



EXPOSURE DRAFT

Proposed Interpretation

Long Association of Senior Personnel With an Attest Client

AICPA Professional Ethics Division
July 14, 2017

Comments are requested by September 15, 2017

Prepared by the AICPA Professional Ethics Executive Committee for comments from those interested in independence, behavioral, and technical standards matters. Comments should be addressed to the Professional Ethics Division, Ethics-ExposureDraft@aicpa-cima.com.

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July 14, 2017

This exposure draft contains an important proposal for review and comment by the AICPA's membership and other interested parties regarding a pronouncement for possible adoption by the Professional Ethics Executive Committee (PEEC). The text and an explanation of the proposed pronouncement are included in this exposure draft.

After the exposure period is concluded and PEEC has evaluated the comments, PEEC may decide to publish the proposed pronouncement. Once published, the pronouncement will become effective on the last day of the month in which it is published in the *Journal of Accountancy*, unless otherwise stated in the pronouncement.

Your comments are an important part of the standard-setting process; please take this opportunity to comment. Responses must be received at the AICPA by September 15, 2017. All written replies to this exposure draft will become part of the public record of the AICPA and will be available at www.aicpa.org/InterestAreas/ProfessionalEthics/Community/ExposureDrafts/Pages/ExposureDrafts.aspx. PEEC will consider comments at its subsequent meetings.

Please email comments to the Professional Ethics Division (Ethics-ExposureDraft@aicpa-cima.com).

Sincerely,

Samuel L. Burke, Chair
AICPA Professional Ethics Executive Committee

Professional Ethics Executive Committee (2016–2017)

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Explanation for the New Interpretation “Long Association of Senior Personnel With an Attest Client”

The Professional Ethics Executive Committee (PEEC) is exposing for comment a new interpretation entitled “Long Association of Senior Personnel With an Attest Client” (ET sec. 1.267.010)¹ under the “Independence Rule” (ET sec. 1.200.001).

Purpose

In developing the proposed interpretation, PEEC considered the new ethics standard *Long Association of Personnel with an Audit Client* of the International Ethics Standards Board for Accountants (IESBA) *Code of Ethics for Professional Accountants* (IESBA code).² PEEC believes that though many of the proposed requirements are consistent with that of the new IESBA standard, certain differences are necessary to enhance the clarity of the proposed interpretation and make it relevant to AICPA members in the United States. Most notably, as discussed further in a subsequent section, certain provisions of the IESBA standard were not included in the AICPA proposal because the SEC already addresses provisions such as partner rotation for registered companies.

Overview

The proposed interpretation does not include partner rotation for reasons explained further in this document. However, partner rotation is a suggested safeguard in the proposed interpretation. Thus, the proposed interpretation is similar to the existing guidance in the AICPA Code of Professional Conduct (AICPA code);³ however, the proposal is more robust and will better guide members when addressing familiarity threats due to long association with an attest client.

Partner Rotation

The IESBA standard requires partner rotation for public interest entities (PIEs). PEEC concluded that partner rotation for PIEs would not be appropriate for inclusion in the AICPA code due to the potential to cause conflicts in application of the partner rotation rules as set forth by the SEC. The SEC already provides rules pertaining to partner rotation of registered entities that are more restrictive than those of the IESBA. As such, PEEC considered only the general provisions of the IESBA standard for convergence, which contain guidance pertaining to all clients to address threats to independence created by the long association with an assurance client (par. 290.148–290.152 of the IESBA code).

Applicability of the Proposed Interpretation—Personnel

The IESBA standard states that any member of the audit or assurance team, not just senior personnel, could be associated with the audit or assurance client long enough to create threats to independence, depending on the nature of the roles the member performs. Therefore, the general provisions of the IESBA’s long association standard apply to evaluating potential threats created by the long association of any individual on the audit team with any client. This is a change in approach from the former standard included in the IESBA code, which addressed senior personnel only.

PEEC did not support applying the general provisions of the IESBA standard to all individuals on the engagement team because key audit partners have the responsibility for all significant judgments. Although non-senior members of the audit or assurance team may participate in key decisions, they will not be responsible for these

¹ All ET sections can be found in AICPA *Professional Standards*.

² Published in January 2017 for inclusion in the International Ethics Standards Board for Accountants (IESBA) *Code of Ethics for Professional Accountants*.

³ The Conceptual Framework for Members in Public Practice (ET sec. 1.000.010) identifies long association as an example of a familiarity threat in item (d) of paragraph .12 and partner rotation as a possible safeguard in item (r) of paragraph .23.

decisions because their work will be reviewed by senior members of the team. Accordingly, threats to independence based on the long association with an attest client of a member of the attest engagement team who is not included in the senior personnel would be mitigated due to review processes. Thus, the proposed interpretation applies only to senior personnel of the attest engagement team.

Applicability of the Proposed Interpretation—Engagement Types

The IESBA standard is bifurcated into two types of services. The first part of the IESBA long association standard addresses audits and reviews and is located in section 290, *Independence—Audit and Review Engagements*, of the IESBA code. The second part of the IESBA long association standard applies to all other assurance engagements and is located in section 291, *Independence—Other Assurance Engagements*, of the IESBA code. PEEC believes that to appropriately address the familiarity threat, the proposed standard should apply to all attest engagements.

Applicability of the Guidance—Threats

The IESBA's long association standard states that familiarity threats and self-interest threats may be created due to long association of an accountant with an assurance client. The standard states that a self-interest threat may be created because of the individual's concern about losing a longstanding client, which may inappropriately influence the individual's judgment (par. 290.148).

PEEC considered the threats created by long association with an attest client and the threats noted in the IESBA standard and agreed that the familiarity threat is applicable; however, the self-interest threat is not. Thus, the proposed interpretation mentions only the familiarity threat.

Requirement to Determine if Rotation Is Necessary

The general provisions of the IESBA long association standard establish a requirement that, if a firm decides rotation of an individual on the audit or assurance team is a necessary safeguard, the firm determine an appropriate period during which the individual shall not participate in the audit or assurance engagement or exert direct influence on the outcome of the audit or assurance engagement. The relevant paragraphs are as follows:

290.152 If a firm decides that the threats are so significant that rotation of an individual is a necessary safeguard, the firm shall determine an appropriate period during which the individual shall not be a member of the engagement team or provide quality control for the audit engagement or exert direct influence on the outcome of the audit engagement. The period shall be of sufficient duration to allow the familiarity and self-interest threats to independence to be eliminated or reduced to an acceptable level. In the case of a public interest entity, paragraphs 290.153 to 290.168 also apply.

291.141 If a firm decides that the threats are so significant that rotation of an individual is a necessary safeguard, the firm shall determine an appropriate period during which the individual shall not be a member of the engagement team, or provide quality control for the assurance engagement, or exert direct influence on the outcome of the assurance engagement. The period shall be of sufficient duration to allow the familiarity and self-interest threats to be eliminated or reduced to an acceptable level.

PEEC agreed that if there is no rotation requirement in the AICPA code, it is counterintuitive to require the firm to determine a rotation period. Firms should be able to evaluate whether rotation is necessary and the appropriate rotation period as needed, based on the facts and circumstances at that time. Thus, there is no corresponding rotation period requirement in the proposed interpretation. Rotation of a member as a safeguard against threats created by long association is noted in the examples of safeguards in paragraph .06 of the proposed standard.

Request for Specific Comments

Although PEEC welcomes comments on all aspects of the proposed interpretation, it specifically requests feedback on the following:

1. The self-interest threat to independence exists when "...a member could benefit, financially or otherwise, from an interest in or relationship with an attest client or persons associated with the attest client" (ET sec. 1.210.010.16). Do you believe this threat may exist when a member is included in senior personnel of an attest engagement team over a long period and should therefore be included as a potential threat to independence in paragraph .02?
2. Are there significant challenges that would require the need for a delayed effective date? If so, please identify the challenges and provide a recommendation regarding an effective date.

Effective Date

PEEC proposes that the final interpretation be effective on the last day of the month in which it is published in the *Journal of Accountancy*.

Text of Proposed Interpretation “Long Association With an Attest Client”

(Applicable to Members in Public Practice)

1.267 Long Association With an Attest Client

1.267.010 Long Association of Senior Personnel With an Attest Client

- .01 For purposes of this interpretation, senior personnel of the attest engagement team are partners, partner equivalents, and any other individuals on the attest engagement team who have responsibility for decision making on significant auditing, accounting, and reporting matters that affect the results of the attest engagement and who maintain regular contact with attest client management or those charged with governance.
- .02 When a member is included in the senior personnel of an attest engagement team over a long period of time, familiarity threats to the member's compliance with the “Independence Rule” [ET sec. 1.200.001] may exist and may increase in significance over time.
- .03 An understanding of an attest client and its environment is fundamental to providing high-quality attest services and contributes to audit quality when performing an audit. However, a member's long inclusion among the senior personnel of the attest engagement team may create a familiarity threat with any of the following:
- The attest client and its operations
 - The attest client's senior management
 - The subject matter of the attest engagement
 - Financial statements on which the firm will express an opinion or the financial information that forms the basis of the financial statements
- .04 The significance of the threats will depend on factors, individually or in combination, relating to both the member and the attest client.
- Factors relating to the member include these:
 - The overall length of the member's relationship with the attest client, including if such relationship existed while the member was at a prior firm
 - How long the member has been on the attest engagement team and the nature of the roles performed
 - The extent to which the work of the member is directed, reviewed, and supervised by other senior personnel
 - The extent to which, due to the member's seniority, the member has the ability to influence the outcome of the attest engagement, for example, by making key decisions or directing the work of other members of the attest engagement team
 - The closeness of the member's personal relationship with senior management or those charged with governance
 - The nature, frequency, and extent of the interaction between the member and senior management or those charged with governance
 - Factors relating to the attest client include the following:
 - The attest client's accounting and financial reporting issues and whether they have changed

- ii. Whether there have been any recent changes in senior management or those charged with governance
 - iii. Whether there have been any structural changes in the attest client's organization that affect the nature, frequency, and extent of interactions the member may have with senior management or those charged with governance
- .05 The combination of two or more factors may increase or reduce the significance of the threats. For example, familiarity threats created over time by an increasingly close relationship between a member and an individual in the attest client's senior management would be reduced by the departure of that individual of the attest client's senior management and the start of a new relationship.
- .06 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 the following:
- a. Changing the role of the member on the attest engagement team or the nature and extent of the tasks the member performs
 - b. Having a professional accountant who was not included in the attest engagement team review the work of the member
 - c. Performing regular independent internal or external quality reviews of the engagement
 - d. Performing an engagement quality control review
 - e. Rotating the member off the attest engagement team for an appropriate period based on the significance of the threats

Effective Date

- .07 This interpretation is effective [the last day of the month in which it appears in the *Journal of Accountancy*].