



Professional Ethics Division

Exposure draft: Proposed revised interpretations and definition Loans, acquisitions, and other transactions

Definition of "beneficially owned"

"Client Affiliates" interpretation

"Loans" interpretation

"Loans and Leases With Lending Institutions" interpretation

"Immediate Family Members" interpretation

October 5, 2021

Comments are requested by January 5, 2022

ethics-exposedraft@aicpa.org

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Invitation to comment

October 5, 2021

If you're an AICPA member or someone interested in the ethics of auditing and accounting, we want to hear your thoughts on this ethics exposure draft.

This proposal is part of the AICPA's Professional Ethics Executive Committee (PEEC) project to evaluate the amended independence rules the SEC issued on October 16, 2020, and determine whether revisions to the AICPA Code of Professional Conduct are required.

This exposure draft is an explanation of the proposed revisions and the full text of the guidance being considered.

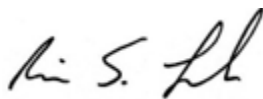
After the exposure period concludes and PEEC has evaluated the comments, PEEC may decide to publish the revised interpretations and definitionf.

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 January 5, 2022. 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/peecprojects. PEEC will consider comments at its subsequent meetings.

Please email comments to ethics-exposedraft@aicpa.org.

You may also submit comments via our online form at aicpa.org/ethicscomments.

Sincerely,



Brian S. Lynch, Chair
Professional Ethics Executive Committee



Toni Lee-Andrews, Director, CPA, PFS, CGMA
Professional Ethics Division

Explanation of the revised interpretations and definition

As part of our convergence efforts, the Professional Ethics Executive Committee (PEEC) is exposing for comment revisions to one definition and four independence interpretations:

- Definition of "beneficially owned" (ET sec. 0.400.06)
- "Loans" interpretation (ET sec. 1.260.010)
- "Loans and Leases With Lending Institutions" interpretation (ET sec. 1.260.020)
- "Immediate Family Members" interpretation (ET sec. 1.270.010)
- "Client Affiliates" interpretation (ET sec. 1.224.010)

If adopted as final, the revisions will be applicable to members in public practice.

Purpose

1. The SEC approved amendments to certain auditor independence requirements in Rule 2-01 of Regulation S-X in October 2020. These amendments were effective as of June 9, 2021, and early compliance was permitted.¹
2. The **final SEC amendments** modernize the rules and more effectively focus the independence analysis on relationships and services that may pose threats to an auditor's objectivity and impartiality. The amendments were informed by decades of SEC staff experience applying the auditor independence framework.
3. The key changes the SEC made to Rule 2-01² are as follows:
 - a. Amend the definitions of "affiliate of the audit client," in Rule 2-01(f)(4), and "investment company complex," in Rule 2-01(f)(14), to address certain affiliate relationships, including entities under common control.
 - b. Amend the definition of "audit and professional engagement period," specifically Rule 2-01(f)(5)(iii), to shorten the "look-back" period for domestic first-time filers in assessing compliance with the independence requirements.
 - c. Amend Rule 2-01(c)(1)(ii)(A)(1) and (E) to add certain student loans and de minimis

¹ Voluntary early compliance was permitted after December 11, 2020, if the final amendments are applied in their entirety from the date of early compliance.

² From SEC [press release](#) "SEC Updates Auditor Independence Rule" (October 16, 2020).

consumer loans to the categorical exclusions from independence-impairing lending relationships.

- d. Amend Rule 2-01(c)(3) to replace the reference to “substantial stockholders” in the business relationships rule with the concept of beneficial owners with significant influence over the entity under audit.
 - e. Add a new provision to Rule 2-01(e) to introduce a transition framework to address inadvertent independence violations that only arise as a result of a merger or acquisition transaction.
 - f. Make certain other miscellaneous updates.
4. For a deeper understanding of the changes, refer to the [final SEC amendments](#) and to the June 2021 [CAQ Alert 2021-02, “Amendments to the SEC Independence Rules.”](#)
 5. PEEC appointed a task force to evaluate these amended rules and determine whether revisions to the AICPA Code of Professional Conduct (the AICPA code) are required. Based on that evaluation, PEEC is proposing revisions to
 - a. add certain student loans and consumer loans as permitted loans.
 - b. replace the reference to “officer, director, or 10 percent or more owner” with “an officer or director with the ability to affect decision-making and a beneficial owner with significant influence.”
 - c. clarify that the definition of “beneficially owned” could include a record owner and should be applied when the phrase “beneficial ownership interest” is used.
 - d. add additional guidance when a financial statement attest client is involved with an acquisition or other transaction that results in a new affiliate.

Student loans

6. The final SEC amendments provide that student loans will not impair independence if they were obtained prior to the borrower becoming a covered person. According to the SEC’s release, they believe “obtaining a loan as a covered person poses a higher risk to the auditor’s objectivity and impartiality and creates, at a minimum, an independence appearance issue that is not present when a non-covered person obtained a similar student loan from such audit client.”
7. The release also indicated that initially the SEC did not want to “extend the exception to a covered person’s immediate family due to concerns...that the amount of the student loan borrowings could be significant when considering student loans obtained for multiple immediate family members and thus could impact the auditor’s objectivity and impartiality.”

8. However, the SEC decided to expand the exception to include immediate family student loans because the mortgage exception applies to immediate family members and these loans could be substantially more significant than student loans.
9. The SEC release clarifies that the loans covered by this exception are intended to be limited to “loans for the covered persons’ and their immediate family members’ educational expenses...and not loans that they undertake to pay for another person’s educational expenses.”
10. Under the AICPA code’s extant “Loans, Leases, and Guarantees” subtopic (ET sec 1.260) of the “Independence Rule” (ET sec. 1.200.001), a student loan is permitted under the unsecured loan provision if the student loan was immaterial and obtained prior to the borrower becoming a covered member.
11. To align more closely with the final SEC amendments, the AICPA proposal permits student loans from an attest client that is a lending institution if
 - a. the student loan was obtained by the covered member (or immediate family member) prior to becoming a covered member;
 - b. the student loan was obtained under the lending institution’s normal lending procedures, terms, and requirements;
 - c. the student loan is kept current; and
 - d. there are no changes to the terms of the student loan.
12. In the proposed revisions, as in the extant guidance, independence will be impaired if the student loan
 - a. was obtained while the borrower is a covered member;
 - b. is not kept current; or
 - c. terms are changed.
13. PEEC’s proposal, like the final SEC amendments, does not impose a materiality threshold, nor does it define what specific expenses are covered by the student loan (for example, tuition, books, and room and board).
14. PEEC’s proposal does differ from the final SEC amendments in that it does not limit whose expenses are covered by the student loan. The final SEC amendment indicates that the expenses should be for the covered person or immediate family member, whereas PEEC’s proposal does not impose this requirement.
15. Accordingly, under the proposal, a student loan obtained by the covered member or immediate family member that covers educational expenses for a **close relative** would be permitted if the loan was obtained prior to the borrower becoming a covered member, the loan is kept current, and no changes are made to the terms.

16. PEEC considers this difference appropriate because the negotiation of the loan occurred prior to the borrower becoming a covered member.

Consumer loans

17. The final SEC amendments permit any consumer loan with a lender that is an audit client if the aggregate outstanding balance owed is reduced to \$10,000 or less on a current basis taking into consideration the payment due date and available grace period.

18. This represents the SEC's view that a limited amount of debt that is routinely incurred by a covered person or any of his or her immediate family members for personal consumption, even if the audit client is the lending entity, will typically not impair an auditor's objectivity and impartiality.

19. PEEC's proposal, like the final SEC amendments, permits consumer loans, assuming the aggregate outstanding balance is \$10,000 or less on a current basis. The proposal includes credit cards, retail installment loans, and home improvement loans as examples of consumer loans that are permitted.

Officer, director, and beneficial owners

20. The SEC's rules prohibit any loan to an audit client, or an audit client's officers, directors, or beneficial owners (known through reasonable inquiry) of the audit client's equity securities, where the beneficial owner has significant influence over the entity under audit.

21. To align the AICPA code with this scope, the proposal replaces the phrase "any officer or director of the attest client, or any individual owning 10 percent or more of the attest client's outstanding equity securities or other ownership interests" in ET sections 1.224.010, 1.260.010, and 1.260.020 with the phrase "any officer or director of the attest client with the ability to affect decision-making, or any individual with a beneficial ownership interest (known through reasonable inquiry) that gives the individual significant influence over the attest client."

Acquisition or other transaction creates a new affiliate

22. A new affiliate relationship can be created because a financial statement attest client or affiliate is involved in an acquisition or other transaction. When this happens, a member may have an interest in or relationship with the new affiliate that will impair independence.

23. The SEC's final amended rules include a transition framework to provide relief in the following circumstances:

- a. The auditor is in compliance with independence standards that are applicable to the entities involved in the transaction from the origination of the relationships or services in question and throughout the period in which the applicable independence standards apply.
- b. The potential independence-impairing service or relationship is addressed before the

effective date of the merger or acquisition, unless doing so would cause significant disruption to the audit client. If it would cause the audit client significant disruption, the transition framework allows for some limited flexibility by requiring that the service or relationship be addressed promptly after the effective date.

- c. The firm's quality control system has procedures and controls that require the firm be timely notified about the audit client's merger and acquisition activity. Upon notification, these procedures and controls allow the firm to identify, before the effective date, services or relationships that could result in independence violations.

24. Because the International Ethics Standards Board for Accountants *Code of Ethics for Professional Accountants* (IESBA code) provides detailed guidance for these situations and the SEC's final amended rules provide a transition framework for these situations, PEEC agreed that the AICPA code's current position should be enhanced.
25. Currently the AICPA code's relief is limited to situations in which the attest client is acquired by a nonclient or a nonattest client, and a covered member has an interest in or relationship with the acquirer that will impair independence.
26. The AICPA code says that independence will not be impaired, even if the situation existed during the period of the professional engagement, as long as the attest engagement covers only periods prior to the acquisition and the covered member will not continue to provide attest services after the effective date of the acquisition. No revision is proposed for this situation.
27. Revisions, however, are proposed for situations that go beyond the client being acquired³ and in which the firm
 - a. plans to continue providing financial statement attest services but can't reasonably end the prohibited relationship by the effective date.
 - b. does not plan to continue providing financial statement attest services after completing the current engagement and the report for the current engagement will include periods after the effective date.

Firm plans to continue providing financial statement attest services but can't reasonably end the prohibited relationship by the effective date

28. A new affiliate relationship may be created because of an acquisition or other transaction and the member plans to continue providing financial statement attest services after the effective date of this transaction. In this situation, the AICPA proposal says that when the member has an independence-impairing interest or relationship that can't reasonably be ended by the effective date, independence will not be impaired when the following specific conditions are met:

³ The proposal includes transactions beyond those in which the client is acquired. For example, the proposal would cover situations in which the client is the acquirer and other transactions such as mergers.

- a. Evaluating the level of the threats created by the interest in or relationship with the new affiliate and discussing your evaluation of the level of threats with those charged with governance
 - b. Discussing with those charged with governance why the independence-impairing relationship or interest with the new affiliate can't be ended by the effective date and obtaining their agreement that you should continue with the engagement and end the interest or relationship as soon as reasonably possible, but no later than six months after the effective date
 - c. Ensuring that any individual who has an independence-impairing interest in or relationship with the new affiliate will not be on the attest engagement team nor be responsible for the engagement quality control review
 - d. Applying any additional transitional measures deemed necessary and discussing these with those charged with governance
29. PEEC believes its proposal is consistent with the international requirements in the IESBA code. Though the proposal is substantially in line with the SEC framework, there are some key differences:
- a. The SEC framework uses the notion of "causing significant disruption to the audit client" as opposed to the PEEC proposal's notion of being "unable to reasonably end the interest or relationship by the effective date."
 - b. The SEC framework states that the firm's quality control system should have procedures and controls that require the firm be timely notified about the audit client's merger and acquisition activity. Upon notification, the procedures should allow the firm to identify, before the effective date, services or relationships that could result in independence violations. PEEC's proposal does not align with this guidance. Rather, the proposal aligns with the IESBA code, which does not include this requirement.
 - c. Although the SEC framework does not provide a specific time period for ending the interest or relationship, the discussion in the release indicates the SEC considers no later than six months to be reasonable. However, the SEC also indicated a shorter period should be used when reasonably attainable. This concept is included in PEEC's proposal.

Firm does not plan to continue providing financial statement attest services after completing the current engagement but the report for the current engagement will include periods after the effective date

30. When the firm does not plan to continue providing financial statement attest services after completing the current engagement but the report for the current engagement will include periods after the effective date, the proposal requires members to take certain specific

actions to safeguard their independence.

31. These actions are aligned with the international requirements of the IESBA code:

- a. A significant amount of work on the current engagement must be completed prior to the effective date of the transaction.
- b. The remaining attest procedures must be completed within a short period of time after the effective date.
- c. Upon issuing the current report, the firm must resign.
- d. Those charged with governance have requested that the engagement be completed even though the interest in or relationship with the new affiliate can't be ended by the effective date.
- e. The member must ensure any individual who has an independence-impairing interest in or relationship with the new affiliate will not be on the attest engagement team nor be responsible for the engagement quality control review.
- f. The member must apply any additional transitional measures deemed necessary and discuss these with those charged with governance.

32. This part of PEEC's proposal goes beyond the SEC framework because it specifies actions that must be taken to maintain independence.

Other considerations when a new affiliate is created because of an acquisition or other transaction

33. Even if an interest in or relationship with a new affiliate can be addressed by one of the provisions in paragraphs 26, 28, and 31, above, PEEC's proposal requires members to ensure their objectivity is not impaired by considering the requirements of the "Conflicts of Interest for Members in Public Practice" interpretation (ET sec. 1.110.010) under the "Integrity and Objectivity Rule" (ET sec. 1.100.001).

34. If a member applies one of the provisions discussed in paragraphs 26, 28, and 31, above, the proposal requires the member to consider documenting certain things such as why the interest or relationship can't be ended by the effective date, transitional measures applied, and why the member believes objectivity is not impaired.

Other clarifications

35. When discussing the proposed revisions, PEEC identified other clarifications that it believes will be helpful when members apply the revised guidance.

Beneficially owned

36. Revisions to the definition of "beneficially owned" (ET sec. [0.400.06](#)) are proposed because, as currently drafted, the definition can be read to imply that it does not include financial interests held by a record owner.

37. PEEC believes its proposed edits clarify that the definition includes financial interests held by an individual or entity who may or may not be the record owner.

Immediate family members

38. PEEC is proposing revisions to clarify that members should also consider loans that immediate family members have when evaluating materiality to the covered member. Currently, the AICPA code calls for members to consider only the materiality of financial interests.

Effective date

39. PEEC issued its [“Temporary Policy Statement of the AICPA Professional Ethics Executive Committee Related to Amendments of Rule 2-01 of Regulation S-X”](#) on December 21, 2020. This policy states,

On October 16, 2020, the SEC announced that it adopted final amendments to certain auditor independence requirements in Rule 2-01 of Regulation S-X (SEC amendments). The SEC amendments will be effective on June 9, 2021, with early adoption permitted. PEEC has agreed to evaluate the SEC amendments and determine if any revisions should be made to the AICPA Code of Professional Conduct (code) in light of the SEC amendments. While this evaluation is underway, PEEC will consider a member to be in compliance with the code if the member implements and complies with the SEC amendments or complies with the existing code. This temporary enforcement policy will be effective until PEEC rescinds it.

40. Even with this policy, PEEC recommends that the proposed revisions in this exposure draft be effective three months after notice is published in the *Journal of Accountancy*, with early implementation allowed. This delay allows members who were not subject to the SEC amendments time to implement these revisions.

Request for comments

41. PEEC welcomes comments on all aspects of the proposed revisions. In addition, PEEC is seeking feedback on the following specific aspects of this proposal:

- a. Are there any other components of the amended SEC rules that PEEC should consider converging with before it rescinds its temporary policy statement and, if so, why?
- b. Do you agree the proposal should not limit whose expenses are covered by the student loan and why or why not?
- c. When an attest client or its affiliate is involved with a transaction that creates a new affiliate, the proposal provides some relief for existing interests and relationships that impair independence when certain safeguards are met.

One such safeguard is that covered members believe they will be able to complete the remaining attest procedures in a “short period of time” ([paragraph .10b](#)).

Do you believe PEEC should provide parameters around what is meant by a “short period of time,” or should this be left to members’ professional judgment?

If you believe parameters should be provided, what should those parameters be and should they be included in the interpretation or in nonauthoritative guidance?

- d. Do you agree that a three-month delayed effective date provides adequate time to implement the proposals? If not, why not? What period would provide adequate time?

Text of proposed revised definition “beneficially owned”

(Additions are presented in *bold italic* text. Deletions are presented in ~~strikethrough~~.)

0.400 Definitions

.06 Beneficially owned, *beneficial ownership interest*. Describes a *financial interest* of which *providing* an individual or entity, ~~is not the record owner, but has a~~ *the* right to some or all of the underlying benefits of ownership. These benefits include the authority to direct the voting or disposition of the interest or to receive the economic benefits of the ownership of the interest.

Text of proposed revised interpretation “Client Affiliates”

(Additions are presented in ***bold italic*** text. Deletions are presented in ~~strikethrough~~.)

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. ***During the period of the professional engagement*** ~~a~~ ***A covered member*** may have a ***loan*** to or from an
 - i. ***officer or director of an affiliate of a financial statement attest client, unless the officer or director has the ability to affect the decision-making at the financial statement attest client.***
 - ii. ***individual with a beneficial ownership interest (known through reasonable inquiry) in an affiliate of a financial statement attest client, unless the ownership interest gives the individual significant influence over the financial statement attest client.***

~~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 covered member who is an individual on the **attest engagement team**, an *individual in a position to influence the attest engagement*, or the *firm* may have a lease that does not meet the requirements of the “**Leases**” interpretation [1.260.040] under the “Independence Rule” with an entity described under items c–l of the definition of *affiliate* during the *period of the professional engagement*. The covered member should use the “Conceptual Framework for Independence” to evaluate whether any *threats* created by the lease are at an **acceptable level**. If the covered member concludes that *threats* are not at an **acceptable level**, the covered member should apply **safeguards** to eliminate the *threats* or reduce them to an **acceptable level**.
- .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]

Acquisition or Other Transaction Involving a Financial Statement Attest Client or Its Affiliates That Results in the Creation of a New Affiliate

.05 *An entity may become a new **affiliate** of an existing **financial statement attest client** because of an acquisition or other transaction. A **threat to independence** and, therefore, to the ability of a **member** or member's **firm** to continue a financial statement attest engagement might be created by previous or current interests or relationships between the member or member's firm and the new affiliate. Paragraphs .06–.13 provide guidance on how independence is affected when such interests in or relationships with a new affiliate exist. 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 nonclient 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.*

An Existing Financial Statement Attest Client Is Acquired and the Member or Member's Firm Will Not Continue Providing Financial Statement Attest Services to Such Client After the Current Attest Report Is Issued and the Report Does Not Include Periods After the Effective Date of the Acquisition

.06 *Independence will not be considered impaired with respect to the financial statement attest client because **When a member** or member's **firm** has an interest in or relationship with the **an** 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), **independence with respect to the financial statement attest client** will not be considered impaired if all the following conditions are met:*

- a. The acquisition occurs during the **period of the professional engagement**.*
- b. The financial statement attest engagement covers only periods prior to the effective date of the acquisition.*
- c. The member or member's firm will not continue to provide financial statement attest services to the existing financial statement attest client for periods after the effective date of the acquisition.*

.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.*

An Existing Financial Statement Attest Client or Its Affiliate Is Involved in an Acquisition or Other Transaction and the Member or Member's Firm Expects to Continue Providing Financial Statement Attest Services to Such Client

.07 *When an acquisition or other transaction creates a new **affiliate** of a **financial statement attest client** during the period of professional engagement and the **member** or member's **firm** expects to continue providing **financial statement** attest services to the financial statement attest client after the effective date of the acquisition or other transaction, the following conditions should be met:*

- a. The member or member's firm should identify and evaluate previous and current interests in and relationships with the new affiliate that, taking into account any actions taken to address the **threat to independence**, might affect independence and therefore the member's or member's firm's ability to continue the financial statement attest engagement after the effective date of the acquisition or other transaction.*
- b. Except as provided for in paragraph .08, the member or member's firm should take steps to end any interests in or relationships with the new affiliate that would impair independence by the effective date of the acquisition or other transaction.*

.08 *As an exception to paragraph .07b, if the interest in or relationship with the new **affiliate** cannot reasonably be ended by the effective date of the acquisition or other transaction (for example, the new affiliate is not able to transition a nonattest service in an orderly manner to another service provider by that date), the **member** or member's **firm** should do the following:*

- a. Evaluate the **threat to independence** that is created by the interest or relationship. Factors that are relevant in evaluating the level of a threat when there are interests and relationships with a new affiliate that cannot reasonably be ended could include these.*
 - i. The nature and significance of the interest or relationship*
 - ii. The nature and significance of the affiliate relationship (for example, whether the affiliate is a subsidiary, parent, or sister entity)*
 - iii. The length of time until the interest or relationship can reasonably be ended*
- b. Discuss with **those charged with governance** the evaluation of the level of threat and the reasons that the interest or relationship cannot reasonably be ended by the effective date of the acquisition or other transaction.*

.09 *Following the discussion in paragraph .08b, if **those charged with governance** request the **member** or member's **firm** to continue to provide financial statement attest services to the **financial statement attest client**, the member or member's firm should do so only under the following circumstances.*

- a. *The interest in or relationship with the new **affiliate** that would impair independence will end as soon as reasonably possible but no later than six months after the effective date of the acquisition or other transaction.*
- b. *Any individual who has such an interest in or relationship with the new affiliate, including one that has arisen through performing a nonattest service that would impair independence under the “**Nonattest Services**” subtopic [1.295] of the “**Independence Rule**” [1.200.001], will not be a member of the **attest engagement team** or an individual responsible for the engagement quality control review.*
- c. *Transitional measures will be applied, as necessary, and discussed with those charged with governance.*

An Existing Financial Statement Attest Client or Its Affiliate Is Involved in an Acquisition or Other Transaction and the Member or Member’s Firm Will Complete the Existing Financial Statement Attest Engagement but Will Not Continue Providing Such Services After the Current Attest Report Is Issued but the Report May Include Periods After the Effective Date of the Acquisition or Other Transaction

*.10 When a **member** or member’s **firm** will not continue to provide **financial statement** attest services to the **financial statement attest client** that is involved in an acquisition or other transaction, the member or member’s firm may issue the current report covering a period after the effective date of the acquisition or other transaction if all the following criteria are met:*

- a. *The member or member’s firm completed a significant amount of work on the current financial statement attest engagement prior to the effective date of the acquisition or other transaction.*
- b. *The member or member’s firm expects to complete the remaining financial statement attest procedures within a short period of time.*
- c. ***Those charged with governance** request that the member or member’s firm complete the financial statement attest engagement despite the member or member’s firm continuing to have an interest in or relationship with the new **affiliate** that will **impair independence**.*
- d. *The member or member’s firm has evaluated the level of the **threat** to independence and discussed the results with those charged with governance.*
- e. *The member or member’s firm complies with the requirements of paragraph .09b–c.*
- f. *The member or member’s firm ceases to be the auditor no later than the date that the attest report is issued.*

Other Considerations When an Existing Financial Statement Attest Client or Its Affiliate Is Involved in an Acquisition or Other Transaction

Objectivity

*.11 Even if all the requirements of paragraphs .06–.10 could be met, the **member** or member’s*

firm should give consideration to the requirements of the “**Conflicts of Interest for Members in Public Practice**” interpretation [1.110.010] under the “**Integrity and Objectivity Rule**” [1.100.001], with regard to any circumstances identified in paragraphs .06, .07, or .10.

Documentation

.12 The **member** or member’s **firm** should consider documenting the following:

- a. Any interests or relationships identified in paragraphs .07 or .10 that will not be ended by the effective date of the acquisition or other transaction and the reasons they will not be ended
- b. The transitional measures applied, if appropriate
- c. The results of the discussion with **those charged with governance**
- d. The reasons the previous and current interests and relationships do not create a **threat** that will compromise objectivity

Circumstances Involving Foreign Network Firms

.13 ~~.08A~~ **member** should refer to paragraph .03 of “**Application of the AICPA Code**” [0.200.020] for guidance on circumstances involving foreign **network firms**.

Text of proposed revised interpretation “Loans”

(Additions are presented in ***bold italic*** text. Deletions are presented in ~~strikethrough~~.)

1.260.010 Loans

.01 If a ***covered member*** has a ***loan*** to or from an ***attest client***, any officer or director of the *attest client* ***with the ability to affect decision-making***, or any individual ***with a beneficial ownership interest (known through reasonable inquiry) that gives the individual significant influence over*** ~~owning 10 percent or more of the attest client’s outstanding equity securities or other ownership interests~~, a self-interest ***threat*** to the *covered member*’s compliance with the “***Independence Rule***” [1.200.001] may exist. *Threats* would not be at an ***acceptable level*** and ***independence*** would be ***impaired*** if the *loan* exists during the ***period of the professional engagement***, except as provided for in the

- a. “***Loans and Leases With Lending Institutions***” interpretation [1.260.020] of the “Independence Rule.”
- b. “***Client Affiliates***” interpretation [1.224.010] of the “Independence Rule.”

Text of proposed revised interpretation “Loans and Leases With Lending Institutions”

(Additions are presented in ***bold italic*** text. Deletions are presented in ~~strikethrough~~.)

1.260.020 Loans and Leases With Lending Institutions

.01 The “**Loans**” interpretation [1.260.010] of the “**Independence Rule**” [1.200.001] provides that a self-interest ***threat*** would not be at an ***acceptable level*** and ***independence*** would be ***impaired*** if a ***covered member*** had a ***loan*** to or from an ***attest client***, any officer or director of the attest client ***with the ability to affect decision-making***, or any individual ***with a beneficial ownership interest (known through reasonable inquiry) that gives the individual significant influence over*** owning 10 percent or more of the attest client’s outstanding equity securities or other ownership interests, except as provided for in this interpretation.

Home Mortgages, Other Secured Loans, and Immaterial Unsecured Loans, and Student Loans

.02 The **loans** covered by paragraph .03 include home mortgages, other secured loans, unsecured loans that are not material to the **covered member’s net worth** (that is, immaterial unsecured loans), and student loans.

~~.03~~ However, ~~Threats~~ **Threats** would be at an ***acceptable level*** and ***independence*** would not be ***impaired*** if a ***covered member*** or his or her ***immediate family*** has ***any of the loans identified in paragraph .02*** an unsecured loan that is not material to the covered member’s net worth (that is, immaterial unsecured loan), a home mortgage, or a secured loan from a ***lending institution*** ***attest client***, if all the following ***safeguards*** are met:

- a. The home mortgage, secured loan, or immaterial unsecured loan ~~was~~ ***loans were*** obtained under the ***lending institution’s normal lending procedures, terms, and requirements***. In determining when the home mortgage, secured loan, or immaterial unsecured loan was obtained, the date a commitment or line of credit is granted must be used, rather than the date a transaction closes, or funds are obtained.
- b. The home mortgage, secured loan, or immaterial unsecured ~~loan~~ ***s were*** was obtained ***in one of the following ways (in determining when the loans were obtained, the date a commitment or line of credit is granted must be used, rather than the date a transaction closes or funds are obtained):***
 - i. ~~From~~ ***From*** the ***lending institution*** prior to its becoming an ***attest client***;
 - ii. ~~From~~ ***From*** a ***lending institution*** for which ***independence*** was not required and ***that*** was later sold to an ***attest client***;

- iii. ~~after May 31, 2002, From a lending institution attest client by a borrower prior to the member his or her becoming a covered member with respect to that attest client; or~~
 - iv. ~~Prior to May 31, 2002, and the requirements of the loan transition provision in www.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf are met-~~
- c. After becoming a covered member, any ~~home mortgage, secured loan, or immaterial unsecured~~ loans must be kept current regarding all terms, at all times, and the terms may not change in any manner not provided for in the original agreement. Examples of changed terms are a new or extended maturity date, a new interest rate or formula, revised collateral, and revised or waived covenants.
 - d. The estimated fair value of the collateral for ~~a home mortgage~~s or other secured loans must ~~must~~ *should* equal or exceed the outstanding balance during the term of the home mortgage~~s~~ or other secured loans. If the estimated fair value of the collateral is less than the outstanding balance of the home mortgage~~s~~ or other secured loans, the portion that exceeds the estimated fair value of the collateral may not be material to the covered member's net worth.

Loans to Partnerships and Other Similar Entities

- ~~.04-.03~~ For purposes of applying the *loan* provision in paragraph .02 when the *covered member* is a partner in a partnership, a *loan* to a limited partnership (or similar type of entity) or general partnership would be ascribed to each *covered member* who is a partner in the partnership on the basis of his or her legal liability as a limited or general partner if
- a. the *covered member's* interest in the limited partnership, either individually or combined with the interest of one or more *covered members*, exceeds 50 percent of the total limited partnership interest, or
 - b. the *covered member*, either individually or together with one or more *covered members*, can *control* the general partnership.

Even if no amount of a partnership *loan* is ascribed to the *covered member(s)* previously identified, *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* through the application of *safeguards* if the partnership renegotiates a *loan* or obtains a new *loan* that is not a permitted *loan*, as described in paragraph .04 of this interpretation. Accordingly, *independence* would be *impaired*.

Other Loans and Leases

- ~~.05-.04~~ *Threats* would be at an *acceptable level* and *independence* would not be *impaired* if a *covered member* obtains one of the following types of *loans* or leases under the *lending institution's normal lending procedures, terms, and requirements*, provided the covered

member complies with the terms of the *loan* or lease agreement at all times (for example, keeping payments current):

- a. Automobile *loans* and leases collateralized by the automobile
- b. *Loans* fully collateralized by the cash surrender value of an insurance policy
- c. *Loans* fully collateralized by cash deposits at the same *lending institution* (for example, passbook *loans*)
- d. ~~Aggregate outstanding balances from~~ *Consumer loans (for example, credit cards, retail installment loans, and home improvement loans)* and overdraft reserve accounts *from the same lending institution* that have a *aggregate outstanding* balance of \$10,000 or less *on a current basis, taking into consideration the* ~~after payment of the most recent monthly statement made by the due date or within~~ *and* any available grace period

Other Matters

- ~~.06~~ ^{.05} *Members* should consider that certain state and federal agencies may proscribe more restrictive requirements over *lending institutions* that are subject to their oversight and that, in turn, impose more restrictive requirements upon *members* that perform *attest engagements* for these *lending institutions*. For example, the Securities and Exchange Commission (SEC) proscribes more restrictive requirements over members providing attest services to *lending institutions* and broker-dealers within their purview. [Prior reference: paragraph .07 of ET section 101 and paragraphs .150–.151 of ET section 191]
- ~~.07~~ ^{.06} *Covered members* may be subject to additional restrictions, as described in the “*Depository Accounts*” interpretation [1.255.010], and the “*Member of a Credit Union*” interpretation [1.280.040], *and the “Leases” interpretation [1.260.040]* of the “*Independence Rule*” [1.200.001].

Text of proposed revised interpretation “Immediate Family Members”

(Additions are presented in ***bold italic*** text. Deletions are presented in ~~striketrough~~.)

1.270.010 Immediate Family Members (excerpt)

.03 When materiality of a financial interest ***or a loan*** is identified as a factor affecting ***independence*** in the ***interpretations*** of the “***Independence Rule***” [1.200.001], interests of the ***immediate family*** member and the ***covered member*** should be combined to determine materiality to the ***covered member***.

Acknowledgments

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Brian S. Lynch, Chair
Catherine Allen
Claire Blanton
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SEC Convergence Task Force

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Catherine Allen
Chris Cahill
Anna Dourdourekas
Anika Heard
William McKeown
Lawrence A. Wojcik

Project staff

Ellen Gorla, Associate Director – Professional Ethics



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