliance with the “Independence Rule” [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards. Independence would be impaired, unless all of the following safeguards are met at the time of entering into or renegotiating the lease:

a. The lease is on market terms and established at arm’s length.
b. The lease is not material to any of the parties to the lease. When evaluating materiality, all leases between the covered member and the attest client should be considered in the aggregate.

.03 Once the covered member enters into or renegotiates the lease, threats to the covered member’s compliance with the “Independence Rule” [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards, and independence would be impaired if the lease amounts are not paid in accordance with the lease terms or provisions by the due date or within any available grace periods during the period of the professional engagement.

Existing Leases

.04 Under the circumstances in paragraph .05, the covered member should evaluate the significance of any threats to determine whether the threats are at an acceptable level. If the covered member determines that threats are not at an acceptable level, the
covered member should apply safeguards to eliminate or reduce the threats to an acceptable level. If no safeguards are available to eliminate or reduce threats to an acceptable level, independence would be impaired.

05 A covered member who is an individual on the attest engagement team, an individual in a position to influence the attest engagement, or the firm has a lease with an attest client that was

a. entered into or renegotiated prior to the
   i. period of the professional engagement,
   ii. member becoming a covered member, or
   iii. counterparty becoming an attest client or an affiliate of a financial statement attest client, or

b. entered into or renegotiated during the period of the professional engagement, in compliance with paragraph .02, but, due to a change in circumstances after the lease is entered into or renegotiated, the lease becomes material to any party to the lease during the period of the professional engagement.

06 The significance of the threats will depend on factors such as the following:

a. The role of the covered member on the attest engagement or with the firm
b. The materiality of the lease to the covered member or the attest client during the period of the professional engagement
c. Whether multiple leases exist with the attest client and, if so, the aggregate materiality of those leases to the covered member or the attest client
d. The extent to which the lease will be subject to attest procedures or financial statement disclosures
e. The duration of the lease term
f. Whether the lease is on market terms or established at arm’s length

07 However, threats to compliance with the “Independence Rule” [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards, and independence would be impaired, if the lease amounts are not paid in accordance with the lease terms or provisions by the due date or within any available grace periods during the period of the professional engagement.

Applicability

08 This interpretation excludes leases addressed by paragraph .04 of the “Loans and Leases with Lending Institutions” interpretation [1.260.020] under the “Independence Rule” [1.200.001].


010 This interpretation is effective for fiscal years beginning after December 15, 2019, with early implementation allowed.
[See Revision History Table.]
1.224.010 Client Affiliates

.01 Financial interests in, and other relationships with, affiliates of a financial statement attest client may create threats to a member’s compliance with the “Independence Rule” [1.200.001]. When a client is a financial statement attest client, members should apply the “Independence Rule” [1.200.001] and related interpretations applicable to the financial statement attest client to their affiliates, except in the following situations:

a. A covered member may have a loan to or from an individual who is an officer, a director, or a 10 percent or more owner of an affiliate of a financial statement attest client during the period of the professional engagement unless the covered member knows or has reason to believe that the individual is in such a position with the affiliate. If the covered member knows or has reason to believe that the individual is an officer, a director, or a 10 percent or more owner of the affiliate, the covered member should evaluate the effect that the relationship would have on the covered member’s independence by applying the “Conceptual Framework for Independence” [1.210.010].

b. A member or the member’s firm may provide prohibited nonattest services to entities described under items c–l of the definition of affiliate during the period of the professional engagement or during the period covered by the financial statements, provided that it is reasonable to conclude that the services do not create a self-review threat with respect to the financial statement attest client because the results of the nonattest services will not be subject to financial statement attest procedures. For any other threats that are created by the provision of the nonattest services that are not at an acceptable level (in particular, those relating to management participation), the member should apply safeguards to eliminate or reduce the threats to an acceptable level.

c. A firm will only have to apply the “Subsequent Employment or Association With an Attest Client” interpretation [1.279.020] of the “Independence Rule” if the former employee, by virtue of his or her employment at an entity described under items c–l of the definition of affiliate, is in a key position with respect to the financial statement attest client. Individuals in a position to influence the attest engagement and on the attest engagement team who are considering employment with an affiliate of a financial statement attest client will still need to report consideration of employment to an appropriate person in the firm and remove themselves from the financial statement attest engagement, even if the position with the affiliate is not a key position.

d. A covered member’s immediate family members and close relatives may be employed in a key position at an entity described under items c–l of the definition of affiliate during the period of the professional engagement or during the period covered by the financial statements, provided they are not in a key position with respect to the financial statement attest client.
e. A covered member who is an individual on the attest engagement team, an
individual in a position to influence the attest engagement, or the firm may have
a lease that does not meet the requirements of the “Leases” interpretation
[1.260.040] under the “Independence Rule” [1.200.001] with an entity described
under items c–l of the definition of affiliate during the period of the professional
engagement. The covered member should use the “Conceptual Framework for
Independence” [1.210.010] to evaluate whether any threats created by the lease
are at an acceptable level. If the covered member concludes that threats are not
at an acceptable level, the covered member should apply safeguards to eliminate
the threats or reduce them to an acceptable level.

[Paragraphs .03–.09 are unchanged.]

[See Revision History Table.]
Text of New Interpretation “Disclosing Client Information in Connection With a Quality Review”

1.700.110 Disclosing Client Information in Connection With a Quality Review

.01 For purposes of the “Confidential Client Information Rule” [1.700.001], a review of a member’s professional practice includes a quality review of a member’s tax practice (for example, a voluntary tax practice review) performed under the monitoring function of the member’s tax practice quality control policies and procedures. When a member uses a third party to perform such reviews of the member’s tax practice, threats to compliance with the “Confidential Client Information Rule” [1.700.001] may exist.

.02 To reduce the threat to an acceptable level, the member should, at a minimum, be satisfied that the member complies with the requirements of Treasury Regulation 301.7216-2(p) and any applicable state or local regulations related to disclosures of any federal, state, or local tax return information during such reviews. In addition, the member should be satisfied that the third-party reviewer is aware of and subject to the requirements of Treasury Regulation 301.7216-2(p) and any applicable state or local regulations. If the member determines that threats have not been reduced to an acceptable level, the member should apply additional safeguards to reduce the threats to an acceptable level (for example, enter into a written confidentiality agreement with the reviewer or de-identify tax return information provided to the reviewer).

.03 Members who perform such reviews should not use to their advantage or disclose any confidential client information that comes to their attention during the review. Members should refer to Treasury Regulation 301.7216-2(p) and any applicable state or local regulations for further guidance related to tax return information obtained during such reviews.