

THE REVISIONS AND ADDITIONS CONTAINED IN THIS DOCUMENT ARE EXPECTED TO BE EFFECTIVE ON MARCH 31, 2016. EARLY IMPLEMENTATION IS ALLOWED.

Ethics interpretations 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 new interpretation under the “Independence Rule” [1.200.001] “Breach of an Independence Interpretation” interpretation [1.298.010] new paragraph .06 of “Application of the AICPA Code” [0.200.020].

Text of Interpretation 1.298.010
(Terms in italic are defined terms.)

1.298 Breach of an Independence Interpretation

1.298.010 Breach of an Independence Interpretation

Introduction

01. AICPA bylaws require *members* to comply with the “Independence Rule” [1.200.001]. This interpretation provides guidance to assist *members* in evaluating and addressing the consequences of a breach of an *independence interpretation* and the effect on the *attest engagement team’s* integrity, objectivity, and professional skepticism so the *member* or *member’s firm* can determine if the consequences of a breach can be satisfactorily addressed. This interpretation also provides specific steps and actions the *member* should take when the *member* becomes aware that a breach of an *independence interpretation* has occurred. However, a *member’s* determination that the consequences of a breach of an *independence interpretation* have been satisfactorily addressed will not preclude an investigation or enforcement action. In any case, the *member* should be prepared to justify such determination.

Required Policies and Procedures Established by the Firm

02. In order for the consequences of an *independence* breach to be addressed by a *member* or the *member’s firm* pursuant to the provisions of this interpretation, the *firm* must be compliant with QC section 10, *A Firm’s System of Quality Control (Redrafted)* (AICPA, Professional Standards), which requires the *member’s firm* to have established policies and procedures designed to provide it with reasonable assurance that the *firm*, its personnel, and, when applicable, others subject to *independence* requirements, maintain *independence* when required. The policies and procedures should enable the *firm* to communicate its *independence* requirements to its personnel and, when applicable, others subject to them; to identify and evaluate circumstances and relationships that create *threats* to *independence*; and to take appropriate action to eliminate those *threats* or reduce them to an *acceptable level* by applying *safeguards* or, if effective *safeguards* cannot be applied, withdrawing from the engagement. These policies and procedures should be designed to provide the *firm* with reasonable assurance that it is notified of breaches of *independence* requirements and to enable it to take appropriate actions to resolve such situations.

Breaches Resulting in Significant Threats

03. In situations in which a *partner* or professional employee of the *firm* breaches an *independence interpretation* and the *threat* to *independence* resulting from the breach is significant such that the *attest engagement team’s* integrity, objectivity, and professional skepticism are compromised, the provisions of this interpretation could not address the consequences of the breach as no actions could be taken to satisfactorily address the consequences of the breach.
04. In situations in which the lead attest engagement partner or an individual in a position to influence the attest engagement either (1) committed the breach or (2) knows of a breach and fails to ensure the breach is promptly communicated to or known by an appropriate individual within the firm as described in this interpretation, there is a rebuttable presumption the provisions of this interpretation would not be able to address the breach as

the *threats* to the attest engagement team's integrity, objectivity, and professional skepticism and the threats to the appearance of independence would be considered so significant that no actions could be taken to satisfactorily address the consequences of the breach.

Identifying and Communicating a Breach

05. When a breach is identified, the *member* should, in accordance with his or her *firm's* policies and procedures, promptly communicate the breach to an appropriate individual within the *firm*, for example, an individual or individuals with responsibility for the policies and procedures relating to *independence*, or the *attest engagement partner* (the responsible individual).
06. The responsible individual should report the breach to those who need to take appropriate action and, when appropriate, should report the breach to relevant *network firms*. The responsible individual should be satisfied that the interest or relationship that caused the breach has been terminated, suspended, or eliminated and should address the consequences of the breach. A consequence of a breach may be that termination of the *attest engagement* is necessary.

Evaluating the Significance of a Breach

07. The responsible individual should evaluate the significance of the breach and its effect on the *attest engagement team's* integrity, objectivity, and professional skepticism and the ability to issue an attest report. The significance of the breach will depend on factors such as the following:
 - a. The nature and duration of the breach
 - b. The number and nature of any previous breaches with respect to the current *attest engagement*
 - c. Whether a *member* of the *attest engagement team* had knowledge of the interest or relationship that caused the breach
 - d. Whether the individual who caused the breach is a *member* of the *attest engagement team* or another individual for whom there are *independence* requirements
 - e. The role of the individual if the breach relates to a *member* of the *attest engagement team*
 - f. The effect of the service, if any, on the accounting records or the *attest client's financial statements* if the breach was caused by the provision of a *professional service*
 - g. Whether a *partner* or *partner equivalent* of the *firm* had knowledge of the breach and failed to ensure that the breach was promptly communicated to an appropriate individual within the *firm*
 - h. Whether the breach involved solely an *affiliate* of a *financial statement attest client* and if so, the nature of the *affiliate* relationship
 - i. The extent of the self-interest, advocacy, undue influence, or other *threats* created by the breach

Addressing the Consequences of a Breach

08. Depending upon the significance of the breach, it may be necessary to terminate the *attest engagement* or it may be possible to take action that satisfactorily addresses the

consequences of the breach. Certain breaches described in this interpretation cannot be addressed by the provisions of this interpretation. For all other breaches, the responsible individual should determine whether satisfactory action can be taken and is appropriate in the circumstances. In making this determination, the responsible individual should exercise professional judgment and take into account whether a reasonable and informed third party, weighing the significance of the breach, the action to be taken, and all the specific facts and circumstances available to the *member* at that time, would likely conclude that the *attest engagement team's* integrity, objectivity, and professional skepticism would be compromised and therefore whether *independence is impaired*.

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

Communicating With Those Charged With Governance at the Attest Client

10. If the responsible individual determines that action cannot be taken to satisfactorily address the consequences of the breach, the responsible individual should inform *those charged with governance* as soon as practicable and take the steps necessary to terminate the *attest engagement* in compliance with any applicable legal or regulatory requirements relevant to terminating the *attest engagement*. Where termination is not permitted by law or regulation, the responsible individual should comply with any reporting or disclosure requirements.
11. If the responsible individual determines that action can be taken to satisfactorily address the consequences of the breach, the responsible individual should discuss the breach and the action taken or proposed to be taken with *those charged with governance* as soon as practicable, unless *those charged with governance* have specified an alternative timing for reporting less significant breaches. The matters to be discussed should include the following:
 - a. The significance of the breach, including its nature and duration
 - b. How the breach occurred and how it was identified
 - c. The action taken or proposed to be taken and the responsible individual's rationale for how the action will satisfactorily address the consequences of the breach and enable the *firm* to issue the attest report
 - d. The conclusion that, in the responsible individual's professional judgment, the integrity, objectivity, and professional skepticism of the *attest engagement team* has not been compromised and the rationale for that conclusion
 - e. Any steps that the responsible individual has taken or proposes to take to reduce or avoid the risk of further breaches occurring

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

Breaches Relating to Previously Issued Reports

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

Documentation

14. The responsible individual should document the breach, the action taken, key decisions made and all the matters discussed with *those charged with governance* and any discussions with a professional body, relevant regulator, or oversight authority. When the *firm* continues with the *attest engagement*, the matters to be documented should also include the conclusion that, in the responsible individual's professional judgment, the integrity, objectivity, and professional skepticism of the *attest engagement team* have not been compromised and the rationale for why the action taken satisfactorily addressed the consequences of the breach such that the *firm* could issue an attest report. Failure to prepare the required documentation does not *impair independence* provided the *member* can demonstrate the *member* satisfactorily addressed the consequences of the breach and discussed the breach, the action taken, and key decisions made with *those charged with governance*, and as applicable, a professional body, relevant regulator, or oversight authority. However, failure to prepare the required documentation would be considered a violation of the "Compliance With Standards Rule" [1.310.001].
15. Refer to the "Unsolicited Financial Interests" interpretation [1.240.020] of the "Independence Rule" [1.200.001] for guidance on unsolicited financial interests.

Effective Date

16. This interpretation is effective March 31, 2016. Early implementation is allowed.

Text of Revised Paragraph .06 and .07 of “Application of the AICPA Code” [0.200.020].
(Additions appear in boldface and deletions are stricken. Terms in italic are defined terms.)

0.200.020 Application of AICPA Code (in part)

06. The “Breach of an Independence Interpretation” [1.298.010] of the “Independence Rule” [1.200.001] contains guidance with which a *member* should comply if the *member* identifies a breach of an *independence interpretation* of the code. If a *member* identifies a breach of any other provision of this code, the *member* should evaluate the significance of the breach and its effect on the member’s ability to comply with the rules of the code. The *member* should take whatever actions may be available, as soon as practicable, to satisfactorily address the consequences of the breach. The *member* should determine whether to report the breach, for example, to those who may have been affected by the breach, a professional body, relevant regulator, or oversight authority. In making the evaluation and in determining what actions should be taken, the *member* should exercise professional judgment and take into account whether a reasonable and informed third party, weighing the significance of the breach, the action to be taken, and all the specific facts and circumstances available to the *member* at that time, would be likely to conclude that the *member* is able to comply with the rules of the code. A *member’s* determination that the *member* has satisfactorily addressed the consequences of the breach will not, however, preclude an investigation or enforcement action concerning the underlying breach of the code and the *member* should be prepared to justify such determination.

Effective Date

.067 [Paragraph .01](#) is effective December 15, 2014. Paragraph .06 is effective March 31, 2016 with early implementation allowed.

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