



PROFESSIONAL ETHICS EXECUTIVE COMMITTEE

Open Meeting Agenda

**August 8, 2018
New York, NY**



AICPA Professional Ethics Executive Committee
Open Agenda
August 8, 2018
New York, NY

Open Meeting : Phone Access: +1 669 900 6833 (US Toll) or +1 646 876 9923 (US Toll) Meeting ID: 581 992 803 Web Access: https://aicpa.zoom.us/j/581992803		
August 8 th	<i>Open Meeting Begins</i>	
9:00 a.m. – 9:10 a.m.	Welcome Mr. Burke will welcome the Committee members and discuss administrative matters.	
9:10 a.m. – 11:00 a.m.	Leases Mr. Mercer and Ms. Snyder will request the Committee's approval to adopt the revised proposal. ❖ External Link – Leases Exposure Draft ❖ External Link – Comment Letters	Agenda Item 1A Agenda Item 1B
11:00 a.m. – 11:15 a.m.	<i>Break</i>	
11:15 a.m. – 12:30 p.m.	State and Local Government Ms. Miller and Ms. Gorla will discuss revisions to the proposal based upon comment letters received, and will seek the Committee's approval to re-expose the proposal. ❖ External Link – SLG Exposure Draft ❖ External Link – Comment Letters	Agenda Item 2A Agenda Item 2B Agenda Item 2C Agenda Item 2D
12:30 p.m. – 1:30 p.m.	<i>Lunch</i>	
1:30 p.m. – 1:35 p.m.	Disclosing Client Information In Connection With A Quality Review Mr. Mercer will update the Committee on comment letters received to date. ❖ External Link: Exposure Draft	
1:35 p.m. – 2:45 p.m.	Staff Augmentation Ms. Snyder and Mr. Mercer will request that the Committee approve exposure of the Task Force's revised proposal for comment.	Agenda Item 3A Agenda Item 3B
2:45 p.m. – 3:45 p.m.	Information Technology and Cloud Services Ms. VanDyne and Ms. Gorla will update the Committee on the comment letters received on the Information Systems Services exposure draft and will seek the Committee's input on the frequently asked questions	Agenda Item 4A Agenda Item 4B Agenda Item 4C

	<p>developed by staff to address questions received related to the Hosting Services interpretation.</p> <ul style="list-style-type: none"> ❖ External Link – Information Systems Services Exposure Draft ❖ External Link – Comment Letters 	
3:45 p.m. – 4:00 p.m.	<i>Break</i>	
4:00 p.m. – 4:15 p.m.	<p>NOCLAR Mr. Denham will update the Committee on the Task Force's progress.</p> <ul style="list-style-type: none"> ❖ External Link – NOCLAR Exposure Draft ❖ External Link – Comment Letters 	
4:15 p.m. – 4:25 p.m.	<p>IESBA Update Ms. Gorla will update the Committee on recent IESBA activity.</p>	
4:25 p.m. – 4:30 p.m.	<p>Minutes of the Professional Ethics Executive Committee Open Meeting The Committee is asked to approve the minutes from the May 2018 open meeting.</p>	Agenda Item 5
	<i>Open Meeting Concludes</i>	
4:30 p.m. – 4:45 p.m.	<i>Break</i>	
4:45 p.m.	<i>Closed Meeting Begins</i>	
Informational Purposes Only	<p>Other Outstanding Exposure Drafts and Other Items</p> <ul style="list-style-type: none"> ❖ External Link – Technical Correction 	
Informational Purposes Only	<p>Committee Project Agenda</p> <ul style="list-style-type: none"> ❖ External Link - Project Agenda 	
	<p>Future Meeting Dates</p> <ul style="list-style-type: none"> • November 7-8, 2018 – Durham, NC • February 2019 – TBD • May 2019 – TBD • July/August 2019 – TBD 	

**Professional Ethics Executive Committee
Leases Task Force**

Task Force Members

Lisa Snyder (Chair), Bill Mann, Chris Cahill, Nancy Miller, David East, Brian Lynch
Staff: Brandon Mercer

Task Force Charge

Revise the independence guidance based upon the revised accounting standards on leases issued by the Financial Accounting Standards Board (FASB).

Reason for Agenda Item

The purpose of the agenda item is to obtain PEEC feedback on and approval of suggested revisions to the exposed standard. The Task Force requests that PEEC approve revisions as recommended in this agenda item, and approve the revised standard for adoption.

Background

The AICPA received seven (7) comment letters on the Leases Exposure Draft. The Task Force held two conference calls in March and April to discuss the comment letters. At the May 2018 PEEC meeting, the Task Force requested feedback on some possible revisions pursuant to the comments and Task Force discussions. The Task Force held two conference calls in June 2018 to address the feedback received from PEEC and to make revisions to the proposed standard. The Task Force's suggested revisions are presented in this agenda item and at **Agenda Item 1B**.

Summary of Issues**Revisions to Paragraph .02**

At the May 2018 PEEC meeting, some members noted that the safeguards required in paragraph .02 for leases of specific covered members were not necessarily applicable on an ongoing basis and questioned whether more clarity was necessary to indicate which safeguards were required when entering into a lease and which were required during the lease period. It was also requested that the Task Force consider alternate terms related to the payment compliance safeguard in .02b to make it clear that any grace periods would be included as a consideration. It was also suggested that the Task Force consider streamlining item .02c.

Some members also noted during the May 2018 PEEC meeting that the proposal should be clearer about when a renewal would be considered a new lease. The Task Force's view is that the renegotiation of terms is the primary aspect of a renewal that would create a potential threat to independence. The Task Force determined that addition of the phrase "*renegotiates terms of an existing lease*" should be added to the paragraph to make it clear that renegotiated terms would be considered entering into a new lease. Conforming revisions are also suggested in other paragraphs of the proposal where entry of a lease is specifically noted, as reflected at **Agenda Item 1B**.

The Task Force discussed PEEC's comments and the clarity and applicability of paragraph .02, and requests that PEEC approve the highlighted revisions below to paragraph .02 of the exposure draft.

.02 If a covered member who is an individual participating 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, and independence would be impaired, unless all of the following safeguards are met during that period:

- a. The lease is entered into or renegotiated on market terms and established at arm's length,
- b. All amounts are paid in accordance with the lease terms or provisions, including any available grace periods, and
- c. The lease is not material to either the attest client or the covered member who is an individual participating on the attest engagement team, an individual in a position to influence the attest engagement, or the firm that are counterparties ~~any of the following parties to the lease.~~
 - i. ~~The firm;~~
 - ii. ~~An individual participating on the attest engagement team;~~
 - iii. ~~An individual in a position to influence the attest engagement;~~
 - iv. ~~The attest client.~~

Action Needed: The Task Force requests that PEEC approve the highlighted revisions to the exposure draft above, specifically:

- Renegotiation of terms of an existing lease
- Available grace periods
- Streamlining of item .02c

New Paragraph .03 – Existing Leases of Specific Covered Members

During the Task Force's discussions regarding grandfathered leases and materiality, it was noted that a member could enter into a material lease just prior to becoming a covered member, and that there was no requirement to evaluate such leases using a threats and safeguards approach. In addition, the Task Force agreed that such leases with specific covered members noted in paragraph .02 should be evaluated using a threats and safeguards approach. The addition of the new paragraph .03 addresses those leases as well as leases that were

“grandfathered” under the exposed proposal. In addition, the Task Force agreed that such leases would create significant threats to independence if the specific covered member failed to pay any amounts due under the lease terms, and included a separate section of the paragraph below to address that position.

.03 If a covered member specified in paragraph .02 has a lease with the attest client which was entered into or renegotiated:

- i) prior to the period of the professional engagement,**
- ii) prior to the member becoming a covered member, or**
- iii) prior to the counterparty becoming an attest client,**

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.

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. **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. **Duration of the lease term**
- f. **Whether the lease has terms that are not market terms or at arm's length**

However, threats would not be at an acceptable level and independence would be impaired if the lease amounts are not paid in accordance with the lease terms or provisions, including any available grace periods, during the period of professional engagement.

Action Needed:

Does PEEC agree with the Task Force’s suggested addition of paragraph .03 above?

Does PEEC agree that, in the case of the covered members specified in paragraphs .02 and .03, threats would not be an acceptable level if lease amounts are not paid in accordance with the lease terms, regardless of when the lease was entered into?

Revisions to Paragraph .04 (renumbered) – Covered Members Except Those in .02/.03

The Task Force agreed to revise paragraph .04 (formerly exposed paragraph .03) to address all covered members that are not specified in paragraph .02, including leases that existed prior to the member becoming a covered member or the counterparty becoming an attest client. As previously agreed to by PEEC, the paragraph uses a “knows or has reason to believe” standard in identifying leases that create significant threats to independence.

- .04 **If a covered member other than those specified in paragraph .02 of this interpretation knows or has reason to believe that a lease between that covered member and the attest client creates significant threats to independence,** ~~If the covered member meets the safeguards in paragraph .02, as applicable, the covered member should evaluate the significance of **the** any other 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 additional 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.~~

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. Materiality of the lease to the *covered member* other than those *covered members* identified in paragraph .02 during the period of professional engagement
- c. Whether multiple leases ~~**exist**~~ are entered into 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. **Duration of the lease term**
- f. **Whether the lease has terms that are not market terms or at arm's length**
- g. **Whether all amounts are paid in accordance with lease terms or provisions, including any available grace periods, during the period of professional engagement**

Action Needed:

Does PEEC agree with the highlighted revision to paragraph .04g above?

Does PEEC agree with the inclusion of item g as a factor to evaluate the significance of threats in paragraph .04 for other covered members, rather than a requirement as treated in paragraph .03 for specific covered members?

Revised Grandfathered Leases / Transition Paragraph

Pursuant to the suggested revisions to prior paragraphs, and as suggested by commenters, the leases that were in the exposed “grandfathering” paragraph are now addressed in the revised paragraphs .02-.04. The proposed revisions to paragraph .05 (renumbered, below) address leases that were in existence under the previously effective independence rules. Note that additional edits to this paragraph were made pursuant to the Task Force’s previously noted discussions regarding renegotiation of a lease.

Grandfathered Leases Transition

.05 Irrespective of materiality, *threats* to compliance with the “Independence Rule” [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired if* provided that the lease **existed prior to December 15, 2019, and the lease was permitted under the preexisting requirements of the “Independence Rule” [1.200.001] and its interpretations, and** ~~is entered into on market terms and established at arm’s length, and during the period of professional engagement all amounts are paid in accordance with the lease terms and provisions, the terms~~ **are not renegotiated** ~~do not change in any manner not provided for in the original lease~~ **during the period of the professional engagement**, and any of the following conditions are met:

- a. ~~The covered member entered into the lease with the attest client prior to becoming a covered member with respect to the attest client.~~
- b. ~~The covered member entered into the lease with a counterparty for which independence was not required, and that counterparty to the lease later becomes, acquires, or is acquired by an attest client.~~
- c. ~~The attest client entered into the lease with a counterparty which was not required to be independent of the attest client, and that counterparty to the lease later acquires or is acquired by the covered member.~~
- d. ~~The lease existed prior to December 15, 2019 and the lease was permitted under the preexisting requirements of the “Independence Rule” [1.200.001] and its interpretations.~~

Automatic renewals provided for in the original lease are not considered **a renegotiation of the** ~~changes in terms~~ for purposes of this interpretation.

Action Needed:

Does PEEC agree with the revisions to paragraph .05 above which would apply to existing operating leases?

Are there any other leases that should be grandfathered under the Interpretation?

Affiliates – New Paragraph .07 and Affiliates Interpretation [1.224]

The Task Force believed that it was appropriate to include a reference to the “Client Affiliates” interpretation [1.224.010] for additional guidance on client affiliate scenarios, similar to a related reference contained in the extant AICPA Code’s financial interest provisions, as shown below. In addition, the Task Force proposes the addition of an exception in that interpretation as shown below.

.07 Refer to the “Client Affiliates” interpretation [1.224.010] of the “Independence Rule” [1.200.001] for additional guidance. [Prior reference: paragraph .17 of ET section 101]

Client Affiliates Interpretation [1.224.010]

When a covered member who is an individual participating on the attest engagement team, an individual in a position to influence the attest engagement, or the firm has a lease 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” interpretation [ET sec. 1.210.010] to evaluate the significance of the threats created by the lease relationship and apply safeguards, if necessary, to eliminate or reduce the threats to an acceptable level.

The Committee should note that for all other covered members, lease relationships with the client or client affiliates would be subject to an evaluation of threats and safeguards under paragraph .04 and therefore an exception for affiliates is unnecessary.

Action Needed:

Does PEEC agree with the drafted exception above and the addition of paragraph .07 to the proposed standard as noted above?

Effective Date

Some commenters requested a one-year delay in the effective date in order to allow firms to implement appropriate identification, evaluation, and monitoring procedures. The Task Force believes this is appropriate.

Action Needed:

Question for PEEC: Does PEEC agree that a one-year delay in effective date is appropriate?

Action Needed

Staff requests that PEEC discuss the suggested revisions above and determine whether it is appropriate to adopt the proposed standard, as revised, at this time.

While the Task Force does not believe re-exposure of the Interpretation is necessary, the Committee is asked to consider whether the revisions made have substantively changed the exposed standards and if it should be re-exposed.

Materials Presented

Agenda Item 1B: Suggested Revisions to Exposed Proposal

Suggested Revisions to Exposed “Leases” Interpretation**Markup Version [Additions appear in boldface italic and deletions are in strikethrough.]****1.260.040 Leases**

- .01 When a *covered member* enters into a lease with an attest client, self-interest, familiarity, and undue influence threats to the covered member’s compliance with the “Independence Rule” [1.200.001] may exist.

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

- .02 If a *covered member* **who is an individual participating 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*, and *independence* would be *impaired*, unless all of the following *safeguards* are met during that period:

- a. The lease is entered into **or renegotiated** on market terms and established at arm’s length,
- b. All amounts are paid in accordance with the lease terms or provisions, **including any available grace periods, and**
- c. The lease is not material to **either the attest client or the covered member who is an individual participating on the attest engagement team, an individual in a position to influence the attest engagement, or the firm that are counterparties** any of the following parties to the lease:
 - i. ~~The firm;~~
 - ii. ~~An individual participating on the attest engagement team;~~
 - iii. ~~An individual in a position to influence the attest engagement;~~
 - iv. ~~The attest client.~~

- .03 **If a covered member specified in paragraph .02 has a lease with the attest client which was entered into or renegotiated:**

- i) prior to the period of the professional engagement,**
- ii) prior to the member becoming a covered member, or**
- iii) prior to the counterparty becoming an attest client,**

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.

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. *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. *Duration of the lease term*
- f. *Whether the lease has terms that are not market terms or at arm's length*

However, threats would not be at an acceptable level and independence would be impaired if the lease amounts are not paid in accordance with the lease terms or provisions, including any available grace periods, during the period of professional engagement.

- .04 *If a covered member other than those specified in paragraph .02 of this interpretation knows or has reason to believe that a lease between that covered member and the attest client creates significant threats to independence,* ~~If the covered member meets the safeguards in paragraph .02, as applicable, the covered member should evaluate the significance of the any other 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 additional 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.~~

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. Materiality of the lease to the *covered member* other than those *covered members* identified in paragraph .02 during the period of professional engagement

- c. Whether multiple leases **exist** ~~are entered into~~ 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. **Duration of the lease term**
- f. **Whether the lease has terms that are not market terms or at arm's length**
- g. **Whether all amounts are paid in accordance with lease terms or provisions, including any available grace periods, during the period of professional engagement**

Grandfathered Leases Transition

.05 Irrespective of materiality, *threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired if* provided that the lease **existed prior to December 15, 2019, and the lease was permitted under the preexisting requirements of the "Independence Rule" [1.200.001] and its interpretations, and** ~~is entered into on market terms and established at arm's length, and during the period of professional engagement all amounts are paid in accordance with the lease terms and provisions, the terms~~ **are not renegotiated** ~~do not change in any manner not provided for in the original lease~~ **during the period of the professional engagement**, and any of the following conditions are met:

- a. ~~The covered member entered into the lease with the attest client prior to becoming a covered member with respect to the attest client.~~
- b. ~~The covered member entered into the lease with a counterparty for which independence was not required, and that counterparty to the lease later becomes, acquires, or is acquired by an attest client.~~
- c. ~~The attest client entered into the lease with a counterparty which was not required to be independent of the attest client, and that counterparty to the lease later acquires or is acquired by the covered member.~~
- d. ~~The lease existed prior to December 15, 2019 and the lease was permitted under the preexisting requirements of the "Independence Rule" [1.200.001] and its interpretations.~~

Automatic renewals provided for in the original lease are not considered **a renegotiation of the** ~~changes in terms~~ for purposes of this interpretation.

Covered Member Leases Primary Residence from Attest Client

.05 Irrespective of materiality, if a ~~covered member~~ leases his or her primary residence from a lessor *attest client*, *threats* to compliance with the "Independence Rule" [1.200.001] would

~~be at an acceptable level and independence would not be impaired, provided the covered member complies with the provisions in paragraph .04.~~

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

.07 **Refer to the “Client Affiliates” interpretation [1.224.010] of the “Independence Rule” [1.200.001] for additional guidance. [Prior reference: paragraph .17 of ET section 101]**

.08 This interpretation is effective December 15, 2019, with early implementation allowed.

Client Affiliates Interpretation [1.224]

When a covered member who is an individual participating on the attest engagement team, an individual in a position to influence the attest engagement, or the firm has a lease with an entity described under items c-I of the definition of affiliate during the period of the professional engagement, the covered member should use the “Conceptual Framework for Independence” interpretation [ET sec. 1.210.010] to evaluate the significance of the threats created by the lease relationship and apply safeguards, if necessary, to eliminate or reduce the threats to an acceptable level.

Final Text of Suggested Revisions to Exposed “Leases” Interpretation

1.260.040 Leases

.01 When a covered member enters into a lease with an attest client, self-interest, familiarity, and undue influence threats to the covered member’s compliance with the “Independence Rule” [1.200.001] may exist.

.02 If a covered member who is an individual participating 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*, and *independence* would be *impaired*, unless all of the following *safeguards* are met during that period:

- a. The lease is entered into or renegotiated on market terms and established at arm's length,
- b. All amounts are paid in accordance with the lease terms or provisions, including any available grace periods, and
- c. The lease is not material to either the *attest client* or the *covered member* who is an individual participating on the attest engagement team, an *individual in a position to influence the attest engagement*, or the firm that are counterparties to the lease.

.03 If a *covered member* specified in paragraph .02 has a lease with the *attest client* which was entered into or renegotiated:

- i) prior to the *period of the professional engagement*,
- ii) prior to the member becoming a *covered member*, or
- iii) prior to the counterparty becoming an *attest client*,

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*.

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. 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. Duration of the lease term
- f. Whether the lease has terms that are not market terms or at arm's length

However, *threats* would not be at an *acceptable level* and *independence* would be *impaired* if the lease amounts are not paid in accordance with the lease terms or provisions, including any available grace periods, during the *period of professional engagement*.

- .04 If a *covered member* other than those specified in paragraph .02 of this interpretation knows or has reason to believe that a lease between that *covered member* and the *attest client* creates significant *threats* to *independence*, the *covered member* should evaluate the significance of the *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*. 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. Materiality of the lease to the *covered member* other than those *covered members* identified in paragraph .02 during the period of 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. Duration of the lease term
 - f. Whether the lease has terms that are not market terms or at arm's length
 - g. Whether all amounts are paid in accordance with lease terms or provisions, including any available grace periods, during the *period of professional engagement*

Transition

- .05 Irrespective of materiality, *threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired* if the lease existed prior to December 15, 2019, and the lease was permitted under the preexisting requirements of the "Independence Rule" [1.200.001] and its interpretations, and the terms are not renegotiated during the *period of the professional engagement*. Automatic renewals provided for in the original lease are not considered a renegotiation of the terms for purposes of this interpretation.
- .06 This interpretation excludes leases addressed by paragraph .04 of the "Loans and Leases with Lending Institutions" interpretation [1.260.020] of the "Independence Rule" [1.200.001].
- .07 Refer to the "Client Affiliates" interpretation [1.224.010] of the "Independence Rule" [1.200.001] for additional guidance. [Prior reference: paragraph .17 of ET section 101]
- .08 This interpretation is effective December 15, 2019, with early implementation allowed.

Client Affiliates Interpretation [1.224]

When a *covered member* who is an individual participating on the attest engagement team, an *individual in a position to influence the attest engagement*, or the firm has a lease 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” interpretation [ET sec. 1.210.010] to evaluate the significance of the *threats* created by the lease relationship and apply *safeguards*, if necessary, to eliminate or reduce the *threats* to an *acceptable level*.

State and Local Government Task Force

Task Force Members: Nancy Miller (Chair), James Curry, John Good, Lee Klumpp, George Dietz, Flo Ostrum, Anna Dourdourekas, Jack Dailey, Randy Roberts, Barbara Romer (Observer), E. Gorla (Staff), J. Kappler (Staff), M. Powell (Staff)

Task Force Objective

Consider incorporating the threats and safeguards approach into the Entities Included in State and Local Government Financial Statements interpretation [1.224.020] and determine if a conceptual framework assessment could be utilized to determine when a member needs to be independent of state and local governmental entities for which he or she is not providing financial statement attest services. The Task Force will also clarify who at the firm and which immediate family members the interpretation should extend to and if the interpretation should contain any exceptions. The Task Force will also determine if the final guidance could be extended to the federal government environment.

Reason for Agenda

Based upon comment letter feedback, the Task Force re-wrote the entire standard to simplify and clarify its original proposal. The Task Force believes the substantive changes¹ made are minimal and address concerns raised by commenters. The Task Force is seeking the Committee's approval to re-expose the proposal. The re-exposure would be focused on or limited to seeking input regarding whether there are any unintended consequences caused by the simplification, clarity and substantive changes and not on the original issues proposed.

Summary of Issues***Applicability (paragraph .01)***

During the May meeting, the Committee requested that the Task Force revise paragraph .01 to make it clear that the examples of special purposes governments are not intended to pull in entities that aren't state or local government entities (e.g., private universities). The Task Force discussed this concern and believes the first two sentences in paragraph .01 make it clear that the examples are only GASB entities.

The Task Force noted that the list of examples included a reference to utilities and then public utilities and to universities and colleges and then to public colleges and universities. The Task Force believes the repetition of these examples were typographical errors and could be what caused the Committee's concern. Accordingly, the Task Force eliminated the duplicative references. If, however, the Committee disagrees with the Task Force's recommendation, paragraph .01 could be revised to read as follows:

This interpretation applies to state and local governmental entities. State and local governmental entities are entities whose GAAP standard setter is GASB. Examples of state and local governmental entities include general purpose governments such as states, counties, cities, towns, villages, and special purpose governments that perform limited activities. Examples of **governmental entities that are** special purpose governments include, but are not limited to, **governmental** cemetery districts, school

¹ Staff is currently developing a matrix to outline the substantive changes and Ms. Miller will speak to these during her presentation to the Committee.

districts, **public** universities and colleges, **public** utilities, hospitals or other health care organizations, public airports, public housing authorities, financing authorities, public transportation systems, public employee retirement systems (PERSs), post-employment benefit plans **for government employees**, pension plans **for government employees**, public entity risk pools, external investment pools, Indian tribes, state tuition programs, and other special districts

Question for the Committee

1. Does the Committee believe paragraph .01 as revised in **Agenda Item 2B** makes it clear that special purposes governments are not intended to pull in entities that aren't state or local government entities now that the duplicative reference to public utilities and public colleges and universities have been removed? If not, why and how should paragraph .01 be revised?

Examples of Relationships or Circumstances with a Non-Affiliate That Could Create Threats to Independence (paragraph .05 items a.-d.)

At the May PEEC meeting, the Task Force recommend that paragraph .05 provide some examples of situations covered members may have with these non-affiliates to get members thinking about when this provision should be applied. The Committee had two observations for the Task Force to discuss.

The first observation was that as revised the examples seem to pull in entities that are not funds, component units or activities (i.e., outside of the financial reporting entity). The Task Force believes that paragraph .05 is just reminding members that they need to use the *Conceptual Framework for Independence* when relationships or circumstances come to their attention and presumably could pull in entities that are outside of the financial reporting entity. While the Task Force also doesn't believe the interpretation is limiting the scope of the conceptual framework, since paragraph .05 uses the term "entity" which is now a defined term, the Task Force believes this paragraph is only applicable to those entities covered by the definition.

The second observation was that the Committee believed the example "Covered member's immediate family member is a mayor or council member of a non-affiliated entity to the financial statement attest client" should be clarified to show the connection between the two entities that were involved. The Task Force discussed this example and agreed that it was too vague and recommends replacing it with two different examples that members could encounter. The substance of these examples appeared in the explanation to the exposure draft. The examples added are:

- Equity method investments that do not meet the *investment* definition in paragraph .06c, such as, public private partnerships and joint ventures.
- Certain financing arrangements such as defeased and conduit debt, debt guarantees, and debt service paid for one entity on behalf of another.

Question 7 in the exposure draft asked commenters if it was clear that the interpretation does not apply to an entity that provides grant funds to the financial statement attest client (or vice versa) unless that entity is a fund or component unit that would otherwise be covered by the

interpretation. Seven commenters² do not believe it is clear and recommend this be clarified while eight commenters³ believe it is clear. The Task Force is not recommending an example be added to paragraph .04 to address an entity that provides grant funds when that entity is not a fund, component unit or otherwise covered by the interpretation.

Questions for the Committee

1. Does the Committee agree that the interpretation should not limit the scope of the Conceptual Framework?
2. Do the revised examples recommended by the Task Force address the Committee's concerns?

Definition of Affiliate

At the May 2018 meeting, the Committee agreed with the Task Force's recommendation that adding the term "affiliate" to the terminology section and defining it to include the entities the exposure draft captured under the "downstream" and "upstream" sections would help simply and streamline the interpretation. The Committee recommended the Task Force consider adding a statement to the commercial definition of "affiliate" in the Preface (ET 0.400.02) that clarifies that the commercial definition not be used for purposes of this interpretation. When considering this recommendation, the Task Force realized that it would be more efficient and result in less confusion if the definition of a SLG affiliate was added to the definition of a commercial affiliate in the Preface (ET 0.400.02) as a second type of affiliate. Doing this would not only make it clearer that there are in fact 2 different types of affiliates but would allow the definition to appear as a pop-up while reading the interpretation so that the reader does not have to scroll within the interpretation to view the definition.

Some commenters sought clarity regarding how far upstream and downstream the Independence Rule and related interpretations need to be applied. To address these concerns, the Task Force is recommending that the following be added

- The following be added to the end of the lead in to the definition of a SLG affiliate
"An entity continues to be an affiliate, until the noted criteria is no longer met."
This would address the downstream questions.
- The boldface italic text be added to the hanging paragraph in paragraph .04 to address the upstream questions. "This evaluation would include determining whether covered members have a relationship or circumstance with such entities that could result in *threats* to independence that are not at an acceptable level. Only when it is determined that this situation exists, would the member be required to identify these relationships or circumstances. If safeguards cannot be applied to eliminate or reduce the *threats* to an acceptable level, independence would be *impaired*. ***This evaluation should continue for all entities up through the organizational structure until the criteria in items a. and b. of this paragraph are no longer met.***"

² CL 1, CL 8, CL 13, CL 14, CL 17, CL 20 and CL 21

³ CL 6, CL 9, CL 10, CL 11, CL 12, CL 15, CL 16 and CL 22

Some commenters questioned whether they were supposed to apply the Independence Rule and related interpretations applicable to the financial statement attest client to investors of the financial statement attest client since the investment section of the proposal only looked downstream. The Task Force believes the more than minimal influence and materiality assessments appropriately scope in the necessary entities as affiliates. Accordingly, if the investor would not be evaluated under paragraph .04, members would only need to evaluate relationships or circumstances with those investors when the criteria in paragraph .05 is met.

The proposed revisions can be found in **Agenda Items 2B and 2C**.

Question for the Committee

1. Does the Committee agree with the Task Force's recommendations?

Nonattest Service Exception (paragraph .08)

At the May 2018 meeting the Committee requested the nonattest service exception be revised so that it is consistent exception found in the Client Affiliate interpretation for commercial entities. Paragraph .08 of **Agenda Item 2B** reflects these revisions.

Best Efforts (paragraph .09)

Question 6 in the exposure draft asked commenters if they believed the best efforts provision to identify investments would be helpful in other situations because the financial statement attest client could have difficulty identifying certain entities.

Eight⁴ commenters were not aware of any other circumstances in which a best efforts provision should be applied with one⁵ noting that upstream and downstream entities would already be subject to disclosure and audit attention and another⁶ noting that they typically perform an analysis of potential component units and funds and obtain an understanding of why management has included or excluded various potential component units or funds.

The other commenters who provided feedback generally fell into one of the following recommendations:

- a. Replace "best efforts" with "reasonable efforts" (CL 1) or with "reasonable best efforts" (CL 14)
- b. Eliminate best efforts for investments because under the GASB standards, investments are required to be on the governmental entity's financial statements so it is likely that auditors will be able to get all this information. (CL 6)
- c. Provide further guidance to assist members in applying the concept of "best efforts" (CL 9)
- d. Add the "best efforts" provision to all affiliate relationships (CL 14 and CL 21) or any part of the interpretation which is reliant on the auditor obtaining information from a client or third party (CL 7). For example,

⁴ CL 5, CL 10, CL 11, CL 12, CL 13, CL 19, CL 20 and CL 22

⁵ CL 19

⁶ CL 20

- i. the more than minimal influence paragraphs includes factors to assess when determining more than minimal influence and many of those factors may not be available or accessible to the client (CL 9, CL 14)
- ii. upstream entities (CL 6)
- iii. excluded entities (CL 6 and CL 7)

The Task Force recommends the best efforts provisions be applied to all affiliates not just investments and to entities covered by paragraph .04. In reaching this conclusion the Task Force noted that this scope would be conceptually consistent with the commercial affiliate conclusion and would likely not be abused since the member would still need to work closely with those charged with governance (TCWG), document the efforts the member made to identify the entities and obtain assurance from TCWG. The Task Force also noted that this provision would not extend to those entities captured by paragraph .05. The Task Force also noted that applying the best efforts provision to all affiliates and paragraph .04 entities would result in members not having to use the Breach of an Independence interpretation to address these situations. Paragraph .09 of **Agenda Item 2B** reflects this revision.

Question for the Committee

1. Does the Committee agree that the best efforts provision should be applied to all affiliates?

More Than Minimal Influence (paragraphs .10-.11)

Availability of Criteria

Question 4 in the exposure draft asked commenters if they believed there are circumstances where the criteria necessary to undertake the “more than minimal influence evaluation” would not readily available to the auditor. Most commenters⁷ that responded to this question believe that this information will be readily available to the member and the Task Force believes extending the best efforts provision to all affiliates will address situations where difficulty is encountered.

Analysis Performed to Determine Entities in the Financial Reporting Entity Differs

Question 5 in the exposure draft asked commenters if it was clear that the more than minimal influence concept would require an analysis that is intended to be different than the analysis required for determining which entities are in a primary government’s financial reporting entity.

Although most commenters⁸ believe the objective is clear, the Task Force is recommending that the discussion from the explanation in the exposure draft that explains that this is a targeted analysis that applies solely to the accounting and financial reporting process of the fund or component unit as opposed to the analysis of what entities are included in the financial reporting entity, be added to paragraph .10. The Task Force’s basis for this recommendation is tied back to a general comment made by several commenters that the Committee consider moving clarifying information from the explanation into the interpretation. Paragraph .10 of **Agenda Item 2B** reflects this revision.

⁷ CL 1, CL 5, CL 11, CL 12, CL 13, CL 14, CL 15, CL 16, CL 17, CL 19, CL 20 and CL 22

⁸ CL 1, CL 5, CL 6, CL 11, CL 12, CL 13, CL 14, CL 15, CL 16, CL 20 and CL 22.

Question for the Committee

1. Does the Committee agree with the Task Force's recommendation?

Material to the Financial Statements as a Whole (paragraph .12)

A number of commenters requested clarification regarding materiality and some suggested moving the discussion related to this from the explanation into the interpretation. The Task Force recommends adding a subsection to the interpretation that would provide general application guidance related to what materiality should be measured against. Paragraph .12 of **Agenda Item 2B** reflects this revision.

Question for the Committee

1. Does the Committee agree with the Task Force's recommendations?

Required Evaluation

Upstream expectation clearer by a) moving it out of the affiliates definition and b) creating a separate requirement that is something less than an affiliate but more than the conceptual framework.

When a financial statement attest client is required to be included in an entity's financial statements and the entity can exert more than minimal influence over the accounting or financial reporting process of the *financial statement attest client* and the *financial statement attest client* is material to the entity's *financial statements as a whole*, the proposal required the member perform an evaluation of relationships and circumstances with this upstream entity. There was concern that it was unclear how this evaluation should be performed.

While the Task Force believes that implementation guidance regarding this evaluation should be developed and issued when the interpretation is adopted, it is also recommending some revisions to clarify that although the evaluation contemplated is similar to the one called for by the Conceptual Framework for Independence there are differences. Specifically, the requirement to identify specific relationships and circumstances that covered members have with the upstream entity and implement safeguards would only take effect when the evaluation identifies relationships or circumstances that the upstream entity has that result in significant threats. To clarify this, the Task Force recommends adding the following to paragraph .04 in **Agenda Item 2B**:

This evaluation would include determining whether covered members have a relationship or circumstance with such entities that could result in *threats* to independence that are not at an acceptable level. Only when it is determined that this situation exists, would the member be required to identify these relationships or circumstances. If safeguards cannot be applied to eliminate or reduce the *threats* to an *acceptable level*, *independence* would be *impaired*. This evaluation should continue for all entities up through the organizational structure until the criteria in items a. and b. of this paragraph are no longer met..

Question for the Committee

1. Does the Committee agree with the Task Force's recommendation?

Re-Exposure

The Task Force believes that the substantive revisions made to the proposal are supported by the comments received and by themselves would not be significant enough to warrant re-exposure. However, since the proposal was significantly re-written to address simplification and clarity concerns, the Task Force is recommending the Committee re-expose the proposal seeking feedback limited to input regarding whether any unintended consequences were caused by: (1) the simplification and clarity changes; and (2) the substantive changes made to the initial exposure draft. The exposure draft should make it clear that input on the original issues proposed is not requested.

Action Needed

The Committee is asked to agree to a targeted re-expose as described above.

Communication Plan and Member Training Tools

Ms. Miller and Staff are scheduled to provide an update to the SLG Expert Panel on August 6th from 1-2 p.m. and the state auditor community on August 1st from 2-4 p.m.

Overall the comment letters received came from firms or organizations that were connected with the project and there was general agreement that significant member enrichment should be planned for implementation. The Task Force believes that an implementation guide or other reference document should accompany the final adopted standard. The Task Force will continue to work on developing a robust communication plan and necessary implementation tools.

Materials Presented

Agenda Item 2B Proposed Revised SLG Interpretation

Agenda Item 2C Proposed Revised Affiliate Definition

1.224.020 ~~Entities Included in State and Local Government Entities Financial Statements~~**Applicability**

- .01 This interpretation applies to state and local governmental entities. State and local governmental entities are entities whose GAAP standard setter is GASB. Examples of state and local governmental entities include general purpose governments such as states, counties, cities, towns, villages, and special purpose governments that perform limited activities. Examples of special purpose governments include, but are not limited to, cemetery districts, school districts, universities and colleges, utilities, hospitals or other health care organizations, public airports, public housing authorities, financing authorities, public transportation systems, public employee retirement systems (PERSs), post-employment benefit plans, pension plans, public entity risk pools, external investment pools, Indian tribes, state tuition programs, and other special districts.

Interpretation

- .02 *Financial Interests* in, and other relationships with entities that have a relationship with a *financial statement attest client* that is a state or local government entity may create *threats* to a *member's* compliance with the "Independence Rule" [1.200.001].
- .03 *Downstream Entities*. *Members* should apply the "Independence Rule" and related *interpretations* applicable to a state or local government *financial statement attest client* to their *affiliates* except as provided for in paragraph .08 of this interpretation.
- .04 *Upstream Entities*. *Members* should evaluate certain relationships and circumstances that *covered members* have with an entity that is required to include the *financial statement attest client* in its *financial statements* and the
- financial statement attest client* is material to the entity's *financial statements* as a whole; and
 - entity can exert more than minimal influence over the accounting or financial reporting process of the *financial statement attest client*. There is a rebuttable presumption that the entity that is required to include a *financial statement attest client* in its *financial statements* has more than minimal influence over the accounting or financial reporting process of funds and blended component units.

This evaluation would include determining whether *covered members* have a relationship or circumstance with such entities that could result in *threats* to *independence* that are not at an *acceptable level*. Only when it is determined that this situation exists, would the *member* be required to identify these relationships or circumstances. If *safeguards* cannot be applied to eliminate or reduce the *threats* to an *acceptable level*, *independence* would be *impaired*. This evaluation should continue for all entities up through the organizational structure until the criteria in items a. and b. of this paragraph are no longer met.

- .05 *Other Entities*. For entities not addressed by paragraphs .03 and .04 of this interpretation, *members* should apply the "Conceptual Framework for Independence" interpretation [ET sec. 1.210.010] if the *member* knows or has reason to believe that a *covered member* has a relationship or circumstance with such entity that would create *threats* to *independence*.

Examples of relationships or circumstances *covered members* may have with such entities include

- a. A *covered member* has an interest in utility bonds of such an entity when the *financial statement attest client* is responsible for payment of the debt service on the utility bonds.
- b. The *member* is considering providing financial information system design services to such an entity of a where the financial information system would be a shared service provided by such entity to the *financial statement attest client*. These services would *impair* the *member's independence* if provided directly to the *financial statement attest client*.
- c. Such entity outsources its internal audit function to the *member* and the scope of the internal audit services include the *financial statement attest client*.
- d. Equity interests, relationships, and circumstances that do not meet the investment definition in paragraph .07b, such as, public private partnerships and joint ventures.
- e. Certain financing arrangements such as defeased and conduit debt, debt guarantees, and debt service paid for one entity on behalf of another.

.06 When an *interpretation* of the “*Independence Rule*” [ET sec. 1.200.001] is applied in a state or local government environment and the *interpretation* uses terminology that is not applicable in this environment, the *member* should use professional judgement to determine if there is an equivalent term. For example, certain *interpretations* use the phrase “officer, director, or owner of the *attest client*.” In some state or local government environments, it may be necessary for the *member* to extend these *interpretations* to officials of the *financial statement attest client* when the individual has governance responsibilities or control over financial reporting.

Terminology

.07 The following terms are defined here solely for use with this interpretation:

- a. **Entity.** An entity is intended to be broadly defined and can include, but is not limited to funds, component units, departments, agencies, programs, organizational units, fiduciary activities, custodial activities, employee benefit plans and sub-organizational units of the preceding entities.
- b. **Investment.** An investment is a security or other asset that the *financial statement attest client* holds primarily for the purpose of income or profit and has a present service capacity based solely on its ability to generate cash or to be sold to generate cash. This includes investments and ownership of an equity interest in common stock accounted for using the equity method of accounting as provided for in GASB Codification Section 150. The following interests are not considered investments for purposes of this interpretation:
 - i. Interests obtained by a *financial statement attest client* as a result of an action by a third party, such as through a bequest or a grant, and that the entity does not intend to retain (temporary investments).
 - ii. Equity interests in joint ventures partnerships, limited liability companies, or other types of entities in which the intent of the *financial statement attest client* is to directly enhance its ability to provide governmental services

- iii. Equity interests in component units in which the intent of the *financial statement attest client* is to directly enhance its ability to provide governmental service
- iv. Entities that would otherwise be considered an entity as defined in item a above.

Exception

.08 The *member* and *member's firm* may provide prohibited nonattest services to entities described under items b.ii. and b.iii. 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 the *covered member's 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*.

Best Efforts

.09 A *member* must expend best efforts to obtain the information necessary to identify *affiliates* and entities identified in paragraph .04 of this interpretation. If, after expending best efforts, a *member* is unable to obtain the information to determine these entities, *threats* would be at an *acceptable level* and *independence* would not be *impaired* if the *member* does all of the following:

- a. Discusses the matter, including the potential impact on *independence*, with *those charged with governance at the financial statement attest client*.
- b. Documents the results of that discussion and the efforts taken to obtain the information
- c. Obtains written assurance from the *financial statement attest client* that it is unable to provide the *member* with the information necessary to identify the *affiliates* of the *financial statement attest client* and entities identified in paragraph .04 of this interpretation.

More Than Minimal Influence Over Accounting and Financial Reporting Process

.10 The overall facts and circumstances should be considered when evaluating the level of influence an entity has over the accounting or financial reporting process of funds and component units in the financial reporting entity. The targeted analysis is applied solely to the accounting and financial reporting process of the fund or component unit as opposed to the analysis of what entities are included in the financial reporting entity. Factors such as the following may assist *members* with this evaluation. The extent:

- a. of involvement the entity has in preparing the *financial statements* of a fund or component unit.
- b. of operational control the entity has over a fund or component unit.
- c. to which both the entity and a fund or component unit have the same
 - i. accounting or finance staff

- ii. accounting systems
 - iii. internal control over financial reporting systems
 - d. to which the entity
 - i. is able to direct the behaviors or actions of the governing board of the fund or component unit
 - ii. has the ability to add or remove members of the governing board of the fund or component unit
 - iii. issues or pays for the fund or component unit's debt
 - iv. finances the fund or component unit's deficits
 - v. uses or takes the fund or component unit's financial resources
- .11 Whereas some factors may indicate influence, others may indicate little to no influence. Some factors may be weighted differently depending on the circumstances and the subject matter of any potential impairment. *Members* should take a substantive approach to evaluating the factors (for example, the entity exercises a right) rather than merely considering form (for example, the entity has a right that is not exercised). The consideration of these factors will require the *member* to exercise professional judgement when reaching the determination of whether more than minimal influence exists.

Material To the Financial Statement Attest Client's Financial Statements As a Whole

- .12 Determination of materiality is a matter of professional judgment. *Members* should consider both quantitative and qualitative factors when determining whether an entity is material to a financial reporting entity. For purposes of this interpretation, materiality is intended to be applied at the financial statement reporting entity as a whole, rather than individual opinion units in circumstances where there may be more than one opinion unit.

Effective Date

- .13 This interpretation will be effective for engagements covering periods beginning on or after [insert date that would be 1 year after adoption]. Early implementation is allowed.

0.400 Definitions**.02 Affiliate**

a. ***When applying the Client Affiliate interpretation (1.224.010)*** The following entities are affiliates of a *financial statement attest client*:

- i. An entity (for example, subsidiary, partnership, or limited liability company [LLC]) that a *financial statement attest client* can *control*.
- ii. An entity in which a *financial statement attest client* or an entity *controlled* by the *financial statement attest client* has a *direct financial interest* that gives the *financial statement attest client* *significant influence* over such entity and that is material to the *financial statement attest client*.
- iii. An entity (for example, parent, partnership, or LLC) that *controls* a *financial statement attest client* when the *financial statement attest client* is material to such entity.
- iv. An entity with a *direct financial interest* in the *financial statement attest client* when that entity has *significant influence* over the *financial statement attest client*, and the interest in the *financial statement attest client* is material to such entity.
- v. A sister entity of a *financial statement attest client* if the *financial statement attest client* and sister entity are each material to the entity that *controls* both.
- vi. A trustee that is deemed to *control* a trust *financial statement attest client* that is not an investment company.
- vii. The sponsor of a single employer employee benefit plan *financial statement attest client*.
- viii. Any entity, such as a union, participating employer, or a group association of employers, that has *significant influence* over a multiemployer employee benefit plan *financial statement attest client* and the plan is material to such entity.
- ix. The participating employer that is the plan administrator of a multiple employer employee benefit plan *financial statement attest client*.
- x. A single or multiple employer employee benefit plan sponsored by either a *financial statement attest client* or an entity *controlled* by the *financial statement attest client*. All participating employers of a multiple employer employee benefit plan are considered sponsors of the plan.
- xi. A multiemployer employee benefit plan when a *financial statement attest client* or entity *controlled* by the *financial statement attest client* has *significant influence* over the plan and the plan is material to the *financial statement attest client*.
- xii. An investment adviser, a general partner, or a trustee of an investment company *financial statement attest client* (fund) if the fund is material to the investment adviser, general partner, or trustee that is deemed to have either *control* or *significant influence* over the fund. When considering materiality, *members* should consider investments in, and fees received from, the fund.

b. ***When applying the State and Local Government Entities interpretation (1.224.020)*** *an entity is an affiliate of a state or local government financial statement attest client in all of the following situations. An entity continues to be an affiliate, until the noted criteria is no longer met.*

- i. *the entity is included in the financial statement attest client's financial statements and the covered member does not make reference to another auditor's report on the entity;*
- ii. *the entity is included in the financial statement attest client's financial statements and the covered member makes reference to another auditor's report on the entity, and*
 - 1. *the entity is material to the financial statement attest client's financial statements as a whole; and*
 - 2. *the financial statement attest client has more than minimal influence over the accounting or financial reporting process over the entity. There is a rebuttable presumption that the financial statement attest client has more than minimal influence over the accounting or financial reporting process of funds and blended component units.*
- iii. *the entity is a material excluded entity and the financial statement attest client has more than minimal influence over the entity's accounting or financial reporting process. A material excluded entity is an entity that is required to be included in the financial statements of the financial statement attest client but is excluded, and is material to the financial statement attest client's financial statements as a whole. There is a rebuttable presumption that the financial statement attest client has more than minimal influence over the accounting or financial reporting process of funds and blended component units.*
- iv. *the financial statement attest client has an investment that either*
 - 1. *is not trivial and clearly inconsequential to the financial statement attest client's financial statements as a whole and gives the financial statement attest client control over the investment or*
 - 2. *is material to the financial statement attest client's financial statements as a whole and gives the financial statement attest client significant influence over the investment.*

Nonauthoritative questions and answers related to the application of the independence rules to affiliates of employee benefit plans are available at www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/faqs-application-independence-rules-affiliates-of-employee-benefit-plans.pdf.

Impact Analysis of Proposed Revisions to “Entities Included in State and Local Government Financial Statements” Interpretation

Color Key

Light Green: Clarifying change.

Yellow: Added guidance to the interpretation.

Red: Change in position based upon feedback.

Blue: Areas that may require additional revision

Extant Interpretation	Additional Independence Requirements Under the Initial Exposure Draft	Rationale for The Exposed Change in The Initial Exposure Draft	Task Force’s Conclusion Regarding Change to The Revised Proposal
GASB Terms			
A. Certain terminology used in the extant interpretation is specifically defined by the Governmental Accounting Standards Board (GASB)	Some of the terminology used was in the proposed interpretation was GASB terminology but defined differently than GASB.	The proposed interpretation used the GASB term primary government but defined it differently than the GASB does so that the users of the interpretation would realize they need to look both up and downstream.	The change from the initial exposure draft was to respond to commenters request that GASB terms that had different definitions than GASB not be used because doing so was confusing. To respond to this concern, GASB terms were eliminated and replaced by more general terms such as “affiliate” and “entity”.
Affiliates (Downstream Entities)			
B. Members need to remain independent of funds and component units that are included in the financial statement attest client’s financial reporting entity in which the covered member does not make reference to another auditor’s report on a fund or component unit. <i>(Refer to paragraph .04 of the extant interpretation.)</i>	The requirement is the same under the proposed interpretation. <i>(Refer to paragraph .05 in the proposed interpretation.)</i>	Not applicable.	The requirement is the same as the extant and the initial exposure draft but instead of in the interpretation, it has been moved to the definition of affiliate found in paragraph .02 of ET 0.400. <i>(The requirement is now found in the proposed new affiliate definition under 0.400.02 item b. i.)</i>
C. Members do not need to remain independent of funds and component units that are included in the financial reporting entity of	When making reference to another auditor’s report, members will need to remain independent of	The Professional Ethics Executive Committee (PEEC) continues to believe that making reference to	The requirement is the same as the initial exposure draft but instead of in the interpretation, it has been moved to the

Extant Interpretation	Additional Independence Requirements Under the Initial Exposure Draft	Rationale for The Exposed Change in The Initial Exposure Draft	Task Force's Conclusion Regarding Change to The Revised Proposal
<p>the financial statement attest client when the member makes reference to another auditor's report. <i>(Refer to paragraph .04 of the extant interpretation.)</i></p>	<p>material funds and component units that are included in the financial reporting entity of the financial statement attest client when the primary government has more than minimal influence over the accounting or financial reporting process of the fund or component unit. <i>(Refer to provision paragraph .06 of the proposed interpretation.)</i></p>	<p>another auditor's report will not always reduce threats to an acceptable level when the fund or component unit is material to the financial reporting entity, and the primary government has more than minimal influence over the accounting or financial reporting process of the fund or component unit.</p>	<p>definition of affiliate found in paragraph .02 of ET 0.400.</p> <p><i>(The requirement is now found in the affiliate definition under 0.400.02 item b. ii.)</i></p>
<p>D. The extant interpretation does not provide any independence guidance related to funds and component units that are excluded from the financial reporting entity but are required to be included under the applicable framework (for example, generally accepted accounting principles, regulatory, or cash basis).</p>	<p>Members should apply the independence rule and related interpretations to material funds and component units that are excluded from the financial reporting entity but required to be included under the applicable framework if the primary government has more than minimal influence over its accounting or financial reporting process. <i>(Refer to provision paragraph .07 of the proposed interpretation.)</i></p>	<p>It is not uncommon for a primary government to exclude a fund or component unit from the financial reporting entity for a variety of reasons, such as unavailability of a component unit's audited financial statements; therefore, PEEC incorporated guidance in its proposed interpretation related to a material fund or component unit that is excluded from the financial statement attest client's financial reporting entity but is required under the applicable framework to be included.</p>	<p>The requirement is the same as the initial exposure draft but instead of in the interpretation, it has been moved to the definition of affiliate found in paragraph .02 of ET 0.400.</p> <p><i>(The requirement is now found in the affiliate definition under 0.400.02 item b. iii.)</i></p>
<p>E. The extent interpretation does not specify how far downstream the member needs to continue looking</p>	<p>N/A</p>	<p>N/A</p>	<p>Commenters asked for clarification regarding how far downstream they need to look. Since the proposal used criteria to determine what downstream entities the</p>

Extant Interpretation	Additional Independence Requirements Under the Initial Exposure Draft	Rationale for The Exposed Change in The Initial Exposure Draft	Task Force's Conclusion Regarding Change to The Revised Proposal
when the independence rules needs to be applied.			<p>independence rules need to be extended to, additional language was added to clarify that members should continue looking at all entities down through the organizational structure until the criteria is no longer met.</p> <p>Recent feedback indicates that the Task Force may need to further clarify the intent of 0.400.02 b.</p> <p><i>(The requirement is now found in the affiliate definition under 0.400.02 item b)</i></p>
Upstream Entities (Required Evaluation of Certain Relationships with Certain Upstream Entities)			
<p>F. Under the extant interpretation, members do not need to remain independent of entities that the member does not audit (for example, upstream entity), except covered members and their immediate family, and close relatives may not have a key position within the primary government. <i>(Refer to paragraphs .07–.08 of the extant interpretation.)</i></p>	<p>When certain upstream entities have relationships or circumstance that would create significant threats if a covered member was involved, members would be required to identify whether any covered members have such and evaluate the relationships and circumstances using the “Conceptual Framework for Independence” interpretation.</p> <p><i>(Refer to paragraph .09 of the proposed interpretation.)</i></p>	<p>PEEC believes that there could be circumstances in which a member could have a relationship that creates a threat(s) that is (are) not at an acceptable level.</p> <p>Furthermore, PEEC believes these situations are more likely to occur when a material fund or component unit is a financial statement attest client and is required to be included in another financial reporting entity and the primary government of that financial reporting entity can exert more than minimal influence over the accounting or financial reporting process of the financial statement attest client.</p>	<p>Requirement is the same as the initial exposure draft but just drafted more clearly.</p> <p><i>(The requirement is now found in paragraph .04 of the revised interpretation)</i></p>

Extant Interpretation	Additional Independence Requirements Under the Initial Exposure Draft	Rationale for The Exposed Change in The Initial Exposure Draft	Task Force's Conclusion Regarding Change to The Revised Proposal
G. The extant interpretation only extends its limited independence restrictions to the primary government and does not address whether these restrictions could continue further upstream.	N/A	N/A	<p>Commenters asked for clarification regarding how far upstream they need to look. Since the proposal used criteria to determine what upstream entities the independence rules need to be extended to, additional language was added to clarify that members should continue looking at all entities up through the organizational structure until the criteria is no longer met.</p> <p>Recent feedback indicates that the Task Force may need to further clarify the intent of 0.400.02 b.</p> <p><i>(The requirement is now found in paragraph .04)</i></p>
Other Funds, Component Units, or Activities That Are Not Considered Affiliates or Upstream Entities (Possible Evaluation of Relationships Using Conceptual Framework)			
H. The extant interpretation does not have a reminder that members should consider the " Conceptual Framework for Independence interpretation " if they encountered situations not addressed by the extant interpretation that result in significant threats. requirement to evaluate threats to independence created by relationships or circumstances the member has with funds, component units, or activities that aren't covered by the interpretation.	If a member knows or becomes aware of relationships or circumstances with a fund, component unit, or activity that is not identified in rows A–E that would create threats to independence, the member would be required to evaluate the matter using the " Conceptual Framework for Independence interpretation ". <i>(Refer to paragraph .10 of the proposed interpretation.)</i>	Member may encounter circumstances or relationships with certain entities that could give rise to threats that are not at an acceptable level.	<p>The requirement is the same as the initial exposure draft except that examples were added.</p> <p><i>(The requirement is now found in paragraph .05 of the revised interpretation)</i></p>
Investments			

Extant Interpretation	Additional Independence Requirements Under the Initial Exposure Draft	Rationale for The Exposed Change in The Initial Exposure Draft	Task Force's Conclusion Regarding Change to The Revised Proposal
<p>I. Under the extant interpretation, there is no guidance regarding when members should extend the "Independence Rule" and related interpretations to investments held by a state or local entity; therefore, members would use the Conceptual Framework for Independence interpretation when evaluation is required.</p>	<p>The proposed interpretation provides that members should apply the independence rules and related interpretations to certain entities that the financial statement attest client invests in.</p> <p><i>(Refer to paragraph .11 of the proposed interpretation.)</i></p>	<p>The independence rules should be extended to:</p> <ul style="list-style-type: none"> • entities in which the financial statement attest client can control the entity and the investment in that entity is not de minimis to the financial statement attest client's financial reporting entity. • include circumstances when a financial statement attest client has significant influence over an entity in which it has a material investment. <p>Furthermore, a de minimis threshold is applied because of the operational problems associated with determining which entities are controlled by a financial statement attest client when those entities are insignificant. Unlike in the commercial sector, state and local governments may not have systems in place to track this information, nor do they have regulatory requirements that might be applicable to commercial</p>	<p>Some commenters thought it was unclear if they should only look downstream to investments the client held or if they should also look upstream to investments held by upstream entities. Including investments in the definition of affiliate should make it clear that members only need to look downstream.</p> <p>The term "de minimis" was changed to "trivial and clearly inconsequential". Instead of appearing in the interpretation, it has been moved to the definition of affiliate found in paragraph .02 of ET 0.400.</p> <p>TF needs to determine if the interpretation is clear that you only need to look at investments of the type i affiliates.</p> <p><i>(The requirement is now found in the affiliate definition under 0.400.02 item b. iii.)</i></p>

Extant Interpretation	Additional Independence Requirements Under the Initial Exposure Draft	Rationale for The Exposed Change in The Initial Exposure Draft	Task Force's Conclusion Regarding Change to The Revised Proposal
		entities to monitor investment relationships.	
Not Subject to Attest Procedures Exception			
The extant interpretation does not have any exceptions for the provision of prohibited nonattest services.	Members may provide nonattest services that would impair independence to funds and component units identified in preceding rows B and C, provided 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 the covered member's 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 (particularly those relating to management participation), the member should apply safeguards to eliminate or reduce the threats to an acceptable level. <i>(Refer to paragraph .08 of the proposed interpretation.)</i>	The exception was incorporated so that the proposed interpretation would be conceptually consistent with the underlying principles of the "Client Affiliates" interpretation because PEEC did not identify a compelling reason to differ from those principles.	<p>The requirement is the same as the initial exposure draft but instead of referring to the nonattest services as services that impair independence, these services are referred to as prohibited nonattest services which is consistent with the commercial affiliate guidance.</p> <p><i>(The requirement continues to be found in paragraph .08 of the revised interpretation.)</i></p>
Best Efforts Provision			
J. Under the extant interpretation, there is no guidance regarding best efforts.	Under the proposed interpretation, the best efforts provision was only	Not specified in the explanation that accompanied the exposure draft.	The only change to this provision from the initial exposure draft is that best efforts can now be applied to not only investments that are affiliates but any

Extant Interpretation	Additional Independence Requirements Under the Initial Exposure Draft	Rationale for The Exposed Change in The Initial Exposure Draft	Task Force's Conclusion Regarding Change to The Revised Proposal
	<p>applied to the identification of investments.</p> <p><i>(Refer to paragraph .13 of the proposed interpretation.)</i></p>		<p>entities that are affiliates as well as upstream entities.</p> <p><i>(The requirement is now found in paragraph .09 of the revised interpretation.)</i></p>
Material to Financial Statements as A Whole			
K. Under the extant interpretation there is no materiality threshold.	<p>Under the proposed interpretation, certain provisions are limited to material funds and component units.</p> <p><i>(Refer to paragraph .06, .07, .09 and .11 of the proposed interpretation.)</i></p>	<p>Although .11 specifies that "An investment that gives the financial statement attest client significant influence over the entity and that is material to the financial statement attest client as a whole", the explanation to the exposure draft contains more clarification regarding how to measure materiality.</p>	<p>Application guidance was added to the interpretation to respond to comments on the ED.</p> <p><i>(The requirement is now found in paragraph .12 of the revised interpretation.)</i></p>
Primary Government Has More Than Minimal Influence Over Accounting and Reporting Process			
L. The more than minimal influence provision is not used in the extant interpretation.	<p>Under the proposed interpretation, application guidance was included for determining whether more than minimal influence existed. However, that application guidance did not specifically mention that this analysis is applied solely to the accounting and financial reporting process of the fund or component unit as opposed to the analysis that a member would perform to determine what entities are included in the financial reporting entity.</p>	<p>PEEC believes the control and significant influence concepts used in the commercial affiliate guidance are not workable in the SLG environment since the SLG environment uses a financial accountability concept instead.</p> <p>PEEC believes that the concept of whether the primary government has more than minimal influence over the accounting and financial reporting process of the fund or component unit is the appropriate concept to use to determine whether</p>	<p>Added application guidance on applying the MTMI solely to the accounting and financial reporting process of the fund or component unit</p> <p><i>(The requirement is now found in paragraph .10 of the revised interpretation.)</i></p>

Extant Interpretation	Additional Independence Requirements Under the Initial Exposure Draft	Rationale for The Exposed Change in The Initial Exposure Draft	Task Force's Conclusion Regarding Change to The Revised Proposal
	<i>(Refer to paragraph .14 and .15 of the proposed interpretation.)</i>	independence should be applied to funds and component units that are required to be included in the financial reporting entity under the applicable framework	
M. The more than minimal influence provision is not used in the extant interpretation.	Under the proposed interpretation, application guidance in the form of examples was included to aid users in determining whether more than minimal influence existed. <i>(Refer to paragraph .14 and .15 of the proposed interpretation.)</i>	PEEC believed including examples would be helpful to members when applying the revised interpretation.	The change from the initial exposure draft was to eliminate the redundancies in the examples. <i>(The requirement is now found in paragraph .10 and .11 of the revised interpretation.)</i>
N. Under the extant interpretation there is no rebuttable presumption.	Under the proposed interpretation, the rebuttable presumption that the primary government has more than minimal influence over the accounting and reporting process was applied to all funds and component units. <i>(Refer to paragraph .14 of the proposed interpretation.)</i>	PEEC believes there is a presumption that the primary government has more than minimal influence over its fund's and component unit's accounting or financial reporting process, it also believes that this presumption will often be rebutted depending upon the specific facts and circumstances.	The only change to the rebuttable presumption from the initial exposure draft is that the rebuttable presumption was eliminated for discretely presented component units! <i>(The requirement is now found in paragraph .06 items ii2, iii and iv2)</i>
GASB Terms			
O. Certain terminology used in the extant interpretation is specifically defined by the Governmental Accounting Standards Board (GASB)	Some of the terminology used was in the proposed interpretation was GASB terminology but defined differently than GASB.	The proposed interpretation used the GASB term primary government but defined it differently than the GASB does so that the users of the	The change from the initial exposure draft was to respond to commenters request that GASB terms that had different definitions than GASB not be used because doing so was confusing. To

Extant Interpretation	Additional Independence Requirements Under the Initial Exposure Draft	Rationale for The Exposed Change in The Initial Exposure Draft	Task Force's Conclusion Regarding Change to The Revised Proposal
	<i>(Refer to items a, b and c in paragraph .04 of the proposed interpretation.)</i>	interpretation would realize they need to look both up and downstream.	<p>respond to this concern, GASB terms were eliminated and replaced by more general terms such as “affiliate” and “entity”.</p> <p><i>(The requirement is now found in the affiliate definition under 0.400.02. and item a in paragraph .07 of the interpretation)</i></p>

ⁱ About a third of the commenters express concerns with the presumption that primary governments have more than minimal influence over funds and component units. The Committee included the rebuttable presumption in the exposure draft with discretely presented component units in mind. Since these entities are legally separate, the Committee believed that the rebuttable presumption would be operative more often when a discretely presented component unit was involved as opposed to when a fund or blended component unit was involved. The Committee believed drafting the rebuttable presumption this way could result in members having to do less “work” since presumably the member wouldn't go through the evaluation unless the member suspected factors existed that would lend to concluding that the primary government might not have more than minimal influence. However, given the concerns expressed by commenters, the Committee acknowledges that perhaps its desire to make the proposal easier to apply was not the best approach. As such, the Committee decided that the rebuttable presumption that the primary government has more than minimal influence over the accounting or financial reporting process should only cover funds and blended component units. The Committee believes that the limitation of the rebuttable presumption to funds and blended component units appropriately considers the reduced likelihood of threats to independence inherent in discretely presented component units. Members will still need to consider the impact of more than minimal influence by a primary government over a discretely presented component unit, but they do not need to rebut a presumption.

**Professional Ethics Executive Committee
Staff Augmentation Task Force
August 8, 2018**

Task Force Members

Lisa Snyder (Chair), Shelly Van Dyne, Coalter Baker, Jeff Lewis, Brian Lynch, Bill Mann
Staff: Brandon Mercer, CPA CGMA

Task Force Charge

The Task Force's charge is to study the issue of staff augmentation and independence, and determine whether additional guidance for members is warranted.

Reason for Agenda Item

The purpose of this agenda item is to discuss revisions made to the Task Force's draft proposal pursuant to feedback received from the Committee at its May 2018 meeting, and to request the Committee approve exposure of the revised draft proposal.

Background

The Task Force presented a draft proposal and questions for the Committee at the Committee's May 2018 meeting. The Task Force held a conference call in July 2018 to consider the Committee's feedback and to make revisions to the draft proposal. Accordingly, the Task Force requests that PEEC consider the revisions made by the Task Force and approve exposure of the proposal for comment. The Task Force's revised proposal can be viewed at **Agenda Item 3B**.

Summary of Issues**Skill, Knowledge, and Experience ("SKE")**

At the Committee's May 2018 meeting, the consensus was that the proposal should utilize the same standard for SKE as the extant "Nonattest Services" interpretation (ET Sec. 1.295), as most agreed that it was reasonable to expect members to evaluate SKE when providing augmented staff to the attest client. The Task Force agreed that the draft proposal reflected this position, but suggests adding the phrase "by the augmented staff" where indicated below to clarify that the member is under the supervision of the client's designated individual. Additionally, the Task Force suggests a revision to paragraph .02c to clarify that the services should not be otherwise *prohibited*, rather than otherwise *permitted*.

.02 Threats to compliance with the "Independence Rule" [1.200.001] would be at an acceptable level, and independence would not be impaired, provided that, in addition to the General Requirements of the "Nonattest Services" interpretation [1.295.000], all of the following safeguards are met:

- a. The member is satisfied that client management designates an individual or individuals who possess suitable skill, knowledge, and experience, preferably within senior management, to be responsible for:

- i. determining the nature and scope of the activities to be performed provided by the individual performing the augmented staff services (the “augmented staff”);
- ii. supervising and overseeing the activities performed by the augmented staff; and
- iii. evaluating the adequacy of the activities performed by the augmented staff and the findings resulting from the activities.
- b. The activities do not result in the augmented staff member assuming management responsibilities as described in the Management Responsibilities” interpretation [1.295.030] of the “Independence Rule” [1.200.001];
- c. The augmented staff only performs activities that would not otherwise be ~~permitted~~ prohibited by the “Nonattest Services” interpretation [1.295.000] of the “Independence Rule” [1.200.001]; and
- d. The duration of the arrangement is temporary in nature.

Does PEEC agree with the suggested revisions to paragraph .02 noted above?

Duration of the Arrangement – Temporary

As noted in paragraph .02d (above), the draft proposal requires that the duration of the arrangement be “temporary in nature.” PEEC previously noted that the term “temporary” is appropriate and if there are other terms utilized (e.g. recurring, routine, short term, etc.) that it should be clear what is intended. The Task Force agrees that the term “temporary” is appropriate and consistent with the IESBA use of the term in its provisions, and does not believe that defining the term “temporary” is necessary. However, the Task Force agreed that a question for commenters should be included in the exposure draft, asking whether it is reasonably clear what is intended by use of the term “temporary” in the proposal.

Does PEEC agree that the term “temporary” does not require further clarification and that a question should be included in the exposure draft regarding the clarity of the term?

Clarifying Revisions to Paragraph .03

The Task Force noted that the “member” evaluating the significance of the threats might not be the one performing the augmented staff services and therefore suggests changing the term “member” to “augmented staff” in paragraph .03 to make it clear that it is the augmented staff, rather than the member, that should not be identified as an employee of the attest client in any correspondence or other communications. See excerpt of paragraph .03 below:

However, threats to compliance with the “Independence Rule” [1.200.001] would not be at an acceptable level and independence would be impaired if the ~~member~~ **augmented staff** is held out or treated as an employee of the attest client as described below:

- i. The **augmented staff** member is listed as an employee in the attest client's directories or other attest client publications;
- ii. The **augmented staff** member is referred to by title or description as supervising or being in charge of any business function of the attest client;
- iii. The **augmented staff** member is identified as an employee in correspondence such as email, letterhead, or internal communications; **or**
- iv. The **augmented staff** member participates in health, retirement, or other benefit plans that are normally only offered to employees of the attest client.

Does the Committee agree with the Task Force's suggested revisions to paragraph .03 noted above? Are there other examples the Committee is aware of that should be included in paragraph .03?

Examples of Safeguards – Paragraph .04

At the May 2018 PEEC meeting, the Task Force asked for suggestions for additional safeguards that should be included in paragraph .04 as examples. The Task Force has revised paragraph .04 to include the suggestions received, and made other clarifying revisions to items a. and b. as shown below:

.04 The significance of any threats should be evaluated and safeguards applied when necessary to eliminate the threats or reduce them to an acceptable level. Examples of such safeguards may include:

- a. ~~Not giving the loaned staff attest responsibility for any function or activity that the staff performed~~ **using the augmented staff on the attest engagement team, or not using the augmented staff to perform attest procedures on any areas for which the staff performed activities** during the augmented staff arrangement;
- b. ~~Not including the augmented staff members on the attest engagement team~~ **Discussion of the threats and any safeguards applied with those charged with governance;**
- c. **Rotation of individuals performing the staff augmentation activities; or**
- d. **Monitoring the scope of activities performed by augmented staff.**

Does PEEC agree with the additional safeguard examples and the Task Force's suggested revisions to paragraph .04?

Effective Date

The Task Force suggests a delayed effective date of six months after the last day of the month in which the pronouncement appears in the *Journal of Accountancy* to allow firms and clients to implement appropriate policies and procedures to comply with the draft proposal.

Does PEEC agree that a six-month delay in the effective date is appropriate?

Does PEEC believe that any additional questions for commenters should be included in the exposure draft?

Action Needed

The Task Force requests PEEC approve exposure of the draft proposal at **Agenda Item 3B** for comment, with a comment period of sixty days from the date of exposure.

Communication Plan

Upon exposure, the exposure draft will be posted to the AICPA website and distributed to both internal and external stakeholders and other interested parties.

Materials Presented

Agenda Item 3B – Draft Proposal

Staff Augmentation Task Force**Revisions to Draft Proposal**

Additions made since May 2018 PEEC meeting are bold underlined, deletions are struck through.

1.295.xxx Staff Augmentation Arrangements

.01 When a member or member's firm has a staff augmentation arrangement with an attest client, self-review and management participation threats to the member's compliance with the "Independence Rule" [1.200.001] may exist.

.02 Threats to compliance with the "Independence Rule" [1.200.001] would be at an acceptable level, and independence would not be impaired, provided that, in addition to the General Requirements of the "Nonattest Services" interpretation [1.295.000], all of the following safeguards are met:

- a. The member is satisfied that client management designates an individual or individuals who possess suitable skill, knowledge, and experience, preferably within senior management, to be responsible for:
 - i. determining the nature and scope of the activities to be performed **provided by the individual performing the augmented staff services (the "augmented staff")**;
 - ii. supervising and overseeing the activities performed **by the augmented staff**; and
 - iii. evaluating the adequacy of the activities performed **by the augmented staff** and the findings resulting from the activities.
- b. The activities do not result in the ~~member~~ **augmented staff** assuming management responsibilities as described in the "Management Responsibilities" interpretation [1.295.030] of the "Independence Rule" [1.200.001];
- c. The augmented staff only performs activities that would **not** otherwise be ~~permitted~~ **prohibited** by the "Nonattest Services" interpretation [1.295.000] of the "Independence Rule" [1.200.001]; and
- d. The duration of the arrangement is temporary in nature.

.03 In all circumstances, the member should consider whether the staff augmentation arrangement creates the appearance of prohibited employment with the attest client (See the "Simultaneous Employment or Association With an Attest Client" interpretation [1.275.005] of the "Independence Rule" [1.200.001].) When evaluating the appearance of prohibited employment with the attest client, the member should consider factors such as the duration of the staff augmentation arrangement and the portion of the ~~member's~~ **augmented staff's** time spent performing augmentation activities for the specific attest client compared to time spent performing professional services or activities for other clients of the member's firm.

However, threats to compliance with the “Independence Rule” [1.200.001] would not be at an acceptable level and independence would be impaired if the ~~member~~ **augmented staff** is held out or treated as an employee of the attest client as described below:

- i. The **augmented staff** ~~member~~ is listed as an employee in the attest client’s directories or other attest client publications;
- ii. The **augmented staff** ~~member~~ is referred to by title or description as supervising or being in charge of any business function of the attest client;
- iii. The **augmented staff** ~~member~~ is identified as an employee in correspondence such as email, letterhead, or internal communications; **or**
- iv. The **augmented staff** ~~member~~ participates in health, retirement, or other benefit plans that are normally only offered to employees of the attest client.

.04 The significance of any threats should be evaluated and safeguards applied when necessary to eliminate the threats or reduce them to an acceptable level. Examples of such safeguards may include:

- a. ~~Not giving the loaned staff attest responsibility for any function or activity that the staff performed~~ **using the augmented staff on the attest engagement team, or not using the augmented staff to perform attest procedures on any areas for which the staff performed activities** during the augmented staff arrangement;
- b. ~~Not including the augmented staff members on the attest engagement team~~ **Discussion of the threats and any safeguards applied with those charged with governance;**
- c. **Rotation of individuals performing the staff augmentation activities; or**
- d. **Monitoring the scope of activities performed by augmented staff.**

Final Version

1.295.xxx Staff Augmentation Arrangements

.01 When a member or member's firm has a staff augmentation arrangement with an attest client, self-review and management participation threats to the member's compliance with the "Independence Rule" [1.200.001] may exist.

.02 Threats to compliance with the "Independence Rule" [1.200.001] would be at an acceptable level, and independence would not be impaired, provided that, in addition to the General Requirements of the "Nonattest Services" interpretation [1.295.000], all of the following safeguards are met:

- a. The member is satisfied that client management designates an individual or individuals who possess suitable skill, knowledge, and experience, preferably within senior management, to be responsible for:
 - i. determining the nature and scope of the activities to be provided by the individual performing the augmented staff services (the "augmented staff");
 - ii. supervising and overseeing the activities performed by the augmented staff; and
 - iii. evaluating the adequacy of the activities performed by the augmented staff and the findings resulting from the activities.
- b. The activities do not result in the augmented staff assuming management responsibilities as described in the Management Responsibilities interpretation [1.295.030] of the "Independence Rule" [1.200.001];
- c. The augmented staff only performs activities that would not otherwise be prohibited by the "Nonattest Services" interpretation [1.295.000] of the "Independence Rule" [1.200.001]; and
- d. The duration of the arrangement is temporary in nature.

.03 In all circumstances, the member should consider whether the staff augmentation arrangement creates the appearance of prohibited employment with the attest client (See the "Simultaneous Employment or Association With an Attest Client" interpretation [1.275.005] of the "Independence Rule" [1.200.001].) When evaluating the appearance of prohibited employment with the attest client, the member should consider factors such as the duration of the staff augmentation arrangement and the portion of the augmented staff's time spent performing augmentation activities for the specific attest client compared to time spent performing professional services or activities for other clients of the member's firm.

However, threats to compliance with the "Independence Rule" [1.200.001] would not be at an acceptable level and independence would be impaired if the augmented staff is held out or treated as an employee of the attest client as described below:

- i. The augmented staff is listed as an employee in the attest client's directories or other attest client publications;
- ii. The augmented staff is referred to by title or description as supervising or being in charge of any business function of the attest client;
- iii. The augmented staff is identified as an employee in correspondence such as email, letterhead, or internal communications; or
- iv. The augmented staff participates in health, retirement, or other benefit plans that are normally only offered to employees of the attest client.

.04 The significance of any threats should be evaluated and safeguards applied when necessary to eliminate the threats or reduce them to an acceptable level. Examples of such safeguards may include:

- a. Not using the augmented staff on the attest engagement team, or not using the augmented staff to perform attest procedures on any areas for which the staff performed activities during the augmented staff arrangement;
- b. Discussion of the threats and any safeguards applied with those charged with governance;
- c. Rotation of individuals performing the staff augmentation activities; or
- d. Monitoring the scope of activities performed by augmented staff.

Information Technology and Cloud Services

Task Force Members: Shelly VanDyne (Chair), Cathy Allen, Katie Jaeb, Anna Dourdourekas, Dan O'Daly, John Ford. Staff: Ellen Gorla

Task Force Objective

Recommend to the Committee any changes necessary to the nonattest services subtopic considering current information technology (including cloud) service offerings by members.

Reason for Agenda

Solicit feedback on the effective date of the Hosting Services interpretation and frequently asked questions drafted by Staff related to inquiries received on the *Hosting Services* interpretation. The Committee will also receive a high level overview of the feedback received on the *Information Systems Services* Exposure Draft.

Action Needed

Mr. Brackens will solicit feedback from the Committee related to concerns raised regarding the September 1, 2018 effective date of the Hosting Services interpretation.

Ms. Van Dyne and Ms. Gorla will solicit feedback from the Committee on the draft frequently asked questions prepared by Staff related to inquiries received on the *Hosting Services* interpretation.

Communication Plan

Staff will work with the communication and publication teams to develop a communication plan and will update the Committee on the details of this plan.

Materials Presented

Agenda Item 4B Draft Hosting Services FAQs

Agenda Item 4C Hosting Services Interpretation

Hosting services

1. **A member uses a third-party clearinghouse to issue attest reports. Would the clearinghouse be considered a member's portal under item e. in paragraph .04 of the Hosting Services interpretation (1.295.143)?**

No, the clearinghouse would not be considered a member's portal provided all of the following criteria are met:

- a. The platform is a document repository designed to facilitate document exchange between users.
 - b. The platform is hosted, run and controlled entirely by a third-party vendor that is not the member.
 - c. The member, attest client and other platform users have their own user agreements with the third-party vendor.
2. **A member prepares and transmits an attest client's income tax return and related schedules (return) in accordance with the Tax Services interpretation (1.295.160) and sends the filed return to the client using the member's portal. Must the member terminate the attest client's access to that return within a reasonable period after preparing and transmitting the return to avoid providing hosting services?**

Yes. Item e. in paragraph .04 of the interpretation indicates that to avoid providing hosting services, *members* should terminate an *attest client's* access to the data or records in the portal within a reasonable period after the conclusion of the engagement.

3. **Item e. in paragraph .04 of the interpretation indicates that to avoid providing hosting services, *members* should terminate an *attest client's* access to the data or records in the portal within a reasonable period after the conclusion of the engagement. What are some examples of a reasonable period?**

Examples of a reasonable period would include enough time for the client to retrieve the information from the portal or the period of time outlined in the firm's retention policy.

4. **Would a member who uses a third-party's general ledger software to perform bookkeeping services for an attest client be providing hosting services to the attest client if the software is solely located on the member's server (or server leased by the member)?**

Yes, the member would be providing hosting services because the member would be accepting responsibility to be the sole host of the attest client's financial information system. As such, the member has assumed responsibility for the attest client's internal control over financial reporting (that is, safeguarding and maintaining the client's data and records), which is a management responsibility that impairs independence (see 1.295.030.02(k)).

5. **Would the answer to question 3 change if the member provides the attest client with reports from the system so that the attest client's books and records are complete?**

No, the answer would not change and the member would still be accepting responsibility for being the sole host of the attest client's financial information system. In this situation, the system in question is not a software product that produces a discrete calculation (for example, depreciation). Rather, the member has assumed responsibility for the attest client's internal control over financial reporting, which is a management responsibility that impairs independence (see 1.295.030.02(k)).

However, the answer would change if *member* and the *attest client* maintain separate instances of the software on their respective servers, and the *member* provides updated financial information electronically to the *attest client*.

- 6. Would the answer change to question 3 if the software is located on a third-party's server (or server leased by the third-party) and the member has the software agreement with the third-party software provider?**

No, the answer would not change. The attest client does not have its own agreement with the third-party provider, making the attest client's access to its financial information dependent on its relationship with the member. Therefore, the member would still be accepting responsibility for being the sole host of the attest client's financial information system. As such, the member has assumed responsibility for the client's internal control over financial reporting, which is a management responsibility that impairs independence (see 1.295.030.02(k)).

However, the answer would change if the *attest client* enters into an agreement with a third-party service provider to maintain the software in a cloud-based solution and grants the *member* access to the software so that the *member* can perform the bookkeeping service for the *attest client*.

- 7. A member returned an attest client's original data or records used to perform a nonattest service but retained a copy as documentation in support of their service. Would the member be providing hosting services if the member complied with the attest client's subsequent request for a copy of its data or records?**

No. Item a. in paragraph .04 of the interpretation clearly allows a member to retain copies of an attest client's original data or records as documentation that supports the member's professional service. An occasional request by the client for copies of original data or records would not, in and of itself, mean that the member was providing hosting services. However, the member should be alert to a situation in which the client repeatedly requests copies of their data or records, which may signify that the member has become a de facto repository for the client's data or records.

- 8. A member uses payroll software that resides on the firm's server (or server leased by the firm) to prepare an attest client's monthly payroll using time records that the attest client has provided and approved. Would the member be providing hosting services?**

The member would not be providing hosting services if the member gives the payroll report to the attest client so that the attest client's books and records are complete. In this situation, the member would need to provide this information to the attest client each payroll period so that the attest client is able to effectively oversee and take responsibility for the member's nonattest service.

This differs from a situation in which a member provides an attest client with bookkeeping services using general ledger software that resides on the firm's server (or server leased by the firm). In such situation, the member has assumed responsibility for maintaining the client's financial information, in total and become a part of the client's internal control over financial reporting, which is a management responsibility that impairs independence (see 1.295.030.02(k)).

- 9. A member provides an attest client access to sales tax computation software on the member's server. The attest client inputs its original data, the software calculates the sales tax and generates a tax return, which the attest client downloads and files. What actions could the member take to avoid providing hosting services?**

To avoid performing hosting services, the member may wish to consider the following:

- a. In obtaining an understanding with the attest client about the scope of the service (paragraph .01 of 1.295.050), specify that it is the attest client's responsibility to maintain its original data and records as well as the information produced by the system (information) and that the member has no responsibility to safeguard or maintain any of these data, records or information.
- b. Terminate the client's access to their data, records and information in the system after a reasonable period.

1.295.143 Hosting Services

- .01 For purpose of this interpretation, hosting services are nonattest services that involve a *member* accepting responsibility for the following:
- a. Acting as the sole host of a financial or non-financial information system of an *attest client*
 - b. Taking custody of or storing an *attest client's* data or records whereby, that data or records are available only to the *attest client* from the *member*, such that the *attest client's* data or records are otherwise incomplete
 - c. Providing electronic security or back-up services for an *attest client's* data or records
- .02 When a *member* provides hosting services, the *member* is maintaining the *attest client's* internal control over its data or records. Accordingly, the management participation threat to the *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*.
- .03 Examples of activities that are considered hosting services, and as such will *impair independence* if performed for an *attest client*, include accepting responsibility for the following:
- a. Housing the *attest client's* website or other non-financial information system
 - b. Keeping the *attest client's* data or records on the *attest client's* behalf, for example, the *attest client's* general ledger information, supporting schedules (such as, depreciation or amortization schedules), lease agreements or other legal documents are stored on the *member's firm's* servers or servers licensed by the *member's firm* or the *member* is responsible for storing hard copy versions of the data or records
 - c. Being the *attest client's* business continuity or disaster recovery provider
- .04 Examples of activities that are not considered to be hosting services, and as such will not *impair independence* provided *members* comply with the requirements of the other *interpretations* of the "[Nonattest Services](#)" subtopic include these:
- a. Retaining a copy of an *attest client's* data or records as documentation to support a service the *member* provided to the *attest client*. Some examples are as follows:
 - i. The payroll data that support a payroll tax return prepared by the *member* for the *attest client*
 - ii. A bank reconciliation that supports attest procedures performed by the *member* on the *attest client's* cash account
 - iii. The *attest client's* vendor data used to prepare an analysis of vendor activity
 - b. Retaining, for a *member's* records, a copy of a work product prepared by the *member* (for example, a tax return).
 - c. Using general ledger software to facilitate the delivery of bookkeeping services when either of the following occurs:
 - i. The *member* and the *attest client* maintain separate instances of the software on their respective servers, and the *member* provides updated financial information electronically to the *attest client*.
 - ii. The *attest client* enters into an agreement with a third-party service provider to maintain its software in a cloud-based solution and grants the *member* access to the software so that the *member* can perform the bookkeeping service for the *attest client*.
 - d. Retaining data collected by the *member* related to a work product that the *member* prepared for an *attest client*. For example, the *member* conducts an employee

survey and provides the *attest client* with a report. The *member* retains the survey data collected to support the work product.

- e. Electronically exchanging data, records, or the *member's* work product with an *attest client* or on behalf of an *attest client* at the *attest client's* request. For example, the *member* uses a portal as follows:
 - i. To exchange data and records with the *attest client* related to *professional services* provided by the *member* to the *attest client*
 - ii. To deliver the *member's* work product to third parties at the *attest client's* request

To avoid providing hosting services, *members* should terminate the *attest client's* access to the data or records in the portal within a reasonable period of time after the conclusion of the engagement.

- f. Licensing software to an *attest client* that the *attest client* uses to input its data and receive an output that the *attest client* is responsible for maintaining, provided the software does not perform an activity that, if performed directly by the *member*, would *impair independence*.
- g. Having possession of a depreciation schedule prepared by the *member*, provided the depreciation schedule and calculation are given to the *attest client* so that *attest client's* books and records are complete.
- h. Retaining an *attest client's* original data or records to facilitate the performance of a nonattest service (for example, obtaining original records to prepare the attest client's tax return), provided that the data or records are returned to the *attest client* at the end of the engagement or, in a multi-year engagement, at least annually. This does not apply to ongoing hosting services as described in [paragraph .01](#) of this interpretation.

Effective Date

.05 This interpretation is effective September 1, 2018.

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
DIVISION OF PROFESSIONAL ETHICS
PROFESSIONAL ETHICS EXECUTIVE COMMITTEE
OPEN MEETING MINUTES
May 9, 2018

The Professional Ethics Executive Committee (Committee) held a duly called meeting on May 9, 2018 in Scottsdale, AZ. The meeting convened 9:00 a.m. and concluded at 4:30 p.m. on May 9, 2018.

<u>Attendance:</u> Samuel L. Burke, Chair Coalter Baker *Carlos Barrera Stanley Berman Chris Cahill *Tom Campbell Robert E. Denham Anna Dourdourekas Brian S. Lynch *participated by phone	William Darrol Mann William McKeown Steven Reed James Smolinski Shelly Van Dyne Lisa Snyder Kelly Hunter Sharon Jensen Martin Levin *Stephanie Saunders
<u>Staff:</u> James Brackens, VP - Ethics & Practice Quality Toni Lee-Andrews, Director Ellen Gorla, Associate Director Shelley Truman, Ethics Specialist Brandon Mercer, Senior Manager *participated by phone	*April Sherman, Manager *Shannon Ziemba, Manager *James West, Manager *Michele Craig, Manager *Jennifer Kappler, Manager *Jennifer Clayton, Senior Manager *John Wiley, Manager *Melissa Powell, Manager *Henry Grzes, Lead Manager – Tax Practice & Ethics
<u>Guests:</u> Jeff Lewis, Chair, Independence/Behavioral Standards Subcommittee Ian Benjamin, Chair, Technical Standards Subcommittee Jason Evans, BDO Kelly Hnatt, External Counsel Dan Dustin, VP State Board Relations, NASBA *Catherine Allen, Audit Conduct Sonia Araujo, PwC *Paula Tookey, Deloitte *George Dietz, PwC *Jennifer Beneke, EY *Jennifer Kary, Crowe Horwath *Debbie Cutler	

*Nigel James (SEC)
*Lynette Linder (CTCPAS)
*Joe Scutellaro

*Participated via phone

1. Welcome and Introductions

Mr. Burke welcomed the Committee.

2. Joint Meeting with Technical Issues Committee(TIC)

The PEEC and TIC held a joint meeting with TIC to discuss regarding recent pronouncements, current PEEC projects, and other issues in the profession. The committees also discussed how they can collaborate in the standard setting process.

3. Leases

Mr. Mercer presented this agenda item. Mr. Mercer explained that the Task Force held two conference calls since the previous PEEC meeting to review comment letters received.

Paragraph .01

Mr. Mercer noted that the Task Force agreed to revise paragraph .01 to remove a redundancy in the proposal. Specifically, paragraphs .01 and .06 duplicate the exception for automobile leases addressed elsewhere in the Independence rule. The Task Force proposed, and PEEC agreed, to delete the sentence from paragraph .01 referencing automobile leases as it is duplicated at paragraph .06. The approved revision to paragraph .01 of the exposed proposal follows:

.01 When a covered member enters into a lease with an attest client, self-interest, familiarity, and undue influence threats to the covered member's compliance with the "Independence Rule" [1.200.001] may exist.

~~This paragraph excludes leases addressed by paragraph .04 of the "Loans and Leases With Lending Institutions" interpretation [1.260.020] of the "Independence Rule" [1.200.001].~~

Paragraphs .02 and .03

Mr. Mercer noted that the Task Force received comments on paragraphs .02 and .03 that expressed concerns over operationalizing the requirements, as well as concerns regarding the required application of a threats safeguards approach even if the lease meets the requirements of .02. Mr. Mercer noted that some commenters viewed this as overly broad and created unnecessary review of insignificant threats. Mr. Mercer also noted that one commenter expressed concerns regarding the materiality safeguard, specifically that it would create hardships for clients and firms, and should be a trigger for a conceptual framework approach rather than a bright line test.

After discussion, PEEC determined that the general scope of the materiality safeguard in paragraph .02 was appropriate, given the significant appearance concerns of such leases as noted by the Task Force. In addition, PEEC requested that the Task Force consider

redrafting .02c to be more concise rather than repeating the list of specific covered members.

Mr. Mercer noted that commenters did not general agree with paragraph .03 being a required evaluation. The Task Force noted that paragraph .03 should only apply to all leases not addressed by paragraph .02, and that if the member knows or has reason to believe that the lease creates significant threats to independence, the member should apply the Conceptual Framework. The Task Force also asked PEEC to consider whether f and g should be factors to consider. Several PEEC members noted that f and g should be thresholds for a threats/safeguards approach; that is, if the lease does not meet f and g, the member should apply the threats/safeguards to the lease. PEEC requested that the Task Force redraft the paragraph reflecting the discussions.

In the course of the discussion, one member asked why the proposal only addresses leases “entered into” throughout the proposal except paragraph .04. Mr. Mercer noted that entry was the time that threats were high due to the risk of “sweetheart deals,” and that existing leases are addressed elsewhere in the proposal. However, some members noted that the safeguards required in .02 only apply at entry, and others are ongoing. The Task Force was asked to consider this nuance in its deliberations.

Paragraph .04

Mr. Mercer noted that the Task Force was not able to discuss the comments on paragraph .04 in detail due to time constraints, but would discuss it on its next conference call. Mr. Mercer asked the PEEC if it was inconsistent to apply the Conceptual Framework to leases in paragraph .03, while existing leases in paragraph .04 would be subject to prescriptive requirements. The Task Force agreed to revisit this issue if the revisions to .02 and .03 do not resolve any possible inconsistencies.

Paragraph .05

Mr. Mercer noted that commenters generally felt the paragraph was not necessary as it merely references paragraph .04. One commenter recommended an exception for primary residence leases entered into during the period of professional engagement, but no PEEC members agreed with the commenter’s position. PEEC agreed that paragraph .04 would already apply to such leases, and that the paragraph should be deleted. However, some members asked if PEEC should consider noting primary residences somewhere, or consider adding examples around primary residences.

Mr. Mercer noted that the Task Force will have calls in June to further discuss comments and the PEEC’s feedback, and hopes to a draft for adoption at the August PEEC meeting.

4. NOCLAR

Mr. Denham reported on the Task Force’s activity since the February 2018 PEEC meeting. The Task Force, including the UAA co-chairs observing, has been meeting monthly to discuss comment letters received. The Task Force thus far has discussed comments that would likely not be considered by the UAA committee, and revised certain language based on those discussions. The Task Force has also discussed at a high level whether or not there should be distinctions made between audit and non-audit services for certain areas, but no specific conclusions have been reached as these matters will be discussed in a more

broader sense after the UAA Committee has begun its meetings. The Task Force is having an informal meeting before PEEC's closed session to talk about the principal items not yet discussed.

5. Minutes of February 2018 PEEC Open Meeting

It was moved, seconded and unanimously agreed to adopt the minutes from the February 2018 open meeting.

6. Voluntary Tax Practice Reviews

Mr. Mercer presented this agenda item, including a proposed interpretation for exposure. Mr. Grzes and Mr. Scutellaro assisted in the discussion. Mr. Mercer explained that the proposal provides an exception for voluntary tax practice reviews, or quality reviews, provided that the member determines that the review complies with the requirements of Treas. Reg. 7216, which addresses disclosures of confidential information exchanged in a quality or peer review. The Committee agreed to use the term "quality review" to be consistent with Treas. Reg. 7216 and to ensure that other quality reviews that may be named differently are not excluded from the guidance. The Committee agreed with the proposal and after edits, unanimously approved the proposal for exposure for comment with a sixty-day comment period. One member requested that the exposure draft include a question asking whether it is reasonably clear what types of reviews are being referenced in the proposal and that state and local tax information is included.

7. Staff Augmentation

Ms. Snyder presented this agenda item to the Committee. The Task Force requested PEEC feedback on whether it is reasonable to expect members to evaluate the skill, knowledge, and experience ("SKE") of the individual at the client who will supervise the augmented staff's activities. After discussion, PEEC agreed that the same standard should apply in augmented staff situations as would to any nonattest service. The Task Force also requested PEEC's input on whether the term "temporary" is the appropriate term to describe the nature of the augmented staff arrangement, compared to terms such as "recurring," "routine," "discrete," or "short term." Members noted that "temporary" is consistent with the IESBA Code and that other terms may not be clear on the intent of the provisions. If the Task Force uses terms other than temporary it should be clear on what those terms mean. One member noted that the activities should not create independence issues if the activities would otherwise be allowed under ET Sec. 1.295, but the client is supervising the activities. Another member noted that if performing nonattest services, and not going beyond what is allowed in ET Sec. 1.295, the only remaining independence threat would be that of the appearance, which is addressed in the proposal.

The Task Force requested suggestions for additional safeguards to include in the provisions related to the appearance of simultaneous employment. Examples noted by PEEC members included discussions with those charged with governance at the attest client, and rotation of the staff assigned to augmented staff activities.

The Task Force agreed to revise the proposal based on the feedback received and bring a proposal for possible exposure to the next PEEC meeting.

8. State & Local Government

Ms. Miller explained the Task Force is recommending the GASB specific terminology be eliminated from the proposal since several commenters believe using definitions that are not consistent with GASB definitions would result in confusion. Ms. Miller went on to explain that instead, the Task Force is recommending adding the term “affiliate” to the terminology section and to define it to include the entities the exposure draft captured under the “downstream” and “upstream” sections. Additionally, the Task Force recommends the term “entity” be added to the terminology section to explain the various types of SLG “entities” that might exist. Ms. Miller explained that the Task Force believes this will significantly simplify the interpretation. The Committee suggested the Task Force consider adding a statement to the commercial definition of “affiliate” in section 0.400 that would clarify that the commercial definition not be used for purposes of the SLG interpretation.

Ms. Miller went on to explain that the Task Force is recommending the presumption that the primary government has more than minimal influence over the accounting or financial reporting process over a discretely presented component unit be eliminated as requested by commenters, since these entities are legally separate and should be evaluated on a case by case basis. However, since funds and blended component units are not legally separate entities, the Task Force believes it continues to be appropriate to presume that the primary government has more than minimal influence over the accounting or financial reporting process but allow for members to rebut that presumption when appropriate. The Committee did not express any concerns with the Task Force’s intended approach and provided minor grammatical edits to the revised paragraphs.

Ms. Miller went on to explain that the Task Force continues to believe that it is appropriate to require the Independence Rule and related interpretations be applied to an excluded entity, as defined in the interpretation, since these entities would result in a GAAP departure and so should not be overly burdensome to identify.

Ms. Miller explained that the exposure draft provides for an evaluation using the conceptual framework when a member knows or has reason to believe a relationship or circumstance exists with non-affiliate that could create significant threats to independence. She noted that a number of commenters requested clarity on this provision. The Task Force recommends that it believes providing examples of situations covered members may have with non-affiliates would be helpful to clarify how the provision is intended to be applied. The Committee requested the Task Force discuss whether the provision was intended to include entities that were not funds, component units or activities (i.e., outside of the financial reporting entity) and to clarify the connection between the two entities included in example c.

The Committee requested that the Task Force revise paragraph .01 to make it clear that the examples of special purposes governments are not intended to pull in entities that aren’t state or local government entities (e.g., private university). The Committee also requested paragraph .07 be drafted consistent with the nonattest services exception found in the Client Affiliate interpretation for commercial entities.

9. IESBA Update

Ms. Goria explained that during the March IESBA meeting progress was made on the professional skepticism consultation paper and the non-assurance briefing paper which were both expected to be released any day. She explained that these papers would be used to facilitate several round table discussions on these topics and that Mr. Burke and she planned to attend the round table being held in DC.

Ms. Goria noted that the fees questionnaire received 70 responses from various stakeholder groups so far and while further analysis of the responses is necessary, at a high level the views expressed varied between the groups. For example, many large practitioners do not believe further changes to the Code are needed for fees because they already have processes in their firms that go beyond the requirements of the Code. One professional body noted that while it believes fees do have an impact on independence, the impact might be more on audit quality rather actual or perceived independence.

She also noted that the Board discussed the feedback received on the Inducements, Including Gifts and Hospitality proposal with a goal of approving the proposal at the May meeting. Also, the Board received an update on the eCode project which is an initiative to take advantage of technological advancements and apply them to the Code in a way that is user friendly, efficient, and effective.

Ms. Goria also noted that the Monitoring Group plans to publish a feedback statement over the course of the next month and expects to engage in a second consultation in the fall of 2018.