



# PROFESSIONAL ETHICS EXECUTIVE COMMITTEE

Open Meeting Agenda

**May 9-10, 2018**  
**Scottsdale, AZ**



**AICPA Professional Ethics Executive Committee  
Open Agenda  
May 9, 2018  
Scottsdale, AZ [Pacific Standard Time]**

**Day 1: Phone Access:** +1 646 876 9923 (US Toll) or +1 669 900 6833 (US Toll)  
Meeting ID: 919 402 4936 **Web Access:** <https://aicpa.zoom.us/j/9194024936>

February 13 <sup>th</sup>	<i>Open Meeting Begins</i>	
9:00 a.m. – 10:30 a.m.	<b>Joint Meeting of PEEC and Technical Issues Committee (TIC)</b>  The Committees will discuss current projects and recently issued guidance, including the following: <ul style="list-style-type: none"> <li>❖ NOCLAR</li> <li>❖ State and Local Government</li> <li>❖ Information Systems Services</li> <li>❖ Leases</li> <li>❖ Staff Augmentation</li> <li>❖ Voluntary Tax Practice Reviews</li> <li>❖ Selected Procedures</li> <li>❖ Long Association and Peer Review Checklist</li> <li>❖ TIC Involvement in PEEC Standard Setting Process</li> <li>❖ Hosting FAQ – TIC Feedback</li> <li>❖ TIC Ideas for Additional Ethics Tools</li> <li>❖ IESBA – TIC involvement</li> </ul>	
10:30 a.m. – 10:45 a.m.	<i>Break</i>	
10:45 a.m. – 10:50 a.m.	<b>Welcome</b> Mr. Burke will welcome the Committee members and discuss administrative matters.	
10:50 a.m. – 12:30 p.m.	<b>Leases</b> Mr. Mercer and Mr. Wilson will request the Committee's feedback on revisions to the proposal, and adoption of the revised interpretation. <ul style="list-style-type: none"> <li>❖ External Link – <a href="#">Leases Exposure Draft</a></li> <li>❖ External Link – <a href="#">Comment Letters</a></li> </ul>	<b>Agenda Item 1A</b> <b>Agenda Item 1B</b> <b>Agenda Item 1C</b> <b>Agenda Item 1D</b> <b>Agenda Item 1E</b>
12:30 p.m. – 1:30 p.m.	<i>Lunch</i>	
1:30 p.m. – 2:15 p.m.	<b>Voluntary Tax Practice Reviews</b> Mr. Mercer and Mr. Grzes will request the Committee's approval to expose a new proposed interpretation of the Confidential Client Information rule.	<b>Agenda Item 2A</b> <b>Agenda Item 2B</b>

2:15 p.m. – 3:00 p.m.	<b>Staff Augmentation</b> Ms. Snyder and Mr. Mercer will update the Committee on the Task Force direction and request feedback.	<b>Agenda Item 3A</b> <b>Agenda Item 3B</b> <b>Agenda Item 3C</b>
3:00 p.m. – 3:15 p.m.	<i>Break</i>	
3:15 p.m. – 4:00 p.m.	<b>State and Local Government</b> Ms. Miller and Ms. Gorla will seek input from the Committee on the Task Force's direction. <ul style="list-style-type: none"> <li>❖ External Link – <a href="#">SLG Exposure Draft</a></li> <li>❖ External Link – <a href="#">Comment Letters</a></li> </ul>	<b>Agenda Item 4A</b> <b>Agenda Item 4B</b>
4:00 p.m. – 4:15 p.m.	<b>NOCLAR</b> Mr. Denham will update the Committee on the Task Force's activities.	
4:15 p.m. – 4:25 p.m.	<b>IESBA Update</b> Ms. Gorla will update the Committee on recent IESBA activity. To launch the external links that follow you may need to log into the IESBA website. <ul style="list-style-type: none"> <li>❖ External Link - <a href="#">Restructured IESBA Code</a></li> <li>❖ External Link - <a href="#">Basis for Conclusions for Improving the Structure of the Code of Ethics for Professional Accountants</a></li> <li>❖ External Link - <a href="#">Basis for Conclusions for Revisions Pertaining to Safeguards in the Code</a></li> <li>❖ External Link - <a href="#">Proposed Strategy and Work Plan, 2019-2023</a></li> <li>❖ External Link - <a href="#">Draft Inducement Standard</a></li> </ul>	<b>Agenda Item 5A</b>
4:25 p.m. – 4:30 p.m.	<b>Minutes of the Professional Ethics Executive Committee Open Meeting</b> The Committee is asked to approve the minutes from the February 2018 open meeting.	<b>Agenda Item 6</b>
	<i>Open Meeting Concludes</i>	
4:30 p.m. – 5:30 p.m.	<b>IFAC Convergence and Monitoring Task Force</b>	
Informational Purposes Only	<b>Outstanding Exposure Drafts</b> <ul style="list-style-type: none"> <li>❖ External Link – <a href="#">Information System Services</a></li> </ul>	
Informational Purposes Only	<b>Committee Project Agenda</b> <ul style="list-style-type: none"> <li>❖ External Link - <a href="#">Project Agenda</a></li> </ul>	
	<b>Future Meeting Dates</b> <ul style="list-style-type: none"> <li>• August 8-9, 2018 – New York, NY</li> <li>• November 7-8, 2018 – Durham, NC</li> </ul>	

	<ul style="list-style-type: none"><li>• February 2019 – TBD</li><li>• May 2019 – TBD</li></ul>	
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**Professional Ethics Executive Committee  
Leases Task Force**

**Task Force Members**

Blake Wilson (Chair), Bill Mann, Chris Cahill, Nancy Miller, David East, Alan Gittelson  
Staff: Brandon Mercer; Observer: Lisa Snyder

**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 update PEEC on the Task Force's review of comments received on the Leases Exposure Draft. The Task Force requests that PEEC approve revisions as recommended in this agenda item and provide feedback on additional questions raised during the review of comment letters.

**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. There were no comment letters objecting to the proposal in general, but each commenter recommended considering specific items for improvement or revision. Staff has summarized the comments below in order of the relevant paragraph in the proposal. The full list of comments and responses to specific questions posed by PEEC in the Exposure Draft is presented at **Agenda Items 1B and 1C**.

**Summary of Issues**Paragraph .01

Commenters noted that the second sentence of paragraph .01 as exposed is repetitive of paragraph .06. Paragraph .01 refers to the "paragraph" while paragraph .06 refers to the "interpretation." The Task Force recommends deleting the sentence from paragraph .01 as paragraph .06 already addresses the application. The revision to the exposed paragraph .01 and paragraph .06 are shown below.

.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].~~

.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].

**Action Needed: The Task Force requests that PEEC approve the revisions above to paragraph .01 of the exposed proposal.**

### Paragraphs .02 and .03

#### *Concerns with Scope of Materiality Safeguard (.02)*

Commenters mostly agreed with the contents of paragraph .02 and the application of the materiality safeguard to specific covered members and the attest client. However, one commenter (CL6) disagreed with the scope of the materiality safeguard, recommending deletion of the safeguard in paragraph .02, and recommending that materiality trigger a conceptual framework evaluation of the threats created by the lease. The commenter further recommended materiality as a factor to consider (paragraph .03). The commenter's view is that if materiality remains as a safeguard in paragraph .02, the scope of the materiality safeguard be narrowed to the firm, the attest engagement partner, and the attest client. In essence, this would potentially permit other members of the attest engagement team and individuals in a position to influence the attest engagement to have a material lease with an attest client subject to an evaluation of threats and safeguards.

During its review of the comments, the Task Force noted that the primary issue with covered members specified in paragraph .02 is the significance of the threat to the *appearance* of independence, even if the threat to independence *in fact* is not significant. The Task Force continues to agree that leases that are material to the firm or the attest client create threats that cannot be safeguarded. However, with regards to individuals on the engagement team and in the chain of command, some commenters were concerned with operationalizing the proposed requirements for those individuals if they remain subject to the materiality safeguard in paragraph .02, as the population of leases that require identification, evaluation, and monitoring/tracking for compliance purposes increases significantly. Other members questioned whether tracking of leases would be significantly different from what firms must currently do for purposes of tracking loans or financial interests.

Other concerns noted by commenters included the following:

- Small firms may lack the resources to apply safeguards contemplated in the proposal, such as reassignment of staff (CL6)
- How to address leases that become material subsequent to entering into the lease, or after being evaluated as immaterial. (CL3)
- A significant population of operating leases, which currently do not impair independence, will have to be identified, monitored, and evaluated on an ongoing basis. (CL4)
- Without an exemption for short-term leases (e.g., short-term rental properties, car rentals, and technology rentals) the burden on the firm and covered member to track

such leases may be prohibitively high with respect to the low level of threats created by such leases. The short duration of such leases mitigates the self-interest, familiarity, and undue influence threats caused by such leases. (CL3)

- Inconsistency with treatment of automobile leases with lending institutions, which are not subject to a materiality requirement (CL6)
- The blanket prohibition based on materiality may create hardships by:
  - o restricting the opportunities currently available to covered members and their immediate family members to acquire housing and personal consumer goods (CL6);
  - o disproportionately affecting junior-level professional staff on the attest engagement team (CL6);
  - o impairing the ability of firms to attract and retain first-rate talent, such as interns, associates, and senior associates, as well as increasing staff recruiting and retention costs for firms (CL6).

**Action Needed: The Task Force requests that PEEC discuss the concerns of the commenters noted above and determine the final scope of paragraph .02 and paragraph .03. Additional comments regarding paragraph .03 and its interaction with paragraph .02 are discussed below.**

*Considerations for Multiple Leases (.02 - .03)*

Commenters noted that although the interpretation indicates that multiple leases with the attest client is a factor impacting the threats to independence, there is no reference to multiple leases in paragraph .02. The commenters recommended adding similar language to paragraph .02 to indicate that leases should be considered individually and in the aggregate when evaluating materiality.

**Action Needed: Staff requests that PEEC consider adding language to the end of paragraph .02, which is reflected in the revisions to paragraph .02 and paragraph .03 later in this agenda item.**

*Required Threats/Safeguards Analysis (.03)*

Commenters expressed concerns regarding the requirements of paragraph .03 of the exposed proposal, which worked in conjunction with paragraph .02 by requiring that the covered member evaluate any other threats created by the lease if the lease was not already prohibited by the materiality requirements of paragraph .02. Concerns included the fact that a large population of leases would require evaluation, even if the threats were not significant. The intent of the exposed structure was to have a set of required safeguards to address those leases that create the most significant threats to independence (.02), then a threats/safeguards approach for all other leases (.03). Commenters generally felt that this additional required evaluation was overly broad and should be limited to leases which a member “knows or has reason to believe” may create threats to independence.

One commenter (CL7) suggested that paragraph .03 only apply to leases that are not material to the covered members and that are not addressed by paragraph .02, questioning the “need to consider other threats if the lease is immaterial to the attest client and the covered members, since we believe that threats in those facts and circumstances are already at an acceptable level.” The commenter recommended providing for a “general evaluation of threats and safeguards consistent with paragraph .03 when the lease is immaterial to the attest client but material to a category of covered member not specified in paragraph .02c.” The commenter noted that the suggested approach would “recognize that immaterial leases do not result in significant threats, and provide guidance to firms on how leases with certain categories of covered members, despite being material to that covered member, may have sufficient safeguards to objectivity and professional skepticism.” This suggested approach would apply the requirements of paragraph .02 only to leases entered into by certain covered members, and all other leases would be subject to a Conceptual Framework approach in paragraph .03. Revisions reflecting this approach, as well as the other comments on .02 and .03, are presented below for discussion purposes.

The Task Force agreed to revise paragraphs .02 and .03 so that paragraph .03 only applies to leases that are not addressed by paragraph .02. This required changing the scope of paragraph .02 to the subset of covered members subject to the materiality safeguard, as these covered members carry the greatest threats. As exposed, paragraph .02 applied to any lease entered into by any covered member, but the materiality safeguard only applied to the subset of covered members. Under the proposed revisions, paragraph .02 only applies to the subset of covered members (i.e., those on the attest engagement team, those in a position to influence the attest engagement, and the firm); while all other covered members are addressed by paragraph .03, as revised. The revised paragraph .03 would apply to any other lease that the covered member has reason to believe creates significant threats to independence. These revisions are shown below for discussion purposes.

**Action Needed: The Task Force requests that PEEC consider the revisions to paragraphs .02 and .03 below. Paragraph .02 would apply to the subset covered members, while all other covered members would be subject to the Conceptual Framework approach in paragraph .03.**

**The Task Force also requests that PEEC review the additions to the list of factors and whether these are appropriate additions, as suggested by commenters.**

.02 If **an individual participating on the attest engagement team, an individual in a position to influence the attest engagement, or the firm** ~~covered member~~ enters into a 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 on market terms and established at arm's length.
- b. All amounts are paid in accordance with the lease terms or provisions.
- c. The lease is not material to 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*.

**For purposes of this paragraph, when evaluating materiality, all leases between the parties, should be considered, both individually and in the aggregate.**

- .03 **If the covered member knows or has reason to believe that any lease arrangements other than those described in paragraph .02 of this interpretation create threats to independence, the covered member should apply the "Conceptual Framework for Independence" interpretation [ET sec. 1.210.010]. When evaluating threats under the Conceptual Framework in such circumstances, the member may consider** ~~If the covered member meets the safeguards in paragraph .02, as applicable, the covered member should evaluate the significance of 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~~ **or the attest client**
  - c. Whether multiple leases 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 arms length**
  - g. **Whether the covered member or the attest client have paid all amounts in accordance with the lease terms or provisions.**

#### Paragraph .04 – Grandfathered Leases

Two commenters questioned the clarity and intent of paragraph .04, including the fact that the circumstances listed in a-c of the paragraph are exceptions, rather than grandfathering provisions. One commenter stated that the only true grandfathering provision was the provision for operating leases existing at the effective date of the interpretation. One commenter requested clarity on renewals subject to paragraph .04, and suggested that there be an exception for one-time short-term renewals at market terms, even if not provided for in the original lease. Another commenter recommended that the proposal provide an exemption for

any renewals of the existing lease, even if not provided for in the original lease. Due to time constraints, the Task Force was not able to discuss renewals at length on its recent calls, but the structure of paragraph .04 was intended to be consistent with the treatment of *loans* that existed prior to independence being required, and includes similar safeguards, including a prohibition of loan terms changing during the period of the professional engagement.

PEEC previously believed that consistency with the treatment of home mortgages was appropriate for the leases described in .04, and provided relief from the materiality safeguard. However, there may be an inconsistency with application of the Conceptual Framework to newly entered leases in paragraph .03. That is, the requirements for existing leases in paragraph .04a-.04c are more prescriptive and may be more restrictive than applying the Conceptual Framework. For example, if a covered member, other than those named in paragraph .02, enters into a new lease, it will be subject to the Conceptual Framework approach in paragraph .03. If the lease is existing (.04a-.04c), it is subject to the prescriptive requirements of paragraph .04, but gets relief from the materiality safeguard.

**Question for PEEC: Does PEEC believe there is an inconsistency in applying paragraph .04 to existing leases (.04a-.04c) while applying the Conceptual Framework to newly entered leases? Should the grandfathered leases in .04a-.04c be subject to the Conceptual Framework in paragraph .03, leaving operating leases that existed at the effective date of the interpretation as the only grandfathered leases?**

The revisions below reflect reduction of the grandfathering paragraph to apply only to existing operating leases, and would render other existing leases to the Conceptual Framework approach in paragraph .03.

### **Grandfathered Leases**

- .04 Threats to compliance with the "Independence Rule" [1.200.001] would be at an acceptable level and independence would not be impaired provided that**  
~~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 provided that the lease 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 do not change in any manner not provided for in the original lease 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. ~~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 do not change in any manner not provided for in the original lease.**

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

#### Paragraph .05 – Primary Residential Leases

Some commenters questioned the necessity of paragraph .05, as it does not provide any additional relief for primary residential leases beyond the relief in paragraph .04. One commenter suggested that there be an exception for primary residential leases entered into during the period of the professional engagement, as the exposed proposal only provides relief to existing primary residential leases. PEEC’s previous view was that primary residential leases should be treated similar to home mortgages, the requirements of which are reflected in the proposal.

**Question for PEEC: Does PEEC agree with the commenters that paragraph .05 is not necessary, if it only states that primary residential leases should meet the requirements of paragraph .04? In deliberating this issue, the PEEC should consider the revisions being proposed in paragraph .04 above and whether primary residential leases should be treated the same or different from other leases.**

#### **~~Covered Member Leases Primary Residence from Attest Client~~**

~~.02 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.~~

#### Exceptions for Upstream and Sister Affiliates

Three commenters (CL5, CL6, CL7) suggested the Task Force consider exceptions for unaudited upstream and sister entities of the attest client (i.e. affiliates). The Task Force generally agreed that upstream and sister affiliate relationships do not present significant threats that should be subject to the requirements of paragraph .02, even if the lease is with the subset of covered members described in paragraph .02. However, if the member has reason to believe that a lease with an affiliate exists that creates significant threats, the member should use the Conceptual Framework approach. The full Affiliates interpretation is presented at **Agenda Item 1E** with the proposed revision below included.

## 1.224.010 Affiliates interpretation

.02 e. A member may have a lease with the attest client that does not meet the safeguards required in the “Leases” interpretation [1.260.040.02] with an entity described under items c-I of the definition of affiliate, unless the member knows or has reason to believe that a lease exists with the affiliate which creates significant threats to independence. The member should evaluate and address the significance of threats created by such leases by applying the “[Conceptual Framework for Independence](#)” [1.210.010].

**Question for PEEC: Does PEEC agree that the exemption for upstream and sister affiliates similar to the draft above is appropriate?**

### 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.

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

### Action Needed

Staff requests that PEEC discuss the comments above and determine whether any revisions of the exposed standard should be made. The Task Force will address any open issues and propose a final standard for adoption at the August 2018 PEEC meeting.

### Materials Presented

**Agenda Item 1B:** Comment Letter Summary: General Comments

**Agenda Item 1C:** Comment Letter Summary: Responses to Specific Questions

**Agenda Item 1D:** Proposed Leases Standard (as exposed)

**Agenda Item 1E:** AICPA Affiliates Interpretation

**COMMENT SUMMARY**  
**PROPOSED Revised “Leases” interpretation of the “Independence Rule”**

<b>Comment Letter</b>		<b>Feedback Highlights</b>	<b>Task Force Response</b>
<b>CL 1</b>	AICPA Technical Issues Committee (TIC) <b>Support</b>	<b>General Comments</b> <ul style="list-style-type: none"> <li>TIC believes that the specific identification of familiarity and undue influence threats in paragraph 01 of the ED should be removed; TIC believes that these would not be significant threats.</li> <li>TIC also notes that ET sec 1.260.020, Loans and Leases with Lending Institutions, only identifies self-interest as a threat. TIC believes this is appropriate. The ED does a very good job of conforming ET sec 1.260.040 with 1.260.020 except for the references to familiarity and undue influence threats, which based on the definitions, would not be significant threats.</li> </ul>	The Task Force and PEEC previously discussed the identification of threats at length and determined that familiarity and undue influence threats would exist to the point which they should be addressed by safeguards. PEEC believed that entry of the lease could be influenced by both threats, hence the safeguard of market terms established at arm's length.
<b>CL 2</b>	NASBA <b>Support</b>	<b>General Comments</b> <ul style="list-style-type: none"> <li>In comparing the proposed revisions to the existing loan interpretation (1.260.020), we noted that the loan interpretation includes a fundamental safeguard that is absent from this proposal, i.e., the Code only permits loans to a covered member from an attest client if the attest client makes loans as part of its normal business operations. We understand the PEEC considered this fact and concluded that because real estate investment trusts, which are not lending institutions, frequently issue real estate leases, the addition would not be appropriate. However, we also note that the current definition of “lending institution” does incorporate automobile lessors. Thus, for consistency purposes and</li> </ul>	PEEC and the Task Force determined that leases are in many cases with non-lending institutions or individuals, especially in smaller geographical areas and in real estate.

Comment Letter	Feedback Highlights	Task Force Response
	<p>to significantly strengthen the proposed leases interpretation, we suggest that PEEC consider whether a similar notion pertaining to lessors more broadly should be incorporated into this standard as a fundamental safeguard.</p> <ul style="list-style-type: none"> <li>• <i>Lending institution. An entity that, as part of its normal business operations, makes loans.</i> This definition is not meant to include an organization that might schedule payment for services for a client over a period of time. Examples of such entities are banks, credit unions, certain retailers, and insurance and finance companies. For example, for automobile leases addressed by the “Loans and Leases with Lending Institutions” interpretation [1.260.020] of the “Independence Rule” [1.200.001], an entity is considered a lending institution if it leases automobiles as part of its normal business operations. [Prior reference: paragraph .09 of ET section 92]</li> </ul>	
<b>CL 3</b> <b>KPMG</b> <b>Support</b>	<p><b>General Comments</b></p> <ul style="list-style-type: none"> <li>• We recommend that PEEC consider an exemption...for short-term leases such as short-term rental properties, car rentals, and technology rentals. Self-interest, familiarity, and undue influence threats related to such leases are low because of the brief duration of the lease. The burden on the firm and covered member to track such leases could be prohibitively high with respect to the low level of threats to independence resulting from short-term leases. We believe that a reasonable lease term to qualify for the exemption would be a term not to exceed thirty days. In order to qualify for the short-term lease exclusion, the lease should not have a renewal option that extends the rental period beyond the period defined as short-term. We</li> </ul>	<p>The Task Force had concerns around how to set a standard for what defines short term, but agreed that a conceptual framework approach may be more appropriate for such short term leases.</p> <p>The revised paragraphs .02 and .03 in this agenda would address short terms leases, but would not provide a full exception for covered members named in .02.</p>

Comment Letter	Feedback Highlights	Task Force Response
	<p>propose PEEC consider the following wording be added to paragraph .01 in order to address the comments reflected above:</p> <p><i>1.260.040.01.b</i>  <i>This interpretation excludes short-term leases entered into by a covered member with an attest client, as threats to compliance with the “Independence Rule” [1.200.001] would be at an acceptable level and independence would not be impaired provided that the lease term is ## days or less, and there is no renewal or extension to the lease term beyond ## days.</i></p> <ul style="list-style-type: none"> <li>• We believe that paragraph .06 is repetitive of the second paragraph of .01, as both discuss the exclusions around leases addressed by paragraph .04 of the “Loans and Leases with Lending Institutions” interpretation [1.260.020] of the “Independence Rule” [1.200.001]. We recommend that PEEC replace the second paragraph of paragraph .01 with paragraph .06, and remove paragraph .06.</li> </ul>	<p>The Task Force agrees but proposes removal of the sentence from paragraph .01.</p>
<p><b>CL 4</b></p> <p>Deloitte LLP  <b>Support</b></p>	<p><b>General Comments</b></p> <ul style="list-style-type: none"> <li>• Paragraph .02 – <i>Materiality Considerations for multiple leases</i>. Paragraph .02 (c) describes materiality safeguards for the firm, individuals participating on the attest engagement team, individuals in a position to influence the attest engagement, and the attest client that must be met to be able to conclude that threats to compliance with the Independence Rule (1.200.001) are or can be reduced to an acceptable level to avoid an independence impairment. However, there is no specific guidance in paragraph .02 related to the materiality considerations for multiple leases. We request the</li> </ul>	<p>Staff has included sample language in the revisions to paragraph .02 in this agenda.</p>

Comment Letter	Feedback Highlights	Task Force Response
	<p>PEEC consider clarifying whether it is necessary to consider aggregate materiality for purposes of applying the paragraph .02(c) safeguards in cases where multiple leases exist between the covered member and the attest client.</p> <ul style="list-style-type: none"> <li>Paragraph .04 – <i>Grandfathered Leases</i>. We request the PEEC consider clarification to Paragraph .04(c) which states, “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.” The current wording is not clear. We believe the intent of this paragraph is to address situations whereby an existing attest client is party to a lease, and the counterparty to such lease, at inception, was not associated with the covered member. However, such counterparty is subsequently acquired by, or acquires the covered member (i.e., the counterparty becomes associated with the covered member, in which case the independence rules would then be applicable to that counterparty). Please clarify PEEC’s intent. In addition, the final sentence in paragraph .04 of the Proposed Interpretation states that “Automatic renewals provided for in the original lease are not considered changes in terms for purposes of this Interpretation.” We believe that addressing only this narrow aspect of a lease in the Interpretation could be read to imply that the application of other common lease terms (e.g., an election to extend a lease on a month-to-month basis at the end of its primary lease term) would be a change in terms for purposes of the Interpretation. We request that the PEEC consider broadening the scope of this sentence to indicate that the application of any provision of an original lease agreement is not considered a</li> </ul>	TBD



Comment Letter		Feedback Highlights	Task Force Response
		<p>change in terms for purposes of this Interpretation.</p> <ul style="list-style-type: none"> <li><i>Paragraph .05 - Covered Member Leases Primary Residence from Attest Client.</i> In our view, paragraph .05 of the Proposed Interpretation does not provide any special exception for leases related to primary residences. Rather, it appears to serve as a reinforcement of the grandfathering provisions already included in paragraph .04 that are available for any leasing arrangement and therefore may be superfluous/unnecessary. If our understanding is correct, PEEC should consider omitting the paragraph if it does not intend to provide any specific exception for primary residence leases. As an alternative, PEEC could consider including an explicit reference to leases on primary residences as an example of leases that can be grandfathered under the provisions of paragraph .04.</li> <li><i>Decision Tree.</i> We request the PEEC consider creating a decision tree to assist practitioners in understanding the new requirements under the interpretation. Given the complexity and analysis that may be required for implementation, a decision tree would provide greater clarity and guidance to members in applying the interpretation.</li> </ul>	<p>TBD</p> <p>TBD</p>
<b>CL 5</b>	Grant Thornton <b>Support</b>	<p><b>General Comments</b></p> <ul style="list-style-type: none"> <li>Grant Thornton suggests the PEEC consider providing examples or illustrations to assist in the application of the new interpretation.</li> </ul>	TBD
<b>CL 6</b>	PwC <b>Support</b>	<p><b>General Comments</b></p> <ul style="list-style-type: none"> <li>We agree with the PEEC's position that the financial statement presentation of a lease should not result in a</li> </ul>	

Comment Letter	Feedback Highlights	Task Force Response
	<p>de-facto conclusion that the lease is permissible or impermissible from an independence perspective. Regardless of whether a lease is classified as an operating or a capital lease, we believe that independence should be evaluated on the basis of the lease's effect on the auditor's objectivity and professional skepticism. However, while we support a model that doesn't default to US GAAP classification, we do have concerns regarding the approach being proposed by the PEEC.</p> <ul style="list-style-type: none"> <li>• In our view, goods and services obtained as a consumer in the ordinary course of business do not, generally, impair an auditor's objectivity or professional skepticism. The current "Leases" interpretation implicitly recognizes this by permitting covered members to enter into an operating lease with an attest client, provided that the terms and conditions set forth in the lease agreement are comparable with other leases of a similar nature, and all amounts are paid in accordance with the lease terms and provisions.</li> <li>• Accordingly, our overarching recommendation is for the PEEC to align more closely with the IESBA Code of Ethics for Professional Accountants by establishing a more principles-based approach that treats leases as permissible provided they are entered into in the normal course of business and on an arm's length basis. Under a principles-based approach such as this, the materiality of the lease to the covered member would be one of the factors to be considered when evaluating threats to independence, rather than the automatic trigger for an independence impairment as is being proposed. Because of the pervasive use of leasing arrangements</li> </ul>	<p>See discussion and related revisions to paragraph .02 and .03 in this agenda.</p> <p>See paragraph .02 and .03 revisions.</p>

Comment Letter		Feedback Highlights	Task Force Response
		to acquire a wide range of consumer goods, this approach would also help to mitigate the potential for any undue burden or hardship that a bright-line test might otherwise create. It would also ensure consistency with the current treatment of automobile leases in the Code of Conduct, which takes the preferred approach of exempting such transactions from the prohibition on loans without regard to materiality. Appendix A expands on the principal suggestion described above, and also offers detailed comments and recommendations regarding other areas of the proposal.	
<b>CL 7</b>	EY <b>Support</b>	<p><b>General Comments</b></p> <p>We are supportive of PEEC's Proposed Revision that prescribes a conceptual framework to evaluate threats and safeguards to independence arising from leases between attest clients and covered members. We believe that the approach of evaluating lease transactions similar to the evaluation required for other business relationships is the most appropriate approach and consistent with other regulatory schemes. Fundamentally, lease transactions are procurement transactions whereby the lessee is contracting for the right to use an asset for a period of time. While the Code generally permits procurement by the member from attest clients, we agree that the typical terms of a lease arrangement often results in additional independence threats, thus requiring an additional evaluation of threats and safeguards that are generally not needed for typical, one-off procurement transactions. While we are generally supportive, we do wish to provide the following comments.</p> <ul style="list-style-type: none"> <li>• <i>Applicability and application of paragraph .02 and .03.</i> Consideration should be given to clarifying the leases subject to 1.260.040.02. The phrase "a covered member enters into a lease" could be read to apply to only new</li> </ul>	See revisions to paragraphs .02 and .03 in this agenda.

Comment Letter	Feedback Highlights	Task Force Response
	<p>leases entered into during the period of professional engagement by a professional that is a covered member when the lease is executed, and not include leases entered into by a professional prior to becoming a covered member. The business relationship and loan interpretations use terms such as “has” or “had”. Use of the term “has”, in this situation seems to be more appropriate when considering the application of the grandfathering provisions.</p> <ul style="list-style-type: none"> <li>• If 1.260.040.02 was intended to only apply to new leases entered into during the period of professional engagement by a professional that is a covered member when the lease is executed, then we believe that paragraph 1.260.040.04 is not a grandfathering provision but rather addresses circumstances other than those described in 1.260.040.02, and should therefore be titled differently than “Grandfathered Leases”.</li> <li>• In addition, we believe that the requirements of paragraph 1.260.040.03, and its interaction with paragraph 1.260.040.02 could be confusing to members and in some circumstances place an undue burden on a firm to document safeguards when there are minimal threats. Paragraph 1.260.040.03 provides that even if the minimum safeguards required in paragraph 1.260.040.02 are met, the member should consider other threats and potential safeguards. It is unclear why there is a need to consider other threats if the lease is immaterial to the attest client and the covered members, since we believe that threats in those facts and circumstances are already at an acceptable level. We believe that it would be more appropriate to provide for a general evaluation of threats and safeguards consistent with paragraph .03 when the lease is</li> </ul>	<p>TBD</p> <p>See revisions to paragraphs .02 and .03 in this agenda.</p>

Comment Letter	Feedback Highlights	Task Force Response
	<p>immaterial to the attest client but material to a category of covered member not specified in paragraph .02c (i.e., a partner, partner equivalent or manager that provides more than 10 hours of nonattest services to the attest client within any fiscal year, or a partner or partner equivalent in the office in which the lead attest engagement partner or partner equivalent primarily practices in connection with the attest client). That approach would recognize that immaterial leases do not result in significant threats, and provide guidance to firms on how leases with certain categories of covered members, despite being material to that covered member, may have sufficient safeguards to objectivity and professional skepticism.</p>	

**COMMENT SUMMARY – RESPONSES TO SPECIFIC QUESTIONS  
PROPOSED Revised “Leases” interpretation of the “Independence Rule”**

**Question 1: Are there any exceptions that should be extended to affiliates of financial statement attest clients?**

**Task Force Response: See proposed revision to the Affiliates interpretation in this agenda in response to these comments.**

<b>CL 1</b>	TIC	TIC agrees that the provisions of this section should apply to affiliates and exceptions should not be extended.
<b>CL 2</b>	NASBA	No, NASBA does not believe that the PEEC should add any exceptions to a covered member’s leasing arrangements with affiliates of financial statement attest clients as (i) exceptions would add unnecessary complexity to the interpretation, and (ii) such treatment would be inconsistent with the way that other financial relationships (e.g., banking or brokerage relationships) are treated under the Code.
<b>CL 3</b>	KPMG	We do not believe that exceptions should be provided for affiliates of attest clients.
<b>CL 4</b>	Deloitte	n/a
<b>CL 5</b>	Grant Thornton	Grant Thornton believes that as ownership interests can change frequently in our current business environment, it would be our recommendation to only require leases that exist between a covered member and the attest client to be evaluated. We do not believe that a lease that exists between an affiliate (e.g., parent or a brother-sister entities not audited by the firm) and a covered member would impair the ability of a firm to be compliant with the Independence rule.
<b>CL 6</b>	PwC	Yes, we believe that exceptions should be extended to certain affiliates. Under the principles-based approach that we’ve recommended in Section I, a lease entered into with an unaudited affiliate under common control with (i.e., a “sister entity”) or upstream of the financial statement attest client could be deemed to raise threats to independence that are less significant than those created by a leasing arrangement with a material subsidiary. This is because, among other considerations, the former would not be subject to financial statement attest procedures or financial statement disclosures. However, the proposal makes no such distinction. In this scenario, the impact on independence would be considered to be the same, incorrectly in our view, and would represent a breach of the Code of Conduct

		<p>reportable to those charged with governance. Establishing a more principles-based approach for evaluating the permissibility of leases, as we've suggested, would allow for flexibility in the independence evaluation and help to avoid disparate and overly prescriptive conclusions relating to certain affiliates, such as those described above.</p> <p>If the PEEC decides to retain the prohibition on material leases with respect to members of the attest engagement team and those individuals in a position to influence the attest engagement, the prohibition should only apply to arrangements with the financial statement attest client and with those affiliates subject to financial statement attest procedures (i.e., downstream affiliates). Limiting the proposed prohibition as such would establish a more meaningful framework that appropriately restricts transactions based on whether they may be subject to financial statement attest procedures or financial statement disclosures.</p>
<b>CL 7</b>	EY	<p>We believe PEEC should consider whether all of the minimum safeguards in paragraph 1.260.040.02 of the Proposed Revision should apply to leases with affiliates that are not subject to an audit by the member. When the lease is with a parent or a sister affiliate, one of the major threats to independence related to leases (having to audit your own transaction) is non-existent. This indicates that a lesser level of safeguards are generally necessary to reduce the relevant threats to an acceptable level. We believe that a general threats and safeguards evaluation consistent with paragraph 1.260.040.3 will be sufficient in these circumstances.</p>

**Question 2: Are there any other situations or circumstances that should be grandfathered which are not grandfathered in the proposal?**

**Task Force Response: TBD – The Task Force did discuss these comments at length on its recent calls.**

<b>CL 1</b>	TIC	TIC cannot think of any other situations or circumstances that should be grandfathered.
<b>CL 2</b>	NASBA	No, NASBA does not believe there are other situations involving a covered member's lease with an attest client that should be grandfathered (in addition to those scenarios suggested).
<b>CL 3</b>	KPMG	<p>We believe that PEEC should consider modifying the interpretation to include the following items as circumstances that should be grandfathered:</p> <p>a) When a covered member enters into a lease with a counterparty prior to independence being</p>

		<p>required, but the lease with the counterparty is later sold or transferred to a counterparty who is an attest client; and</p> <p>b) When a covered member enters into a lease with an attest client that is immaterial to the covered member or the attest client but subsequently becomes material to the covered member or the attest client.</p>
CL 4	Deloitte	<p>Paragraph .04 of the Proposed Interpretation does not address the circumstances whereby a member enters into a lease with a counterparty for which independence is not required, and such lease is subsequently sold / transferred to a counterparty for which independence is required. In our view, the interpretation should allow for grandfathering of such leases similar to the grandfathering provisions applicable for mortgages and immaterial unsecured loans described in Interpretation 1.260.020.02(b)(ii), Loans and Leases With Lending Institutions.</p>
CL 5	Grant Thornton	<p>Grant Thornton agrees with the circumstances provided in the proposal for grandfathered leases. However, we suggest that PEEC consider providing further guidance on whether renewal of terms (or specific terms) of the original lease would be covered under grandfathered leases in the interpretation or in a frequently asked questions document. Specific examples should be provided. The proposal does state that automatic renewals provided for in the original lease are not considered changes in terms. However, specific guidance is not provided on whether other renewal of terms (not automatic renewals), but may be acceptable if the term revisions are not material to the original lease or are an extension of the original lease.</p>
CL 6	PwC	<p>As described in more detail in Section III.A, if the PEEC decides to retain the prohibition on material leases as proposed, we recommend that an exemption be provided for leases of primary residences entered into after the covered member is required to be independent of the lessor. An exemption for new leases of primary residences would help to eliminate a potentially significant hardship for covered members and their immediate family members who may otherwise see their range of options for housing in certain markets of the country considerably reduced by the independence restriction on material leases.</p>
CL 7	EY	<p>Since many leasing transactions, particularly in residential real estate, are for periods of one year or less without automatic renewals, the grandfathering provisions in paragraph 1.260.040.04 will provide insufficient relief in many situations. We believe that PEEC should consider whether there are safeguards available that would allow for a on-time, arms-length, ordinary course renewal of a short term lease on market terms as part of its grandfathering provision, subject to the general evaluation of threats and safeguards in 1.260.040.03, even if such renewals are not “automatic” or provided for in the</p>



		lease document, particularly with respect to primary residence leases.
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**Question 3: Do you agree with the application of the materiality safeguard in paragraph .02? Specifically, do you agree that there are no safeguards available when a covered member specified in paragraph .02 has a lease with the attest client that is material to the covered member?**

**Task Force Response: The Task Force did not recommend reducing the scope of covered members subject to paragraph .02; however, see revisions to paragraphs .02 to clarify the structure and apply .02 to only the specific covered members.**

<b>CL 1</b>	TIC	TIC agrees that with the application of the materiality safeguard in paragraph .02 and TIC agrees that no safeguards would be available in the case of a material lease with a covered member.
<b>CL 2</b>	NASBA	Yes, NASBA agrees that the materiality safeguard is essential within the context described in paragraph .02 of the proposed interpretation, that is, entering into a lease that is material to certain covered members creates an insurmountable threat to the firm's independence.
<b>CL 3</b>	KPMG	We agree that when a lease with a covered member is material to the covered member, there are no safeguards available that would reduce the threat to an acceptable level.
<b>CL 4</b>	Deloitte	We agree with the application of the materiality safeguard in paragraph .02, and that there are no safeguards available when a covered member specified in such paragraph has a lease with the attest client that is material to that covered member.
<b>CL 5</b>	Grant Thornton	Grant Thornton agrees with the application of materiality in evaluating leases between a covered member and an attest client.
<b>CL 6</b>	PwC	We do not agree with the application of the materiality safeguard in paragraph .02 as it relates to members of the attest engagement team and individuals in a position to influence the attest engagement for the reasons outlined in our detailed comments and suggestions above. However, as described in more detail in Section III.A, if the revised interpretation is to establish some form of a bright-line test based on materiality, we recommend that the PEEC give consideration to limiting that prohibition to those leasing transactions entered into by the attest engagement partner (or partner equivalent) and by the firm. Please refer to our detailed comments and recommendations in Section III.A.

<b>CL 7</b>	EY	n/a
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**Question 4: Do you agree that there are no safeguards that would reduce the threat to an acceptable level when the lease with a covered member is material to the attest client?**

**Task Force Response: No revisions needed as commenters and Task Force agree with the safeguard.**

<b>CL 1</b>	TIC	TIC agrees that there are no safeguards that would reduce the threat to an acceptable level in this circumstance.
<b>CL 2</b>	NASBA	Yes, NASBA agrees that a lease agreement between a covered member (as described in paragraph .02 of a proposed interpretation) and an attest client that is material to the attest client impairs independence.
<b>CL 3</b>	KPMG	We agree that when a lease with a covered member is material to the attest client, there are no safeguards available that would reduce the threat to an acceptable level.
<b>CL 4</b>	Deloitte	n/a
<b>CL 5</b>	Grant Thornton	Grant Thornton agrees there are no safeguards that would reduce the threat to an acceptable level when the lease with a covered member is material to the attest client. We do believe firms could appropriately segregate an individual that is not in the chain of command (or does not meet the other criteria for being a covered member) with leases that were material to an attest client which would result in the individual not being classified as a covered member.
<b>CL 6</b>	PwC	As indicated in Section I, we believe that independence would be impaired by a lease that is material to the attest client and agree that such leases should be prohibited. However, although we agree with the direction of the PEEC's proposal in this respect, we note that, for financial statement attest clients, a lease that is material to any affiliate of the financial statement attest client would also be prohibited under the proposal. As described in more detail in our response to Question 1, we believe that a lease entered into with an unaudited entity that is under common control with (i.e., a "sister entity") or upstream of the financial statement attest client raises threats to independence that can be less significant than those created by a lease entered into with the financial statement attest client itself or with a material subsidiary. Therefore, for the reasons outlined in our response to Question 1, we do not

		agree that a lease that is material to a sister entity or an upstream affiliate represents an unequivocal impairment of independence in all circumstances. A more principles-based approach that looks at whether the material lease could be subject to financial statement attest procedures or financial statement disclosures may be more appropriate.
<b>CL 7</b>	EY	n/a

**Question 5: Do you agree that the requirements of the proposal should extend to immediate family, as proposed?**

**Task Force Response: No revisions necessary.**

<b>CL 1</b>	TIC	TIC agrees that the requirements should extend to immediate family.
<b>CL 2</b>	NASBA	Yes, NASBA agrees that the requirements of the proposed interpretation should also apply to the covered member's immediate family, which is generally consistent with the application of other independence interpretations in the Code to those persons.
<b>CL 3</b>	KPMG	We agree with the proposed interpretation with respect to including the immediate family members of the covered members.
<b>CL 4</b>	Deloitte	In our view, it is reasonable to expect that rules on leases applicable to covered members should also apply to the immediate family of those individuals. We note, however, that while the Explanation of the Proposed Revision section of the Exposure Draft (see "Applicability") indicates that "the requirements of the proposed revision extend to the immediate family of the covered member and to affiliates of a financial statement attest client," the Proposed Interpretation does not explicitly include such language. This appears inconsistent with other areas of the AICPA Code where the rules and interpretations intended to apply to the immediate family member of covered members are explicitly stated in the rule/interpretation. PEEC should consider including such language in the body of the proposal to avoid any ambiguity or confusion in applying the standard.
<b>CL 5</b>	Grant Thornton	Grant Thornton agrees immediate family member should also be required to comply with the requirements of the proposal for leases similar to other financial relationship requirements under the AICPA's Independence Rules.

<b>CL 6</b>	PwC	We agree that the provisions of the proposed revised interpretation should also apply to leases entered into by the immediate family members of covered members.
<b>CL 7</b>	EY	n/a

**Question 6: What do you foresee as major obstacles to implementation or hardships? Do you expect significant changes in quality controls, procedures, tools, or technology to monitor leases?**

**Task Force Response: See discussion in the agenda of the obstacles to implementation of the standard, and the related revisions to paragraphs .02 and .03 in this agenda.**

<b>CL 1</b>	TIC	<p>TIC believes that the only threat to independence represented by leases is a self-interest threat. Based on the definitions of familiarity threat and undue influence threat, they are not significant in a lease between a covered member and an attest client that meets the safeguards in paragraph 02. The standard as written would create a hardship by adding the requirement to evaluate (and document) these threats and safeguards when TIC does not believe these threats would ever be significant. In addition, TIC does not believe any other threats, as contemplated in paragraph 03, would be relevant or significant to a lease that meets the safeguards in paragraph 02. Rather than requiring an evaluation of any other threats, TIC recommends this requirement be removed from the ED and the factors in paragraph 03 be retained solely for purposes of evaluating the self-interest threat. Since these other threats are not relevant or significant, this effort will not add anything to the independence determination.</p> <p>Other than the issues in the preceding paragraph, the interpretation should not require significant changes to monitor leases.</p>
<b>CL 2</b>	NASBA	<p>NASBA believes that two possible challenges to implementation may fall more heavily on practitioners in smaller firms:</p> <ul style="list-style-type: none"> <li>(i) lack of awareness of the revised independence requirements, which would prevent firms from preparing for the changes, and</li> <li>(ii) inter-relationships between the smaller firms and their clients are likely to be more prevalent than in larger firm environments, thus the smaller firms (especially in more rural areas) may find it challenging to avoid or safeguard against situations that create significant threats to their independence. Thus, we believe these practitioners will need significant lead time to</li> </ul>

		develop appropriate safeguards and effectively implement the proposed revisions.
<b>CL 3</b>	KPMG	Other than the impact on short-term leases as previously discussed, we don't anticipate significant changes in processes as a result of implementing this interpretation.
<b>CL 4</b>	Deloitte	<p>In our view, the Proposed Interpretation as written may require significant consideration of and potential revisions to a member's existing controls, processes, procedures, systems and human resources in order to appropriately identify and effectively monitor its professionals' leasing arrangements. This view is based in part on the notion that under the Proposed Interpretation, a significant population of operating leases, which are currently "scoped out" under the extant code, will need to be identified, monitored and evaluated. We ask PEEC to consider the following:</p> <ul style="list-style-type: none"> <li>• We believe the Proposed Interpretation covers all leasing arrangements, regardless of the substance or length of the arrangements. Lease arrangements may include, for example, (a) short-term auto leasing arrangements (also known as "buy-back" or "purchase-repurchase" arrangements that are popular for extended vacations and which technically qualify as a lease rather than a rental), (b) short-term lodging arrangements on vacation and apartment rentals such as those offered by Airbnb or VRBO and (c) personal leases for appliances, home furnishings, and computers. We ask PEEC to evaluate the potential threats to independence arising from these type of lease arrangements and consider whether excluding such arrangements from the scope of the Proposed Interpretation would be appropriate based on the potential threats. We recognize the likelihood of such leases being material to the firm, its professionals or to the attest client may be very low, and thus, will likely not violate the Proposed Interpretation. However, absent specific exclusion of such arrangements, members will be responsible for gathering necessary information (likely a very significant volume of information for many firms) to be able to evaluate such arrangements and make a determination on compliance with the Proposed Interpretation.</li> <li>• Paragraph .02 includes certain "bright-line" conditions and considerations for evaluating leasing arrangements. We agree that such bright-line conditions and related safeguards are responsive in addressing the most significant threats to independence arising from leasing arrangements. Additionally, paragraph .03 of the Proposed Interpretation establishes a requirement for further analysis to be performed on lease arrangements that have already met the safeguards in paragraph .02. While this additional analysis of threats to independence may have precedent in the rules and interpretations of the AICPA Code, we ask the PEEC to consider that the requirement for additional analysis be limited to circumstances whereby the covered member "knows or has reason to believe" that certain factors may be present. Such an approach has been adopted in other</li> </ul>

		<p>sections of the Code, including Interpretation 1.224.010 Client Affiliates related to certain lending relationships and acquisitions; and Interpretation 1.270.100 Close Relatives, with respect to financial interests of close relatives. We believe that the additional analysis that may be necessary under this approach, coupled with the bright line conditions and safeguards included in paragraph .02, should serve to adequately address the most significant threats to independence arising from leasing arrangements.</p>
CL 5	Grant Thornton	<p>Grant Thornton believes it would be appropriate to have a period of transition to allow firms to determine if changes need to be made to internal policies in identifying any leases that exist between the firm or covered members and attest clients. Firms will also need to determine whether their existing quality control procedures require revision due to the new interpretation. We do not believe that significant changes would be needed as long as attest clients are only considered to be the attest client and downward affiliates. We agree that existing leasing relationship between a covered member and an attest client could be grandfathered which should alleviate potential hardships.</p>
CL 6	PwC	<p>Given the pervasive use of leasing arrangements, our main concern relates to the potential hardship and disruption that a bright-line test based on materiality would create for covered members and their immediate family members. Although real estate property and automobiles are perhaps the most prominent examples of assets available for leasing, the PEEC must recognize that leases are also widely utilized for a broad spectrum of other routine consumer goods, ranging from technology products – for example, cellular phones, tablets, computers, cable and internet equipment – to household equipment such as appliances, furniture, and power tools. A blanket prohibition on the basis of materiality could restrict the opportunities currently available to covered members and their immediate family members to acquire housing and personal consumer goods.</p> <p>As a practical matter, a prohibition based on the materiality of the lease would also disproportionately affect junior-level professional staff on the attest engagement team, in particular those persons with a high student loan debt burden. A junior-level staff person could easily find himself or herself running afoul of the materiality threshold, especially if leases have to be aggregated (such as may be the case, for example, if an associate on the attest engagement team and his or her spouse lease their personal cell phones, tablets, and cable and internet equipment from the same wireless service provider). Furthermore, this could also potentially have a detrimental effect on the ability of firms to attract and retain first-rate talent, such as interns, associates, and senior associates, increasing staff recruiting and retention costs for firms.</p> <p>The potential impact of a prohibition on these consumer relationships is exacerbated by the fact that the grandfathering provisions in paragraph .04 of the proposed revised interpretation do not provide the</p>

		same level of relief as the grandfathering currently available for pre-existing loans, as discussed in more detail in Section III.A. While a firm could theoretically reassign a staff person holding an impermissible lease to a different attest engagement, this may not be a practical solution for certain firms, especially smaller firms (where the pool of available staff with the requisite expertise may be limited) as well as those firms with a large portfolio of attest clients from an industry involved in the business of leasing (such as real estate). This safeguard would likely also not be available to the firm if the staff person holding the impermissible lease is a covered member by virtue of being in a position to influence the attest engagement as it may not be feasible to “isolate” the individual.
<b>CL 7</b>	EY	n/a

**Question 7: Do you agree that it is appropriate to grandfather primary residence leases in a similar manner to home mortgages, as proposed?**

**Task Force Response: TBD**

<b>CL 1</b>	TIC	TIC believes it is appropriate to grandfather primary residence leases.
<b>CL 2</b>	NASBA	Yes, NASBA believes it is appropriate to grandfather primary residence leases in a similar manner to home mortgages, as proposed, since under the new lease accounting standard, leases generally will be treated as secured loans.
<b>CL 3</b>	KPMG	We believe it is appropriate to grandfather primary residence leases. However, since primary residence leases meet the grandfathering criteria in paragraph .04, we don't believe that paragraph .05 is necessary and could be confusing to practitioners.
<b>CL 4</b>	Deloitte	<p>We agree. Also see Item B in the Additional Comments and Feedback section (below)</p> <p>Paragraph .04 – Grandfathered Leases. We request the PEEC consider clarification to Paragraph .04(c) which states, “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.” The current wording is not clear. We believe the intent of this paragraph is to address situations whereby an existing attest client is party to a lease, and the counterparty to such lease, at inception, was not associated with the covered member. However, such counterparty is subsequently acquired by, or acquires the covered member (i.e., the counterparty becomes associated</p>

		<p>with the covered member, in which case the independence rules would then be applicable to that counterparty). Please clarify PEEC's intent.</p> <p>In addition, the final sentence in paragraph .04 of the Proposed Interpretation states that "Automatic renewals provided for in the original lease are not considered changes in terms for purposes of this Interpretation." We believe that addressing only this narrow aspect of a lease in the Interpretation could be read to imply that the application of other common lease terms (e.g., an election to extend a lease on a month-to-month basis at the end of its primary lease term) would be a change in terms for purposes of the Interpretation. We request that the PEEC consider broadening the scope of this sentence to indicate that the application of any provision of an original lease agreement is not considered a change in terms for purposes of this Interpretation.</p>
<b>CL 5</b>	Grant Thornton	Grant Thornton agrees it would be appropriate to grandfather primary residence leases and individuals could renew the lease if the leases meet the safeguards established. We suggest the PEEC consider providing examples to assist with the application of this change, including clarification regarding automatic renewals and if rent increases are considered a change in terms.
<b>CL 6</b>	PwC	Yes, if the PEEC decides to retain the prohibition on material leases as proposed, it would be appropriate to grandfather leases for primary residences as these transactions would likely be material to covered members, particularly junior-level professional staff. Please also refer to our detailed comments and recommendations in Section III.A.
<b>CL 7</b>	EY	Since many leasing transactions, particularly in residential real estate, are for periods of one year or less without automatic renewals, the grandfathering provisions in paragraph 1.260.040.04 will provide insufficient relief in many situations. We believe that PEEC should consider whether there are safeguards available that would allow for a on-time, arms-length, ordinary course renewal of a short term lease on market terms as part of its grandfathering provision, subject to the general evaluation of threats and safeguards in 1.260.040.03, even if such renewals are not "automatic" or provided for in the lease document, particularly with respect to primary residence leases.

**Question 8: Are there any other factors affecting the significance of the threats to independence that you believe should be added to paragraph .03? Do you believe any of the factors in paragraph .03 should be removed?**

**Task Force Response: See revisions to paragraph .03 in this agenda.**



CL 1	TIC	TIC believes the factors affecting the significance of the threats in paragraph .03 are appropriate.
CL 2	NASBA	NASBA believes that the factors in paragraph .03 are sufficient as proposed, however, paragraph .03(d), the extent to which the lease will be subject to attest procedures or financial statement disclosures, seems to imply a possible self-review threat, which is not otherwise mentioned in the proposed interpretation. Also, from a practical standpoint, it is questionable whether the practitioner will be able to effectively assess this factor during pre-engagement.
CL 3	KPMG	We have no changes to propose to paragraph .03.
CL 4	Deloitte	n/a
CL 5	Grant Thornton	Additional considerations that could be given would be the length of time of the lease as well as the date the lease originated. These factors could potentially impact the significance of a leasing relationship as well as the determination of whether a leasing relationship between a covered member or firm and the attest client may impair the firm's independence in fact or appearance.
CL 6	PwC	<p>The possible factors to consider in evaluating the significance of the threats to independence created by a lease would vary based on the specific facts and circumstances of the leasing arrangement. Therefore, as it relates specifically to paragraph .03 of the proposed revised interpretation, a list of the most likely and relevant factors, that is not intended to be all-inclusive (as proposed by the PEEC in paragraph .03) should be sufficient.</p> <p>However, as it relates to the proposal as a whole (and as described in more detail in Section I), we recommend that the materiality of the lease to the attest engagement team member or to the individual in a position to influence the attest engagement be identified in the revised interpretation as one of the factors to be considered when evaluating the impact on independence. Under this approach, rather than cause an automatic impairment of independence in all circumstances, the materiality of the lease should trigger a "threats and safeguards" evaluation taking into consideration factors such as those we have suggested in Section I and others as relevant.</p>
CL 7	EY	n/a

**Question 9: Do you agree that an effective date consistent with the FASB Update effective date for private companies is appropriate (December 15, 2019)? If not, what is a more appropriate effective date?**

**Task Force Response: TBD – The Task Force did not discuss this on its recent calls.**

<b>CL 1</b>	TIC	TIC believes the effective date is appropriate as proposed.
<b>CL 2</b>	NASBA	NASBA believes it is appropriate to sync the effective date of the proposed independence standard, which requires a new approach to addressing leasing relationships, to that of the FASB Update for leases.
<b>CL 3</b>	KPMG	We believe the proposed December 15, 2019 effective date, with early implementation allowed, is appropriate.
<b>CL 4</b>	Deloitte	Given the nature of the potential operational and procedural changes that may be necessary to comply with the Proposed Interpretation, members will need to perform a comprehensive review of their existing processes. While we believe that the proposed December 15, 2019 effective date should provide sufficient time to allow firms and practitioners to update their controls, procedures, tools or technology to effectively implement the provisions of the interpretation, such determination will be contingent upon its final scope and requirements.
<b>CL 5</b>	Grant Thornton	Grant Thornton does not believe the effective date of the proposal needs to be consistent with that of the FASB leasing standard. Based on the proposed revisions, we believe the proposed replacement of the extant GAAP categorization approach with a conceptual framework approach can be effective at any date. PEEC should consider allowing a one year effective date to provide adequate time for members to implement the proposed revisions.
<b>CL 6</b>	PwC	Yes, we agree that the PEEC's proposed effective date of December 15, 2019 is appropriate, provided that, upon adoption of the revised interpretation by the PEEC, this date still allows members sufficient time (for example, 1 year) to make the necessary changes to their policies, processes and procedures to implement the interpretation.
<b>CL 7</b>	EY	n/a

**Text of Exposed Revisions to “Leases” Interpretation**

[Additions appear in boldface italic and deletions are in strikethrough.]

**1.260.040 Leases**

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

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

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 enters into a 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, if a covered member has a lease that meets the criteria of a capital lease (as described in GAAP). Accordingly, independence would be impaired because the lease would be considered to be a loan with an attest client. unless all of the following safeguards are met during that period:~~

- a. The lease is entered into on market terms and established at arm’s length.***
- b. All amounts are paid in accordance with the lease terms or provisions.***
- c. The lease is not material to 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 the covered member meets the safeguards in paragraph .02, as applicable, the covered member should evaluate the significance of 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*
- c. Whether multiple leases 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*

#### **Grandfathered Leases**

*.04 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 provided that the lease 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 do not change in any manner not provided for in the original lease, 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 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 paragraph *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** *This interpretation is effective December 15, 2019, with early implementation allowed.*

## Final Text of Exposed Revisions to “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.

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* enters into a 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 on market terms and established at arm's length.
- b. All amounts are paid in accordance with the lease terms or provisions.
- c. The lease is not material to 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 the *covered member* meets the *safeguards* in paragraph .02, as applicable, the *covered member* should evaluate the significance of 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

- c. Whether multiple leases 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

### **Grandfathered Leases**

- .04 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* provided that the lease 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 do not change in any manner not provided for in the original lease, 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 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 This interpretation is effective December 15, 2019, with early implementation allowed.

## AICPA Code - Affiliates Interpretation

### 1.224.010 Client Affiliates

.01 *Financial interests in, and other relationships with, affiliates of a financial statement attest client may create threats to a member's compliance with the "[Independence Rule](#)" [1.200.001].*

.02 When a client is a financial statement attest client, members should apply the "[Independence Rule](#)" [1.200.001] and related *interpretations* applicable to the financial statement attest client to their affiliates, except in the following situations:

- a. A covered member may have a loan to or from an individual who is an officer, a director, or a 10 percent or more owner of an affiliate of a financial statement attest client during the period of the professional engagement unless the covered member knows or has reason to believe that the individual is in such a position with the affiliate. If the covered member knows or has reason to believe that the individual is an officer, a director, or a 10 percent or more owner of the affiliate, the covered member should evaluate the effect that the relationship would have on the covered member's independence by applying the "[Conceptual Framework for Independence](#)" [1.210.010].
- b. A member or the member's firm may provide prohibited nonattest services to entities described under items c–l of the definition of affiliate during the period of the professional engagement or during the period covered by the financial statements, provided that it is reasonable to conclude that the services do not create a self-review threat with respect to the financial statement attest client because the results of the nonattest services will not be subject to financial statement attest procedures. For any other threats that are created by the provision of the nonattest services that are not at an acceptable level (in particular, those relating to management participation), the member should apply safeguards to eliminate or reduce the threats to an acceptable level.
- c. A firm will only have to apply the "[Subsequent Employment or Association With an Attest Client](#)" interpretation [1.279.020] of the "Independence Rule" if the former employee, by virtue of his or her employment at an entity described under items c–l of the definition of affiliate, is in a key



*position with respect to the financial statement attest client. Individuals in a position to influence the attest engagement and on the attest engagement team who are considering employment with an affiliate of a financial statement attest client will still need to report consideration of employment to an appropriate person in the firm and remove themselves from the financial statement attest engagement, even if the position with the affiliate is not a key position.*

- d. A covered member's immediate family members and close relatives may be employed in a key position at an entity described under items c–l of the definition of affiliate during the period of the professional engagement or during the period covered by the financial statements, provided they are not in a key position with respect to the financial statement attest client.*
- e. A member may have a lease with the attest client that does not meet the safeguards required in the “Leases” interpretation [1.260.040.02] with an entity described under items c–l of the definition of affiliate, unless the member knows or has reason to believe that a lease exists with the affiliate which creates significant threats to independence. The member should evaluate and address the significance of threats created by such leases by applying the “Conceptual Framework for Independence” [1.210.010].***

.03 A member must expend best efforts to obtain the information necessary to identify the affiliates of a financial statement attest client. If, after expending best efforts, a member is unable to obtain the information to determine which entities are affiliates of a financial statement attest client, threats would be at an acceptable level and independence would not be impaired if the member (a) discusses the matter, including the potential impact on independence, with those charged with governance; (b) documents the results of that discussion and the efforts taken to obtain the information; and (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.

.04 This interpretation does not apply to a financial statement attest client that is covered by the [“Entities Included in State and Local Government Financial Statements”](#) interpretation [1.224.020] of the “Independence Rule” [1.200.001]. [Prior reference: paragraph .20 of ET section 101]

### **Acquisitions and Other Business Combinations That Involve a Financial Statement Attest Client**



.05 The exception in [paragraph .06](#) would apply when (1) a *financial statement attest client* is acquired during the *period of the professional engagement* by either a non-client or a nonattest client (acquirer), (2) the *attest engagement* covers only periods prior to the acquisition, and (3) the *member* or *member's firm* will not continue to provide *financial statement* attest services to the acquirer.

.06 *Independence* will not be considered *impaired* with respect to the *financial statement attest client* because a *member* or *member's firm* has an interest in or relationship with the acquirer that may otherwise *impair independence* as a result of the requirements of this interpretation or the definition of "*attest client*" (as it relates to the entity or person that engages the member or member's firm to perform the *attest engagement*).

.07 Notwithstanding [paragraph .06](#), a *member* should give consideration to the requirements of the "[Conflicts of Interest](#)" interpretation [1.110.010], under the "Integrity and Objectivity Rule" [1.100.001], with regard to any relationships that the *member* knows or has reason to believe exist with the acquirer, the *financial statement attest client*, or the *firm*.

.08 A *member* should refer to [paragraph .03](#) of "Application of the AICPA Code" [0.200.020] for guidance on circumstances involving foreign network firms.

#### **Effective Date**

.09 [Paragraphs .01–.04](#) are effective for engagements covering periods beginning on or after January 1, 2014. Early implementation is allowed.

[See [Revision History Table](#).]

**Professional Ethics Executive Committee  
Voluntary Tax Practice Reviews (VTPR) and Confidentiality**

**Staff**

Brandon Mercer, CPA CGMA  
Henry J. Grzes, CPA

**Reason for Agenda Item**

Staff received an inquiry from the AICPA Tax Practice Responsibilities Committee regarding whether voluntary tax practice reviews (VTPR) are considered authorized reviews of members' professional practice under the Confidential Client Information rule, and thus do not require specific consent from clients to disclose information to tax practice reviewers. Staff requests that PEEC expose a proposed interpretation for comment (See **Agenda Item 2B**).

**Background**

At the February 2018 PEEC meeting, staff requested feedback on whether VTPR create an obligation of the member to obtain client consent in accordance with the Confidential Client Information rule. The extant Code provides an exemption for certain reviews of the members' practice, including reviews for purchase of a practice and those performed under "AICPA or state society or state board authorization" (e.g. peer review). After discussion, PEEC requested that staff draft proposed revisions to the Code that would provide similar relief for VTPR. A draft proposal for PEEC review is included at **Agenda Item 2B**.

**Voluntary Tax Practice Reviews**

A Voluntary Tax Practice Review is part of a firm's tax practice quality control system. The review should consist of two steps: a self-assessment or inspection of the tax practice, and a firm-on-firm review or "peer review" of the tax practice. The VTPR process includes establishing a system of quality control; documenting the system; monitoring the system; and making adjustments based on the monitoring process. The concept of a VTPR originated with an initiative in the 1990's to design a program of tax practice review to assist small firms, which may not have the resources to maintain a large quality control system. The project eventually resulted in the issuance of the *Guidelines for Voluntary Tax Practice Review* ("VTPR Guide") by the AICPA in 1995, and the *Tax Practice Quality Control Guide* ("TPQC Guide") in 2002. The VTPR Guide's objective was to "apply the elements of quality control set out by the AICPA Quality Control Standards to a tax practice." The VTPR guide is in the process of being reviewed for a future update. It was last revised in 1997 but has been removed from the website due to its age and is no longer available to AICPA members. The updated version of the TPQC Guide was released in November 2017.

**VTPR Confidential Information Disclosure Exceptions - IRC 7216**

The Internal Revenue Code (IRC) Section 7216 contains guidance regarding tax return information disclosures by tax return preparers when obtaining or providing a VTPR, and allows

disclosures “for the purpose of a quality or peer review to the extent necessary to accomplish the review.” The IRC also restricts the disclosure and retention of tax return information that is utilized for the review.

**Treas. Reg. Sec. 301.7216-2(p)**

**(p) Disclosure or use of information for quality, peer, or conflict reviews.**

(1) The provisions of section 7216(a) and [§ 301.7216-1](#) shall not apply to any disclosure for the [purpose](#) of a quality or peer review to the extent necessary to accomplish the review. A quality or peer review is a review that is undertaken to evaluate, monitor, and improve the quality and accuracy of a [tax return preparer's tax preparation, accounting, or auditing services](#). [A quality or peer review may be conducted only by attorneys, certified public accountants, enrolled agents, and enrolled actuaries who are eligible to practice before the Internal Revenue Service. See Department of the Treasury Circular 230, 31 CFR part 10. Tax return information may also be disclosed to persons who provide administrative or support services to an individual who is conducting a quality or peer review under this paragraph \(p\), but only to the extent necessary for the reviewer to conduct the review. Tax return information gathered in conducting a review may be used only for purposes of a review. No tax return information identifying a taxpayer may be disclosed in any evaluative reports or recommendations that may be accessible to any person other than the reviewer or the tax return preparer being reviewed. The tax return preparer being reviewed will maintain a record of the review, including the information reviewed and the identity of the persons conducting the review. After completion of the review, no documents containing information that may identify any taxpayer by name or identification number may be retained by a reviewer or by the reviewer's administrative or support personnel.](#)

(3) Any [person](#) (including administrative and support personnel) receiving [tax return information](#) in connection with a quality, peer, or conflict review is a [tax return preparer for purposes](#) of sections 7216(a) and 6713(a). [Tax return information disclosed and used for purposes of a quality, peer, or conflict review shall not be disclosed or used for any other purpose.](#)

## Summary of Issues

### AICPA Confidential Client Information Rule

The extant Confidential Client Information rule (1.700.001) requires that members obtain specific consent of the client prior to disclosing confidential client information to others. An exception to the requirement to obtain specific consent is provided in certain circumstances, including when a member has a “review of a member’s professional practice under AICPA or state CPA society or Board of Accountancy authorization” (see below). Peer reviews and reviews of a practice in conjunction with a prospective purchase of the practice are considered a review of the member’s practice for purposes of the exception to 1.700, and are addressed at

1.700.050 (see below). However, the extant rule does not contain an exception for firm-on-firm reviews of a tax practice.

#### **1.700.001 Confidential Client Information Rule**

*.01 A member in public practice shall not disclose any confidential client information without the specific consent of the client.*

*.02 This rule shall not be construed (1) to relieve a member of his or her professional obligations of the "[Compliance With Standards Rule](#)" [1.310.001] or the "[Accounting Principles Rule](#)" [1.320.001], (2) to affect in any way the member's obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a member's compliance with applicable laws and government regulations, (3) to prohibit review of a member's professional practice under AICPA or state CPA society or Board of Accountancy authorization, or (4) to preclude a member from initiating a complaint with, or responding to any inquiry made by, the professional ethics division or trial board of the Institute or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy. Members of any of the bodies identified in (4) above and members involved with professional practice reviews identified in (3) above shall not use to their own advantage or disclose any member's confidential client information that comes to their attention in carrying out those activities. This prohibition shall not restrict members' exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above. [Prior reference: paragraph .01 of ET section 301]*

#### **1.700.050 Disclosing Client Information in Connection With a Review or Acquisition of the Member's Practice**

*.01 For purposes of the "[Confidential Client Information Rule](#)" [1.700.001], a review of a member's professional practice includes a review performed in conjunction with a prospective purchase, sale, or merger of all or part of a member's practice. Such reviews may threaten a member's compliance with the "[Confidential Client Information Rule](#)." To reduce the threat to an acceptable level, a member must take appropriate precautions (for example, through a written confidentiality agreement with the prospective purchaser) to help ensure that the prospective purchaser does not disclose any confidential client information obtained in the course of the review.*

*.02 Members who perform such reviews should not use to their advantage or disclose any confidential client information that comes to their attention during the review. [Prior reference: paragraph .04 of ET section 301]*

*.03 Members who obtain client files as the result of acquiring all or part of another member's professional practice should not disclose any confidential client information contained in such files. Members should refer to the "[Transfer of Files and Return of Client Records in Sale, Transfer Discontinuance or Acquisition of a Practice](#)" interpretation under the "Acts Discreditable Rule" [1.400.205] for guidance related to client files obtained through acquiring a practice.*

**Effective Date**

Staff proposes an effective date of the last day of the month of which the proposal appears in the Journal of Accountancy, with early implementation allowed.

**Action Needed**

Staff requests that PEEC discuss the proposed interpretation at **Agenda Item 2B**, and approve exposure of the proposal for comments.

**Communications Plan**

PEEC feedback or approval of exposure will be communicated to the AICPA Tax Practice & Ethics group and the Tax Practice Responsibilities Committee, and the proposal will be included in an exposure draft that will be distributed to external and internal stakeholders and posted on the AICPA website for public access.

**Materials Presented**

**Agenda Item 2B:** Proposed Interpretation

**Professional Ethics Executive Committee  
Voluntary Tax Practice Reviews (VTPR) and Confidentiality**

Proposed Interpretation

**1.700.110 Disclosing Client Information in Connection With a Voluntary Tax Practice Review**

**.01** For purposes of the “[Confidential Client Information Rule](#)” [1.700.001], a review of a *member’s* professional practice includes a Voluntary Tax Practice Review performed under the monitoring requirements of the *member’s* tax practice quality control document. When a member utilizes a third party to perform such reviews of the *member’s* tax practice, *threats* to compliance with the “[Confidential Client Information Rule](#)” [1.700.001] may exist.

**.02** To reduce the *threat* to an *acceptable level*, the *member* should, at a minimum, be satisfied that the member complies with the requirements of Treasury Regulation 301.7216-2(p) related to disclosures of tax return information during such reviews. If the member determines that threats have not been reduced to an acceptable level, the member should apply additional safeguards to reduce the threat to an acceptable level (for example, enter a written confidentiality agreement with the reviewer, or de-identify tax return information provided to the reviewer).

**.03** *Members* who perform such reviews should not use to their advantage or disclose any *confidential client information* that comes to their attention during the review. Members should refer to Treasury Regulation 301.7216-2(p) for further guidance related to tax return information obtained during a Voluntary Tax Practice Review.



**Professional Ethics Executive Committee  
Staff Augmentation Task Force  
May 9, 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 initial 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 the feedback received from PEEC at its February 2018 meeting and possible revisions to the Task Force's draft guidance.

**Background**

SEC Investigation Report

In 2014, the SEC found a firm was not independent due to a staff augmentation arrangement with an audit client. Pursuant to the findings, the SEC issued an [investigation report](#) "in order to address uncertainty regarding the Commission's interpretation of the 'acting as an employee' provisions of Rule 2-01," which prohibit an accountant from providing certain non-audit services to an audit client, including "acting temporarily or permanently as a director, officer, or employee of an audit client." The SEC noted the following primary points in the discussion section of its report regarding the nature of the delivery of otherwise permitted non-audit services:

1. "An auditor may not provide otherwise permissible non-audit services to an audit client in a manner which is inconsistent with other provisions of the independence rules. Thus, the auditor must scrutinize both the nature of the proposed non-audit services, *as well as the manner in which those services are to be delivered.*"
2. "An arrangement or relationship that results in an accountant acting as an employee of the audit client implicates Rule 2-01(c)(4)(vi)...An accountant is not independent under Rule 2-01(c)(2)(i) when a current 'professional employee of the accounting firm is employed by the audit client'...*Rule 2-01(c)(4)(vi) prohibits accountants from doing indirectly (acting as an employee) what they may not do directly (being an employee).*"
3. "Rule 2-01...requires accountants and audit committees to *carefully consider whether the relationship or service in question would cause the accounting firm's professionals to resemble...the employees of the audit client. A key inquiry into this analysis is the degree of control that the audit client exercises over audit firm personnel.*

Compared to the AICPA Code, the SEC provisions explicitly require the accountant to consider whether the accountant resembles an employee of the audit client in all situations, and further prohibits acting as an employee of the audit client on a "temporary or permanent" basis. The AICPA Code also prohibits simultaneously being an employee of the audit client but does not explicitly address the appearance as it relates to temporary staffing arrangements and does not



distinguish between temporary and permanent employment. The AICPA Code does address the appearance of employment as it relates specifically to internal audit services provided by the member in the “Nonattest Services” interpretation [1.295], and provides examples of factors that may create such an appearance.

### IESBA Ethics Handbook – Temporary Staff Assignments

The IESBA Code specifically addresses staff augmentation at Section 290.140 *Temporary Staff Assignments*, shown below:

#### ***Temporary Staff Assignments***

*290.140 The lending of staff by a firm to an audit client may create a self-review threat. Such assistance may be given, but only for a short period of time and the firm’s personnel shall not be involved in:*

- a) Providing non-assurance services that would not be permitted under this section; or*
- b) Assuming management responsibilities.*

*In all circumstances, the audit client shall be responsible for directing and supervising the activities of the loaned staff.*

*The significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include.*

- a) Conducting an additional review of the work performed by the loaned staff;*
- b) Not giving the loaned staff audit responsibility for any function or activity that the staff performed during the temporary staff assignment; or*
- c) Not including the loaned staff as a member of the audit team.*

### **Summary of Issues**

The Task Force presented an agenda item to PEEC at its February 2018 meeting for feedback, which included a draft proposal for discussion. The Task Force held a conference call in April 2018 to discuss the feedback and continue work on the draft proposal. The Task Force requests that PEEC consider the issues discussed below and related revisions to the draft proposal at **Agenda Item 3B**. Additions to the draft are shown in bold underlined font, deletions are shown in strikethrough font.

#### ***Application of the General Requirements to Staff Augmentation Services***

At the February 2018 PEEC meeting, the Committee agreed that provision of staff to the attest client (i.e. staff augmentation) is a non-attest service, and should be subject to the General Requirements of the “Nonattest Services” interpretation [1.295] (See **Agenda Item 3C**). The Task Force included the following paragraph in the draft proposal (See **Agenda Item 3B**) to indicate that the General Requirements would apply. The Task Force is requesting feedback from PEEC on the revised paragraph below. Revisions made by the Task Force are shown in bold underline and strikethrough fonts.

**.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;
  - ii. supervising and overseeing the activities performed; and
  - iii. evaluating the adequacy of the activities performed and the findings resulting from the activities.
- b. The activities do not result in the member assuming performance of 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 otherwise be permitted by the “Nonattest Services” interpretation [1.295.000] of the “Independence Rule” [1.200.001]; and
- d. The duration of the arrangement is ~~short term and~~ temporary in nature; ~~and~~
- e. ~~The activities performed by augmented staff under the arrangement are discrete and non-recurring in nature.~~

The Task Force discussed the fact that item .02a requires the member to be satisfied that client management designates an individual with appropriate skill, knowledge, and experience (“SKE”) to be responsible for the scope, oversight, and evaluation of activities performed. The Task Force believed that it was appropriate to include that provision for staff augmentation as well, but some members questioned whether practitioners may find it problematic or impractical to make that assessment in the staff augmentation environment, depending on the type of activities being performed.

The Task Force also discussed the use of the term “temporary” compared to “short-term” or “non-recurring.” The revisions above reflect PEEC’s previous position that “temporary” was appropriate terminology. IESBA also uses the term “temporary” in its provisions. However, the Task Force would like additional feedback on the use of “temporary” versus other terms such as “short-term” or “non-recurring.”

**Questions for PEEC:**

**Does PEEC believe it is reasonable to expect the member to assess whether the individual overseeing the augmented staff’s activities has the appropriate skill, knowledge, and experience to oversee the activities?**

**Does PEEC continue to believe that “temporary” is the appropriate terminology in .02d?**

PEEC previously agreed that it would be helpful to address the appearance of simultaneous employment in the guidance, as it is referenced in other areas of 1.295, including the provisions on internal audit services. The Task Force included paragraph .03 in its draft proposal to address the prohibited employment issue. Revisions made by the Task Force are shown and discussed below. The Task Force also requests feedback on specific issues related to the paragraph:

**.03** In all circumstances, the member should consider whether the staff augmentation arrangement creates the appearance of prohibited ~~simultaneous employment or association~~ with the attest client ~~(See that is addressed by 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 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 is held out or treated as an employee of the attest client as described below:**

- i. The member is** ~~should not be~~ listed as an employee in the attest client’s directories or other attest client publications,
- ii. The member is** referred to by title or description as supervising or being in charge of any business function of the attest client;
- iii. The member is identified as an employee in correspondence such as email, letterhead, or internal communications.**
- iv. The member participates in health, retirement, or other benefit plans that are normally only offered to employees of the attest client**

PEEC previously agreed that the duration of the arrangement is a factor to consider when evaluating the appearance of employment. Staff noted that the portion of the member’s time spent doing staff augmentation activities for a single client versus other firm clients may be a factor when combined with other factors, and was noted by the SEC in its report.

The Task Force discussed the factors listed in i.-iv above and whether they should be factors to consider or be a separate prohibited situation. The Task Force generally agreed that these factors would create an impairment that could not be addressed, as the appearance of prohibited employment would create threats so significant that safeguards could not be applied.

<b>Questions for PEEC:</b>
<b>Does PEEC believe that a member’s staff augmentation activities being exclusive to a</b>

single client of the firm is a factor that should be considered when evaluating the appearance of prohibited employment?

Does PEEC agree that the situations factors noted in i-iv of paragraph .03 cannot be addressed by the application of safeguards? Does PEEC agree with the paragraph structure indicating the prohibitions?

Are there any factors that PEEC believes should be included in addition to i-iv in paragraph .03?

*Paragraph .04 – Examples of Safeguards*

The Task Force previously discussed with PEEC whether an augmented staff member who is also on the attest engagement team should have his/her work reviewed by another professional. It was pointed out that this safeguard may not be workable, as the staff would likely be at the client site performing activities under the client's supervision, so that the client can take responsibility. The Task Force further discussed the safeguard on its recent conference call and agreed to strike safeguard item "a" from the paragraph. In addition, the Task Force revised safeguards b and c to align with the IESBA provisions and ensure that the safeguards address the issue of augmented staff having responsibility for attest work (b).

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

- a. ~~Conduct an additional review of the work performed by the augmented staff~~
- b. **Not giving the loaned staff attest responsibility for any function or activity that the staff performed during the augmented staff arrangement** Have attest procedures which are related to the activity that the staff performed during the augmented staff arrangement performed by another member of the attest engagement team; or
- c. **Not including** Separate the augmented staff members on and the attest engagement team.

**Question for PEEC:**

**Does PEEC agree with the revisions to paragraph .04?**

**Is PEEC aware of any other safeguards that should be noted in paragraph .04?**

**Effective Date**

The Task Force will discuss the potential effective date of the proposal during its next conference call.

**Action Needed**

The Task Force requests PEEC consideration of the issues noted in this agenda item. The Task Force will revise its draft proposal accordingly and prepare a draft interpretation for exposure at the August 2018 PEEC meeting.

**Communications Plan**

N/A

**Materials Presented**

**Agenda Item 3B** – Draft Proposal

**Agenda Item 3C** – AICPA Code Sections

## Staff Augmentation Task Force

## Revisions to Draft Proposal – Markup

**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;
  - ii. supervising and overseeing the activities performed; and
  - iii. evaluating the adequacy of the activities performed and the findings resulting from the activities.
- b. The activities do not result in the member assuming performance of 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 otherwise be permitted by the "Nonattest Services" interpretation [1.295.000] of the "Independence Rule" [1.200.001]; and
- d. The duration of the arrangement is ~~short term and~~ temporary in nature; and
- e. ~~The activities performed by augmented staff under the arrangement are discrete and non-recurring in nature.~~

**.03** In all circumstances, the member should consider whether the staff augmentation arrangement creates the appearance of prohibited ~~simultaneous employment or association~~ with the attest client ~~(See that is addressed by 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 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 is held out or treated as an employee of the attest client as described below:**

- i. **The member is** ~~should not be~~ listed as an employee in the attest client’s directories or other attest client publications,
- ii. **The member is** referred to by title or description as supervising or being in charge of any business function of the attest client;
- iii. **The member is identified as an employee in correspondence such as** email, letterhead, or internal communications.
- iv. **The 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~~**all** be evaluated and safeguards applied when necessary to eliminate the threats ~~s~~ or reduce ~~#them~~ to an acceptable level. Examples of such safeguards may include:

- a. ~~Conduct an additional review of the work performed by the augmented staff~~
- b. **Not giving the loaned staff attest responsibility for any function or activity that the staff performed during the augmented staff arrangement** ~~Have attest procedures which are related to the activity that the staff performed during the augmented staff arrangement performed by another member of the attest engagement team; or~~
- c. **Not including** ~~Separate~~ the augmented staff members **on** ~~and~~ the attest engagement team.

## Revisions to Draft Proposal – Final

### ***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;
  - ii. supervising and overseeing the activities performed; and

- iii. evaluating the adequacy of the activities performed and the findings resulting from the activities.
- b. The activities do not result in the 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 otherwise be permitted 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 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 is held out or treated as an employee of the attest client as described below:

- i. The member is listed as an employee in the attest client's directories or other attest client publications,
- ii. The member is referred to by title or description as supervising or being in charge of any business function of the attest client;
- iii. The member is identified as an employee in correspondence such as email, letterhead, or internal communications.
- iv. The 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 during the augmented staff arrangement; or
- b. Not including the augmented staff members on the attest engagement team.

**Staff Augmentation Task Force**

AICPA Code Sections 1.275, 1.295 (excerpts only)

**1.275.005 Simultaneous Employment or Association With an Attest Client**

.01 In this interpretation, simultaneous employment or association with an *attest client* is serving as a director, an officer, an employee, a promoter, an underwriter, a voting trustee, a trustee for any pension or profit-sharing trust of the *attest client*, or in any capacity equivalent to that of a member of management of an *attest client* during the period covered by the *financial statements* or the *period of the professional engagement*.

.02 If a *partner* or professional employee of the *member's firm* is simultaneously employed or associated with an *attest client*, familiarity, management participation, advocacy, or self-review *threats* 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*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraph .02C of ET section 101]

.03 However, *threats* will be at an *acceptable level* and *independence* will not be *impaired* when either of the following situations exists:

- a. A *partner* or professional employee of a *firm* serves as an adjunct faculty member of an educational institution that is an *attest client* of the *firm*, and the *partner* or professional employee meets all of the following *safeguards*:
  - i. Does not hold a *key position* at the educational institution
  - ii. Does not participate on the *attest engagement team*
  - iii. Is not an *individual in a position to influence the attest engagement*
  - iv. Is employed by the educational institution on a part-time and non-tenure basis
  - v. Does not participate in any employee benefit plans sponsored by the educational institution, unless participation is required
  - vi. Does not assume any management responsibilities or set policies for the educational institution

Upon termination of employment, the *partner* or professional employee should comply with the requirements of the “[Former Employment or Association With an Attest Client](#)” interpretation [1.277.010] of the “[Independence Rule](#)” [1.200.001]. [Prior reference: paragraph .21 of ET section 101]

- b. A *member* in a government audit organization performs an *attest engagement* with respect to the government entity and the head of the government audit organization meets at least one of the following:



- i. Is directly elected by voters of the government entity with respect to which *attest engagements* are performed
- ii. Is appointed by a legislative body and is subject to removal by a legislative body
- iii. Is appointed by someone other than the legislative body, as long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body

.04 *Members* that are simultaneously employed or associated with an *attest client* should consider their obligations as a *member in business* under [part 2](#) of the code. [No prior reference: new content]

#### **Effective Date**

.05 [Paragraph .04](#) of this interpretation is effective December 15, 2014.

A nonauthoritative question and answer regarding independent contractors retained by the firm who are simultaneously employed or associated with an attest client is available at [www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf](http://www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf).

### **1.295.040 General Requirements for Performing Nonattest Services**

.01 When a member performs a nonattest service for an *attest client*, *threats* to the member's compliance with the "[Independence Rule](#)" [1.200.001] may exist. Unless an *interpretation* of the "[Nonattest Services](#)" subtopic [1.295] under the "Independence Rule" states otherwise, *threats* would be at an *acceptable level*, and *independence* would not be *impaired*, when all the following *safeguards* are met:

- a. The member determines that the *attest client* and its management agree to
  - i. assume all management responsibilities as described in the "[Management Responsibilities](#)" interpretation [1.295.030].
  - ii. oversee the service, by designating an individual, preferably within senior management, who possesses suitable skill, knowledge, and/or experience. The member should assess and be satisfied that such individual understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or re-perform the services.

- iii. evaluate the adequacy and results of the services performed.
- iv. accept responsibility for the results of the services.
- b. The member does not assume management responsibilities (See the “[Management Responsibilities](#)” interpretation [1.295.030] of the “Independence Rule”) when providing nonattest services and the member is satisfied that the *attest client* and its management will
  - i. be able to meet all of the criteria delineated in item a;
  - ii. make an informed judgment on the results of the member’s nonattest services; and
  - iii. accept responsibility for making the significant judgments and decisions that are the proper responsibility of management.

If the *attest client* is unable or unwilling to assume these responsibilities (for example, the *attest client* cannot oversee the nonattest services provided or is unwilling to carry out such responsibilities due to lack of time or desire), the member’s performance of nonattest services would *impair independence*.

- c. Before performing nonattest services the member establishes and documents in writing his or her understanding with the *attest client* (board of directors, audit committee, or management, as appropriate in the circumstances) regarding
  - i. objectives of the engagement,
  - ii. services to be performed,
  - iii. *attest client*’s acceptance of its responsibilities,
  - iv. member’s responsibilities, and
  - v. any limitations of the engagement.

.02 The *safeguards* in [paragraph .01](#) and the “[Documentation Requirements When Providing Nonattest Services](#)” interpretation [1.295.050] of the “Independence Rule” [1.200.001] do not apply to certain routine activities performed by the member, such as providing advice and responding to the *attest client*’s questions as part of the *attest client*-member relationship. However, in providing such services, the member must not assume management responsibilities, as described in the “[Management Responsibilities](#)” interpretation [1.295.030] of the “Independence Rule.” [Prior reference: paragraph .05 of ET section 101]

Nonauthoritative questions and answers regarding suitable skill, knowledge, and experience are available at [www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf](http://www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/nonattestservicesfaqs.pdf).

### 1.295.150 Internal Audit

.01 For purposes of this interpretation, internal audit services involve assisting the *attest client* in the performance of its internal audit activities, sometimes referred to as “internal audit outsourcing.” When a member provides internal audit services to an *attest client*, self-review and management participation *threats* to the *covered member’s* compliance with the “[Independence Rule](#)” [1.200.001] may exist.

.02 The *attest client’s* management is responsible for directing the internal audit function, including the management thereof. Such responsibilities include, but are not limited to, designing, implementing and maintaining internal control. *Threats* to compliance with the “[Independence Rule](#)” [1.200.001] would not be at an *acceptable level*, cannot be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* if the *attest client* outsources the internal audit function to the member, whereby the member, in effect, manages the *attest client’s* internal audit activities.

.03 However, except for the outsourcing services discussed in [paragraph .02](#), *threats* to compliance with the “[Independence Rule](#)” [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired* if the member assists the *attest client* in performing financial and operational internal audit activities, provided that, in addition to the “[General Requirements for Performing Nonattest Services](#)” interpretation [1.295.040] of the “Independence Rule,” the member is satisfied that management

- a. designates an individual or individuals who possess suitable skill, knowledge, and experience, preferably within senior management, to be responsible for the internal audit function.
- b. determines the scope, risk, and frequency of internal audit activities, including those the member will perform in providing the services.
- c. evaluates the findings and results arising from the internal audit activities, including those the member will perform in providing the services.
- d. evaluates the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures.

.04 For example, if the member applies the *safeguards* in [paragraph .03](#), the member may assess whether performance is in compliance with management’s policies and procedures, identify opportunities for improvement, and recommend improvement or further action for management consideration and decision making.

.05 The member may assist the individual responsible for the internal audit function in performing preliminary audit risk assessments, preparing audit plans, and recommending audit priorities. The member should also be satisfied that *those charged with governance* are informed about the member’s and management’s respective roles and responsibilities in connection with the engagement. Such information should provide *those charged with governance* a basis for developing

guidelines for management and the member to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

.06 *Threats* to compliance with the “[Independence Rule](#)” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, in addition to those activities listed in the “[Management Responsibilities](#)” interpretation [1.295.030] of the “Independence Rule,” a member

- a. performs ongoing evaluations (see [paragraph .10](#) that follows) or control activities (for example, reviewing *loan* originations as part of the *attest client’s* approval process or reviewing customer credit information as part of the customer’s sales authorization process) that affect the execution of transactions or ensure that transactions are properly executed or accounted for, or both, and performs routine activities in connection with the *attest client’s* operating or production processes that are equivalent to those of an ongoing compliance or quality control function.
- b. performs separate evaluations on the effectiveness of a significant control such that the member is, in effect, performing routine operations that are built into the *attest client’s* business process.
- c. has *attest client* management rely on the member’s work as the primary basis for the *attest client’s* assertions on the design or operating effectiveness of internal controls.
- d. determines which, if any, recommendations for improving the internal control system should be implemented.
- e. reports to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function.
- f. approves or is responsible for the overall internal audit work plan, including the determination of the internal audit risk and scope, project priorities, and frequency of performance of audit procedures.
- g. is connected with the *attest client* as an employee or in any capacity equivalent to a member of management (for example, being listed as an employee in the *attest client’s* directories or other *attest client* publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the *attest client’s* internal audit function, or using the *attest client’s* letterhead or internal correspondence forms in communications).

.07 *Monitoring activities*. Designing, implementing, or maintaining the *attest client’s* monitoring activities are management responsibilities. Accordingly, *independence* would be *impaired* if a member accepts responsibility for performing such activities. Monitoring activities are procedures performed to assess whether components of internal control are present and functioning. Monitoring can be done through ongoing evaluations, separate evaluations, or some combination of the two. Ongoing evaluations are generally defined, routine operations built in to

the *attest client's* business processes and performed on a real-time basis. Ongoing evaluations, including managerial activities and everyday supervision of employees, monitor the presence and functioning of the components of internal control in the ordinary course of managing the business. A member who performs such activities for an *attest client* would be considered to be accepting responsibility for maintaining the *attest client's* internal control. Accordingly, the management participation *threat* created by a member performing ongoing evaluations is so significant that no *safeguards* could reduce the *threat* to an *acceptable level*, and thus *independence* would be *impaired*.

.08 Separate evaluations are conducted periodically and generally not ingrained within the business but can be useful in taking a fresh look at whether internal controls are present and functioning. Such evaluations include observations, inquiries, reviews, and other examinations, as appropriate, to ascertain whether controls are designed, implemented, and conducted. The scope and frequency of separate evaluations is a matter of judgment and vary depending on assessment of risks, effectiveness of ongoing evaluations, and other considerations. Because separate evaluations are not built into the *attest client's* business process, separate evaluations generally do not create a significant management participation *threat* to *independence*.

.09 Members should refer to the Committee of Sponsoring Organizations of the Treadway Commission's (COSO's) *Internal Control—Integrated Framework*, for additional guidance on monitoring activities and distinguishing between ongoing and separate evaluations.

.10 Members should use judgment in determining whether otherwise permitted internal audit services performed may result in a significant management participation *threat* to *independence*, considering factors such as the significance of the controls being tested, the scope or extent of the controls being tested in relation to the overall *financial statements* of the *attest client*, as well as the frequency of the internal audit services. If the *threat to independence* is considered significant, the member should apply *safeguards* to eliminate or reduce the *threat* to an *acceptable level*. If no *safeguards* could reduce the *threat* to an *acceptable level*, then *independence* would be *impaired*.

.11 *Attest-related services*. Services considered extensions of the member's audit scope applied in the audit of the *attest client's financial statements*, such as confirming accounts receivable and analyzing fluctuations in account balances, are not considered internal audit services and would not be subject to this interpretation even if the extent of such testing exceeds that required by generally accepted auditing standards (GAAS). In addition, engagements performed under the attestation standards would not be considered internal audit services and, therefore, would not *impair independence*.

.12 When a member performs internal audit services that would not *impair independence* under this interpretation and is subsequently engaged to perform an attestation engagement to report on management's assertion regarding the effectiveness of its internal control, *independence* would not be considered *impaired*, provided the member is satisfied that *attest client* management does not rely on the member's work as the primary basis for its assertion. [Prior reference: paragraph .05 of ET section 101]

**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), Teresa Bordeaux (Staff), Laura Hyland (Staff), Sue Hicks (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**

Twenty-Three [comment letters](#) were received on the exposure draft, with the majority of the commenters providing recommendations. At a high level, many of the commenters requested the proposal be clarified, simplified and streamlined. Accordingly, the Task Force's discussions so far have focused on clarifying the interpretation while seeking opportunities to simplify and/or streamline the interpretation. The task force continues to focus on an appropriate balance of appropriate responses to threats to independence considering the cost of compliance. Though its discussions, the Task Force believes that the complexity of the interpretation was driven by two main factors: (1) the desire to minimize the impact the revised interpretation would have to only those situations where threats were most likely to not be at an acceptable level and (2) to avoid using the term "affiliate" so as not to confuse users who may have financial statement attest clients in both the commercial and SLG sectors.

**Summary of Issues***Terminology Section*

The first clarification recommended by the Task Force is an overhaul to the terminology section. Several the commenters<sup>1</sup> were concerned that using definitions (i.e., primary government) that are not consistent with GASB terminology would result in confusion. The Task Force is proposing to eliminate use of GASB specific terminology from the interpretation. The Task Force believes this change allows the independence interpretation to be applied without having to reference GASB terminology (i.e. the interpretation stands on its own).

The Task Force is also 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. This resulted in the definition of affiliates included in the terminology section rather than later in the interpretation (as exposed). The Task Force believes that this also helps streamline/simplify the interpretation for the members.

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<sup>1</sup> [CL 2](#), [CL 4](#), [CL 6](#), [CL 7](#), [CL 8](#), [CL 9](#), [CL 10](#), [CL 14](#) and [CL 23](#).

Since the definition of an affiliate looks both upstream and downstream, the Task Force is recommending the term “entity” be added to the terminology section and the definition just explain the various types of SLG “entities” that might exist. The Task Force believes using this generic term combined with the affiliate definition allows for the definition of “primary government” to be eliminated.

Task Force believes that the terminology section as redrafted in **Agenda Item 4B** will be easier for members to understand and apply.

**Question for the Committee**

1. Does the avoidance of GASB terminology and the use of the word “affiliate” help to clarify the interpretation?

*Exceptions (paragraphs .07 and .08)*

Since the Task Force is proposing to include the entities the exposure draft captured under the “downstream” and “upstream” sections under the new definition of “affiliate” the exceptions identified in these sections needed to be relocated. Accordingly, the Task Force is recommending relocating them to an “Exception” section. The exceptions appear in paragraphs .07 and .08 of **Agenda Item 4B**.

*Rebuttable Presumption that the Primary Government Has More Than Minimal Influence Over Funds and Component Units (paragraphs .10 and .11 and paragraph .06 a. ii, iii and iv)*

About a third<sup>2</sup> of the commenters express concerns with the presumption that primary governments have more than minimal influence over funds and component units. The Task Force discussed the various concerns and is recommending a modification and a couple of clarifications to this section of the exposure draft.

The Task Force included the rebuttable presumption in the exposure draft with discretely presented component units in mind. Since these entities are legally separate, the Task Force 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 Task Force 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 Task Force acknowledges that perhaps its desire to make the proposal easier to apply was not the best approach. As such, the Task Force is recommending the rebuttable presumption that the primary government has more than minimal influence over the accounting or financial reporting process only cover funds and blended component units. The Task Force 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

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<sup>2</sup> [CL 4](#), [CL 6](#), [CL 7](#), [CL 9](#), [CL 10](#), [CL 18](#), [CL 21](#) and [CL 22](#).



government over a discretely presented component unit, but they do not need to rebut a presumption.

As noted above, the Task Force is also recommending a couple of clarifications to this section. The first clarification is to relocate the rebuttable presumption language into the specific affiliates (i.e., affiliates ii, iii and iv) that use the “more than minimal influence over the accounting or financial reporting process” criteria to identify whether an entity is in fact an affiliate of a financial statement attest client. The other clarification is to streamline this section as there seemed to be a significant amount of duplication in the factors found in the two paragraphs. To streamline this section, the Task Force recommends presenting the factors in a way that would require the member to determine the extent that the factor exists or does not exist. The benefit of presenting the factors in this manner is it encourages thoughtful consideration. These revisions appear in *paragraphs .10 and .11* and paragraph .06 a. ii, iii and iv. of **Agenda Item 4B**.

**Question for the Committee**

1. Does the Committee have any concerns with the Task Force’s intended approach?

*Excluded Entities (paragraph .06 a. iii.)*

The exposure draft proposed that when a state or local government financial statement attest client has more than minimal influence over a material excluded entity’s accounting or financial reporting process, the member should apply the “Independence Rule” and related interpretations applicable to a state or local government financial statement attest client to the material excluded entity (i.e., mandated conceptual framework analysis).

The Task Force discussed the circumstances where excluded entities exist in practice. The general consensus is that these are not common in the environment but neither are they rare events. The Task Force discussed whether members should only be required to go through a conceptual framework analysis when the member knows or has reason to believe that a relationship or circumstance exists with such entity that would create threats to independence. Members on the Task Force believe that it should be likely be fairly easy to identify these entities since excluding such entities impacts the audit opinion as a GAAP departure. The Task Force concluded that the threats related to excluded entities that meet the affiliate criteria warrant affiliate status and that the cost of compliance is not overly burdensome. Therefore, the Task Force does not propose eliminating such entities as affiliates. Excluded entities can be found in paragraph .06 item a. iii. of **Agenda Item 4B**.

*Examples of Relationships or Circumstances with a Non-Affiliate That Could Create Threats to Independence (paragraph .04 items a.-d.)*

Unlike the mandated conceptual framework analysis required for certain excluded entities, 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 would create threats to independence. The Task Force is recommending that examples of situations covered members may have with these non-affiliates be included to clarify how this provision is intended to be applied. These examples were added as items a through d in paragraph .04 of **Agenda Item 4B**.

**Question for the Committee**

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|--|
| 1. Does the Committee find the examples helpful? |
|--|

*Do Threats Change Depending Upon The Organizational Structure*

The Task Force has begun discussion of whether threats change as a result of how far upstream or downstream a related entity is to the financial statement attest client to determine whether the requirements should be limited further up or down the organizational structure. We have tentatively concluded that if the upstream entity meets the minimal influence test for a material downstream entity, the placement of those entities in the organization chart should not impact the threat analysis. The placement of entities within organizational structures are more “form” as opposed to the substance of the minimal influence test and materiality.

The task force is currently discussing whether a “knows or has reason to believe approach” is appropriate for upstream entities.

<b><i>Request for the Committee</i></b>
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| 1. The Task Force would appreciate the Committee’s input on whether the organizational structure should impact the level of threats. |
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**Action Needed**

The Committee’s feedback on the Task Force’s direction is appreciated.

**Communication Plan and Member Training Tools**

TBD

**Materials Presented**

**Agenda Item 4B** Proposed Revised Interpretation

## Agenda Item 4B

*In part as the Task Force has not developed recommendations for certain portions of the interpretation.*

*Items in [brackets and yellow highlight] are items that the Task Force has to discuss.*

### **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 utilities, public employee retirement systems (PERSs), post-employment benefit plans, pension plans, public entity risk pools, external investment pools, public colleges and universities, 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 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 .07 and .08 of this interpretation. The term affiliate is described in paragraph .06 of this interpretation.
- .04 When an entity does not meet the affiliate criteria described in paragraph .06 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 relationship or circumstance exists with such entity that would create [threats](#) to [independence](#). Examples of situations covered members may have with entities that are included in the financial reporting entity that do not meet the definition of an affiliate (non-affiliate entity) include
- a. Covered member has an interest in utility bonds of a non-affiliated entity when the financial statement attest client is responsible for payment of the debt service on the utility bonds owned at the non-affiliated entity.
  - b. The member is considering providing financial information system design services to a non-affiliated entity of a financial statement attest client where the financial information system would be a shared service provided by the non-affiliated 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. Covered member's immediate family member is a mayor or council member of a non-affiliated entity to the financial statement attest client.
  - d. The non-affiliated entity outsources its internal audit function to the member and the scope of the internal audit services include the financial statement attest
- .05 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**

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

- a. **Affiliate.** An entity is an affiliate of a state or local government [financial statement attest client](#) when:
  - 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*; 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 primary government 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 that 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](#). There is a rebuttable presumption that the primary government has more than minimal influence over the accounting or financial reporting process of funds and blended component units.
  - iv. an entity that is required to include a [financial statement attest client](#) in its financial statements and the
    - 1. [financial statement attest client](#) is material to the entity's financial statements; and
    - 2. 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 primary government has

more than minimal influence over the accounting or financial reporting process of funds and blended component units.

- v. the financial statement attest client has an investment in the entity that either
  1. is not de minimis to the financial statement attest client as a whole and gives the financial statement attest client control over the entity. De minimis amounts are dollar amounts that in the member's professional judgement are clearly inconsequential to the financial statement attest client as a whole.
  2. is material to the financial statement attest client as a whole and gives the financial statement attest client significant influence over the entity.
- vi. [Reserved in the event the Task Force decides to recommend that certain investors of the financial statement attest client should be considered affiliates.]
- b. **Entity.** An entity is intended to be broadly defined and can include, but are not limited to [the primary government], funds, component units, departments, agencies, programs, organizational units, fiduciary activities, custodial activities, employee benefit plans and sub-organizational units of the preceding entities.
- c. [Reserved for other definitions the Task Force determines need to be included, such as investments].

### **Exceptions**

- .07 The member and member's firm may provide nonattest services that impair independence to affiliates ii. and iii. described in paragraph .06a. 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.
- .08 When the entity is an affiliate as described in item iv. of paragraph .06a, instead of applying the "Independence Rule" and related interpretations applicable to the financial statement attest client to the entity, members should use the "Conceptual Framework for Independence" interpretation [ET sec. 1.210.010] to evaluate relationships and circumstances that a member has with the entity.

### **Best Efforts [to Identify Investments]**

- .09 Reserved for best efforts guidance.

### **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 a primary government has over the accounting or financial reporting process of funds and component units in the reporting entity. Factors such as the following may assist members with this evaluation. The extent:

- a. of involvement the primary government has in preparing the financial statements of a fund or component unit.
  - b. of operational control the primary government has over a fund or component unit.
  - c. that both the primary government 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. that the primary government is
    - 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 primary government exercises a right) rather than merely considering form (for example, the primary government has a right that is not exercised). The consideration of these factors **[runs along a spectrum and]** will require the member to exercise professional judgement when reaching the determination of whether more than minimal influence exists.

### ***Effective Date***

- .12 This interpretation will be effective for engagements covering periods beginning on or after June 15, 2019. Early implementation is allowed.

**Professional Ethics Executive Committee  
International Ethics Standards Board for Accountants Update**

**Staff**

Ellen T. Gorla, Associate Director – Global Professional Ethics

**Reason for Agenda Item**

To provide the PEEC with an overview of the IESBA's activities and March 12-14, 2018 meeting.

**Summary of Issues**

- **Restructured IESBA Code.** In April 2018 the IESBA issued the [Restructured IESBA Code](#), [Basis for Conclusions for Improving the Structure of the Code of Ethics for Professional Accountants](#) and the [Basis for Conclusions for Revisions Pertaining to Safeguards in the Code](#). The IFAC Convergence & Monitoring Standing Group<sup>1</sup> will be meeting this upcoming quarter to begin discussions regarding what convergence efforts need to be undertaken as a result of these changes.
- **Proposed Strategy and Work Plan, 2019-2023.** The IESBA also issued a consultation paper for its [Proposed Strategy and Work Plan, 2019-2023](#) and comments are due by July 16, 2018. The IFAC Convergence & Monitoring Standing Group will be meeting this upcoming quarter to develop a response to this paper.
- **Inducements.** On April 23, 2018 the IESBA adopted the final inducement standards. When these standards are issued, the Inducements Task Force<sup>2</sup> will meet to determine what revisions should be made to the AICPA Code and CGMA Code for convergence purposes. The [Draft Inducement Standard](#) provided to the Board for adoption will be used by the Task Force unless the final is available sooner.
- **Professional Skepticism.** The IESBA plans to issue a Professional Skepticism Consultation Paper in early May. The IFAC Convergence & Monitoring Standing Group will be meeting on the afternoon of May 9<sup>th</sup> to determine what comments Mr. Burke should convey to the IESBA during the DC round table scheduled for June 11 and in writing by the comment deadline.
- **Impact Non-Assurance Services Has On Independence** The IESBA plans to issue a Non-Assurance Services Briefing Paper in early May. The IFAC Convergence & Monitoring Standing Group will be meeting on the afternoon of May 9<sup>th</sup> to determine what comments Mr. Burke should convey to the IESBA during the DC round table scheduled for June 11 and in writing by the comment deadline.

**Action Needed**

Members of the Committee are encouraged to share with Staff with any feedback they have on the consultation papers or briefing paper.

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<sup>1</sup> S. Burke, L. Snyder, B. Lynch, B. McKeown, C. Cahill, M. Brand, S. Jensen

<sup>2</sup> S. Berman (Chair), E. Pittlekow, J. Schiavo, S. Reed

**AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**  
**DIVISION OF PROFESSIONAL ETHICS**  
**PROFESSIONAL ETHICS EXECUTIVE COMMITTEE**  
**OPEN MEETING MINUTES**  
**February 13, 2018**

The Professional Ethics Executive Committee (Committee) held a duly called meeting on February 13, 2018. The meeting convened 9:30 a.m. and concluded at 5:00 p.m. on February 13, 2018.

<b><u>Attendance:</u></b> Samuel L. Burke, Chair Coalter Baker Carlos Barrera Stanley Berman Michael Brand Chris Cahill Tom Campbell Robert E. Denham Anna Dourdourekas Brian S. Lynch	William Darrol Mann William McKeown *Steven Reed James Smolinski Shelly Van Dyne Lisa Snyder Kelly Hunter Sharon Jensen Martin Levin Stephanie Saunders
<b><u>Staff:</u></b> James Brackens, VP - Ethics & Practice Quality Sue Coffey, EVP – Public Practice Toni Lee-Andrews, Director Ellen Gorla, Associate Director Shelley Truman, Ethics Specialist Brandon Mercer, Senior Manager	*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 Carl Peterson, VP – Small Firms Kristy Illuzi, Senior Manager - PCPS *Liese Faircloth, Manager – Product Development
<b><u>Guests:</u></b> Jeff Lewis, Chair, Independence/Behavioral Standards Subcommittee Ian Benjamin, Chair, Technical Standards Subcommittee Jason Evans, BDO Kelly Hnatt, External Counsel Nancy Miller, KPMG Dan Dustin, VP State Board Relations, NASBA Catherine Allen, Audit Conduct Sonia Araujo, PwC Paula Tookey, Deloitte	



\*George Dietz, PwC  
Vincent DiBlanda, Deloitte  
Barbara Rommer, PwC  
\*Elizabeth Pittelkow  
\*Jennifer Beneke  
Jennifer Kary, Crowe Horwath  
Jim Dalkin

\*Participated via phone

### 1. Welcome and Introductions

Mr. Burke welcomed the Committee and expressed appreciation for their efforts in joining the meeting.

### 2. PEEC Planning Subgroup

Ms. Lee-Andrews reported that the Planning Subgroup had met to review the Committee's three-year project agenda and to discuss input from external and internal stakeholders in developing suggested topics for future consideration regarding where the PEEC should be focusing efforts over the next 12-36 months. The Planning Subgroup's recommendations for future projects were discussed with the Committee. The Committee approved the development of a Request for Information or Discussion Memorandum to solicit further feedback and input from firms and stakeholders.

### 3. Information Technology and Cloud Services

Ms. VanDyne explained that the Task Force recommends defining "financial information system" consistent with the SEC guidance because defining it differently would likely cause confusion and a need to clarify the differences between the two. It was noted that in order for the proposed definition to be consistent with the SEC guidance the definition should stipulate that the system generates information that is significant to a **financial processes** taken as a whole as opposed to an **other financial information system** taken as a whole. It was believed that this change would clarify that general information technology controls would be covered by the definition. The Committee agreed with this revision and requested that the exposure draft seek input on whether commenters believe

- it is necessary for the definition of a financial information system to include specific guidance on what is "significant," or if this determination should be left up to the professional judgment of the member.
- that by including the concept of "significant" in the definition of a financial information system, it could be perceived that the Committee has proposed a less restrictive standard than the current interpretation, which would allow the member to design or develop a component of the financial information system that is not significant to the financial statements or financial process as a whole.
- the phrase "financial process" makes it clear that members should be thinking broadly about processes that may affect a financial process such as information technology general controls.

Ms. VanDyne went on to explain that the Task Force is also recommending the definition provide some factors that may help members decide if nonattest services are *related to* a financial information system. Several suggested edits were made to the proposed factors that the Committee agreed would help streamline and clarify the guidance. In addition, the Committee requested that the exposure draft seek input on whether commenters believe that systems that gather data that assist management in making decisions that directly affect financial reporting would include systems that generate management-level dashboard reporting.

For clarity purposes, the Committee requested that proposed paragraphs .02 and .03 be placed after the terminology section and be preceded by appropriate subheadings. The Committee also believed doing this would allow for proposed paragraph .04 to be eliminated which seemed to reduce the perceived complexity of the proposal.

The Committee discussed the additional examples of maintenance, support and or monitoring services that would impair independence added by the Task Force and made some minor edits. In addition, the Committee revised example c to clarify that this example would cover situations where the member *has the responsibility for monitoring or maintaining* the attest client's network performance. The Committee revised example d to clarify it is intended to cover *an information technology* help desk.

The Committee discussed the additional examples of maintenance, support and or monitoring services that do not impair independence added by the Task Force and clarified that when analyzing a network, the member would likely provide the attest client with its observations or recommendations. The Committee also clarified that a common example of what a member might assess of an attest client's security over information systems is the design or operating effectiveness. The Committee also noted that a member may also conduct an assessment of the attest client's information technology security policies without impairing independence.

It was noted that in order for the examples listed not to impair independence, the services had to be discrete projects. The Committee was asked if there was a need to provide some context around the meaning of discrete. The Committee agreed that this should be left to the professional judgment of the member and so did not add any clarification.

The Committee agreed that the exposure draft should propose a one year delayed effective date but to seek input regarding the length of time members believe would be necessary to implement the guidance and whether the terminology used in the proposal was consistent with industry practice and be readily understood.

It was moved, seconded and passed by a vote of 18 with one abstention to expose the interpretation as revised by the Committee for a 90-day exposure period.

#### **4. Compilation of Proforma and Prospective Financial Information**

Mr. Brand reported that the Task Force's charge was to evaluate the independence rules applicable to AUP and selected procedures engagements. The Task Force had no activity

since the last meeting, and Mr. Brand noted that the Task Force was in need of new members. Mr. Brand solicited volunteers to participate on the Task Force. The Task Force will report on its activities at the May PEEC meeting.

## **5. Long Association**

Ms. Dourdourekas explained that the comment letters indicated that Long Association is more troubling to smaller firms. The Task Force initially thought that in order to converge with IESBA, it needed to issue an interpretation. Mr. Burke asked if there was anything we needed to do to report to IESBA, and staff indicated that there is an annual reporting that is done to IESBA.

One PEEC member asked whether members would evaluate using the conceptual framework if there is not an interpretation, and whether doing otherwise would be in the best interests of the public. Other members inquired whether staff should add guidance to the *Plain English Guide to Independence* or in the Conceptual Framework Toolkit. Mr. Brand noted that firms reading the Code will follow the conceptual framework.

The PEEC took a straw poll regarding the next steps for the Task Force, with the Committee determining that members should rely on the conceptual framework approach in the extant Code, but that PEEC should supplement that with nonauthoritative guidance. The Task Force was instructed to formulate such guidance for consideration at the next PEEC meeting.

## **6. State & Local Government**

Ms. Miller explained that twenty-three comment letters were received on the exposure draft, with the majority of the commenters providing recommendations. She noted that the Task Force met and discussed the comments at a high level and began to drill down into the individual comment letters. Overall the Task Force does not believe the project should be tabled as tabling the project would result in the guidance for SLG affiliates to be inconsistent with the commercial affiliate guidance with no basis for the inconsistency. She also noted that Task Force believes there are too many situations where the extant guidance would not be responsive to threats and are concerned that members may not take action until a big issue arises that ends up harming the public. Ms. Miller explained that she believes the complexity of the proposal was driven by the desire to minimize the impact of the proposal and so the Task Force will first try to streamline the guidance while balancing the costs of compliance.

## **7. Leases**

Mr. Mercer noted that the comment period for the Leases Exposure Draft closed in January 2015 and that the Task Force had not yet met to review the comment letters. Mr. Mercer noted that commenters questioned the application of the materiality safeguard to certain covered members, and requested PEEC's feedback on which covered members should remain subject to the materiality safeguard. After brief discussion, PEEC did not recommend any changes to the materiality safeguard as exposed, as concerns remained regarding leases that are material to individuals in a position to influence the engagement or in the chain of command. The Task Force will perform its review of the comment letters and report on its activity at the May 2018 PEEC meeting.

**8. NOCLAR**

Mr. Denham reported on the Task Force's activities since the November PEEC meeting. The Task Force, including the UAA co-chairs observing, is meeting monthly to discuss comment letters received. The task force agreed to bi-furcate the comments between those that would likely not be considered by the UAA committee and those that will and first address those that don't have UAA implications. Staff is preparing several analyses before the next meeting to include comparisons of the exposure draft to applicable U.S. audit standards and the IESBA standard regarding non-auditor responsibilities and evaluation of non-attest provisions.

**9. Staff Augmentation**

Ms. Snyder and Mr. Mercer presented the Task Force's agenda item to PEEC and requested feedback on specific issues that the Task Force discussed in its deliberations.

*Staff Augmentation as a Non-attest Service*

PEEC generally agreed that provision of staff to the attest client is a non-attest service in that the member is providing human resources who are being supervised by the attest client. One member noted that a factor to consider with regards to the supervision aspect is whether the member's alliance is to the firm or the attest client. A member also noted that it may be appropriate to treat these individuals similar to members formerly employed by a client.

*Application of the General Requirements of 1.295*

Staff asked PEEC if there were any General Requirements of 1.295 that should not apply to staff augmentation services. It was noted that if any do not apply, then a member could not augment staff to the attest client if the activities would constitute the member performing management responsibilities.

*Appearance of Simultaneous Employment*

Staff noted that the appearance of simultaneous employment is referenced in other areas of 1.295, including the provisions on internal audit services. One member believed it would be helpful if the guidance addressed the appearance of the augmented staff being employed by the attest client.

*Safeguards – Short Term, Temporary, Non-recurring*

Staff asked PEEC if it believed safeguards d. and e. of paragraph .02 (below), regarding the augmentation being temporary and non-recurring, should be included in the guidance. One member recommended removing the "non-recurring" terminology. Other members recommended removing the concept of "short term" and instead add the duration of the contractor relationship as a factor to consider in the appearance discussion. Members also noted that there should not be a different conclusion than if the activities were performed as a non-attest service by the firm rather than through staff augmentation,

One PEEC member noted that if the member is also on the attest engagement team, the attest work should be reviewed by another professional. Ms. Snyder pointed out that this safeguard may not be workable, as the staff would likely be at the client site performing activities under the client's supervision, so that the client can take responsibility. One other

member noted that he could see review as a safeguard, if the work done by the augmented staff is related to the attest service.

The Task Force will report on its progress at the May 2018 PEEC meeting.

#### **10. IESBA Update**

Ms. Gorla reported that at the December 2017 IESBA meeting, the board approved the final text of the restructured code. If the PIOB approves the restructured Code as anticipated the new code will be released in April. With the exception of the revised provisions pertaining to the long association of firm personnel with an audit or assurance client:

- Parts 1, 2 and 3 of the restructured Code will be effective as of June 15, 2019;
- Part 4A relating to independence for audit and review engagements will be effective for audits and reviews of financial statements for periods beginning on or after June 15, 2019; and
- Part 4B relating to independence for assurance engagements with respect to subject matter covering periods of time will be effective for periods beginning on or after June 15, 2019; otherwise, it will be effective as of June 15, 2019.

Ms. Gorla also explained that the Board also received an update on the Professional Skepticism long term initiative to consider whether the concept of professional skepticism should be applied to all professional accountants. The plan is for the Task Force to bring a draft consultation paper to the March meeting.

#### **11. IESBA Fees Questionnaire**

Ms. Gorla explained that instead of responding to the specific questions in the questionnaire PEEC submitted a letter that explains the regulatory environment here and what the challenges would be for us in going any further than we currently have on this topic in our authoritative and non-authoritative guidance. The response also noted that PEEC believes that the IESBA Code establishes sufficient and appropriate provisions to assist professional accountants and firms in addressing threats to compliance with the fundamental principles and independence that might be created by the level of fees charged. The letter also suggested that if the Board concluded that additional illustrative information on this topic would be useful, it may want to consider providing such information in the form of nonauthoritative information and pointed to the nonauthoritative illustrative information provided by Staff starting on page 48 of the [AICPA Plain English Guide to Independence](#).

#### **12. Minutes of the Professional Ethics Executive Committee Open Meeting**

After edits to the November 2017 PEEC meeting attendance list, it was moved, seconded and unanimously agreed to adopt the minutes from the November 2017 open meeting.