



Ernst & Young LLP
5 Times Square
New York, NY 10036-6530

Tel: +1 212 773 3000
Fax: +1 212 773 6350
ey.com

January 19, 2018

BY EMAIL

Professional Ethics Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036
Ethics-ExposureDraft@aicpa-cima.com

Comments on Proposed Revision to the Leases Interpretation

We are pleased to provide our comments on the American Institute of Certified Public Accountants' Proposed Revision to the Leases Interpretation (ET sec. 1.260.040), issued by the Professional Ethics Executive Committee ("PEEC") (the "Proposed Revision").

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.

Applicability and application of paragraph .02 and .03

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 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.

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”.

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 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.

Application to Affiliates (Question 1)

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.

Grandfathering (Questions 2 and 7)

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.

* * * *

If you have any questions regarding any of the above comments, please contact Brian S. Lynch at 212-773-8332.

Sincerely,

Ernst + Young LLP