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

The Professional Ethics Executive Committee has adopted the following revised paragraph .02 of “Definitions” [0.400] and new interpretation under the “Independence Rule” [1.200.001] “Firm Mergers and Acquisitions” [1.220.040].
Text of Revised Definition of “Affiliate”
(Additions appear in boldface italic, and deletions are stricken. Defined terms are hyperlinked and italicized.)

02. Affiliate. The following entities are affiliates of a financial statement attest client:

a. An entity (for example, subsidiary, partnership, or limited liability company [LLC]) that a financial statement attest client can control.

b. An entity in which a financial statement attest client or an entity controlled by the financial statement attest client has a direct financial interest that gives the financial statement attest client significant influence over such entity and that is material to the financial statement attest client.

c. An entity (for example, parent, partnership, or LLC) that controls a financial statement attest client when the financial statement attest client is material to such entity.

d. An entity with a direct financial interest in the financial statement attest client when that entity has significant influence over the financial statement attest client, and the interest in the financial statement attest client is material to such entity.

e. A sister entity of a financial statement attest client if the financial statement attest client and sister entity are each material to the entity that controls both.

f. A trustee that is deemed to control a trust financial statement attest client that is not an investment company.

g. The sponsor of a single employer employee benefit plan financial statement attest client.

h. Any entity, such as a union, or participating employer, or a group association of employers, that has significant influence over a multiple or multiemployer employee benefit plan financial statement attest client and the plan is material to such entity.

i. The participating employer that is the plan administrator of a multiple employer employee benefit plan financial statement attest client.

i.j. An single or multiple employer employee benefit plan sponsored by either a financial statement attest client or an entity controlled by the financial statement attest client. A financial statement attest client that sponsors an employee benefit plan includes, but is not limited to, a union whose members participate in the plan and All participating employers of a multiple employer employee or multiemployer benefit plan are considered sponsors of the plan.

j.k. A multiemployer employee benefit plan when a financial statement attest client or entity controlled by the financial statement attest client has significant influence over the plan and the plan is material to the financial statement attest client. An investment adviser, a general partner, or a trustee of an investment company financial statement attest client (fund) if the fund is material to the investment adviser, general partner, or trustee that is deemed to have either control or significant influence over the fund. When considering materiality, members should consider investments in, and fees received from, the fund.

l. An investment adviser, a general partner, or a trustee of an investment company financial statement attest client (fund) if the fund is material to the investment adviser, general partner, or trustee that is deemed to have either control or significant influence over the fund. When considering materiality, members should consider investments in, and fees received from, the fund.

Note: Conforming changes to items b, c and d of paragraph .02 of the “Client Affiliates” interpretation [1.224.010] are necessary. Specifically, the phrase “…described under items c–j of the definition of affiliate…” was updated to read “…described under items c–l of the definition of affiliate….” These conforming changes were not published in the official release.
1.220.040 Firm Mergers and Acquisitions

01. When (1) a member’s firm merges with or acquires another firm or entity or all or part of the business thereof (acquired firm) or (2) a member’s firm, or all or part of the business thereof, is merged with or acquired by another firm (acquiring firm), threats to compliance with the “Independence Rule” [1.200.001] may exist as a result of employment or association with, or the provision of nonattest services to, an attest client of the acquired or acquiring firm.

02. When determining which firm is the acquirer, members should consider the guidance contained in paragraphs .11–.15 of FASB ASC 805-10-55, among other sources.

Employment or Association With an Attest Client

03. If a partner or professional employee was formerly employed by or associated with an entity as a director, officer, employee, promoter, underwriter, voting trustee, trustee of any pension or profit-sharing trust of the entity, or in any capacity equivalent to that of a member of management and that entity becomes an attest client through a merger or acquisition, then threats will be at an acceptable level and independence will not be impaired provided all of the following safeguards are met:

a. The partner or professional employee terminates the relationship with the attest client (for example, resigns as a director) prior to the closing date of the merger or acquisition.

b. The partner or professional employee does not participate on the attest engagement team and is not an individual in a position to influence the attest engagement for the attest client when the attest engagement covers any period that includes his or her former employment or association with that attest client.

c. The applicable disassociation safeguards in paragraph .04 of the “Former Employment or Association With an Attest Client” interpretation [1.277.010] are implemented prior to the closing date of the merger or acquisition.

d. As soon as practicable under the circumstances but before issuing the attest report, a responsible individual within the firm assesses the prior relationship of the partner or professional employee with the attest client, as well as the position he or she holds at the firm, to determine if threats are created that are not at an acceptable level. If the responsible individual determines that threats are not at an acceptable level, he or she should be satisfied that safeguards are applied to eliminate or reduce the threats to an acceptable level. Threats will not be at an acceptable level if

   i. the partner or professional employee will have interaction with members of the attest engagement team regarding the attest client or
   ii. the attest engagement team is placed in a position of evaluating the partner or professional employee’s representations and work while he or she was employed or associated with the attest client.

In such situations, an individual within the firm with the appropriate stature, expertise, and objectivity should review the subsequent attest engagement prior to issuing the attest report to determine whether the attest engagement team maintained integrity; objectivity; and, as appropriate, professional skepticism.

e. As soon as practicable under the circumstances but before issuing the attest report, the nature of the relationship and any safeguards that were applied are
discussed with those charged with governance. Documentation of the substance of the discussion with those charged with governance is encouraged.

Nonattest Services

04. Nonattest services provided to an entity that becomes an attest client through a merger or an acquisition may create self-review, management participation, and advocacy threats to the member’s compliance with the “Independence Rule” [1.200.001]. Specifically, threats may exist if, during the period of the professional engagement or the period covered by the financial statements, nonattest services that would otherwise impair independence (prohibited nonattest services) under the interpretations of the “Nonattest Services” subtopic [1.295] are performed by

a. the acquiring firm, with respect to an attest client of the acquired firm or
b. the acquired firm, with respect to an attest client of the acquiring firm.

Prohibited Nonattest Services Provided by Acquiring Firm

05. If the acquiring firm provided prohibited nonattest services to an attest client of the acquired firm during the period covered by the financial statements, threats to compliance with the “Independence Rule” [1.200.001] will not be at an acceptable level and cannot be reduced to an acceptable level by the application of safeguards. Accordingly, the acquiring firm’s independence will be impaired with respect to the attest client.

Prohibited Nonattest Services Provided by Acquired Firm

06. If the acquired firm provided prohibited nonattest services to an attest client of the acquiring firm prior to the financial statement period covered by the acquiring firm’s next attest report, the acquiring firm’s independence would not be impaired.

07. If the acquired firm provided prohibited nonattest services to an attest client of the acquiring firm during the period of the professional engagement (except as provided for in paragraph .06) or the period covered by the financial statements, the acquiring firm’s independence would be impaired unless all of the following conditions are satisfied:

a. The acquired firm terminates the prohibited nonattest services (or modifies the service offerings such that they would not impair independence) prior to the closing date of the merger or acquisition.

b. Any individual who participated in the engagement to provide the prohibited nonattest services is neither on the attest engagement team nor an individual in a position to influence the attest engagement.

c. An evaluation of the threats is performed and threats are determined to be at an acceptable level or reduced to an acceptable level by the application of safeguards. The evaluation should be conducted on the basis of the attribution of the results of the nonattest services to the acquiring firm. That is, if the nonattest services

i. can be attributed to the acquiring firm because the acquiring firm will assume responsibility for the results of the nonattest services, then the evaluation should assess all prohibited nonattest services that the acquired firm performed for the attest client during the financial statement period to be covered by the acquiring firm’s next attest report; or

ii. cannot be attributed to the acquiring firm, then the evaluation should assess all prohibited nonattest services that the acquired firm performed for the attest client during the period in which the merger or acquisition was
pending (that is, from the commencement of negotiations through the closing date of the merger or acquisition).

08. In evaluating the significance of any threats, consideration should also be given to the following:
   a. Whether the nonattest service is attributed to the acquiring firm and whether the work performed or its results will be subject to attest procedures.
   b. The significance of the results of the nonattest service to the attest client’s financial statements.
   c. The extent to which the attest client and its management were involved in overseeing the nonattest services performed (including making any significant judgments and decisions with respect to the nonattest services) and whether the attest client and its management possessed the suitable skill, knowledge and/or experience to oversee such services.
   d. Whether the nonattest services involved the assumption of a management responsibility.

09. If the member concludes that the threats to independence are not at an acceptable level, the member should apply safeguards to reduce threats to an acceptable level.

10. Examples of safeguards include the following:
   a. An individual not associated with the nonattest engagement reviews the nonattest services work performed.
   b. Another firm performs an attest engagement on the subject matter of the nonattest service.
   c. Another firm re-performs the nonattest service to the extent necessary for it to take responsibility for that service.

If no safeguards exist that will eliminate or reduce the threats to an acceptable level, independence will be impaired.

**Communications With Those Charged With Governance**

11. As soon as practicable under the circumstances but before issuing the attest report, the nature of the prohibited nonattest services performed by the acquired firm that are subject to evaluation in paragraph .07b and any safeguards applied should be discussed with those charged with governance. Documentation of the substance of the discussion with those charged with governance is encouraged.

**Other Interests in and Relationships With an Attest Client**

12. This interpretation addresses only threats to independence that may arise as a result of a merger or an acquisition relating to employment or association with, or the provision of nonattest services to, an attest client. However other interests in, and relationships with, an attest client may also result in threats to compliance with the “Independence Rule” [1.200.001] or other rules during a merger or acquisition. Accordingly, members should take whatever pre-merger actions are necessary to be satisfied that the firm is in compliance with all relevant rules prior to the closing date of the merger or acquisition.

**Confidentiality Considerations**

Effective Date

14. This interpretation is effective for mergers or acquisitions with closing dates on or after January 31, 2016. Early implementation is allowed.