AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
DIVISION OF PROFESSIONAL ETHICS
PROFESSIONAL ETHICS EXECUTIVE COMMITTEE
OPEN MEETING MINUTES
FEBRUARY 4, 2016
NEW ORLEANS, LOUSIANNA

The Professional Ethics Executive Committee (Committee) held a duly called meeting on February 4, 2016. The meeting convened 9 a.m. and concluded at 5:15 p.m.

Attendance: Samuel L. Burke, Chair Carlos Barrera Stanley Berman* Michael Brand Tom Campbell Richard David Robert E. Denham Anna Dourdourekas Jana Dupree Greg Guin Brian S. Lynch	 Bill Mann Andrew Mintzer Jarold Mittleider Steven Reed Lawrence I. Shapiro James Smolinski Laurie Tish Shelly Van Dyne **Not In Attendance:** Janice Gray
Staff: Lisa Snyder, Director Susan Coffee, SVP - Public Practice & Global Alliances* James Brackens, VP - Ethics & Practice Quality Michael Buddendeck, General Counsel Ellen Goria, Sr. Manager Jason Evans, Sr. Technical Manager	 Liese Faircloth, Technical Manager Michele Craig, Technical Manager* Brandon Mercer, Technical Manager* April Sherman, Technical Manager* Shannon Ziemba, Technical Manager* James West, Technical Manager*
Guests: Jeff Lewis, Chair, Independence/Behavioral Standards Subcommittee Ian Benjamin, Chair, Technical Standards Subcommittee Nancy Miller, KPMG Vincent DiBlanda, DT Sonja Araujo, PwC George Dietz, PwC* Catherine Allen, Audit Conduct Blake Wilson, BDO Joan Sterling, BDO* Eric Holbrooke, GAO* Edith Yaffe, E&Y* *Via Phone	

1. **Definition of Client**
   Mr. Mintzer provided a short background of the Task Force's activities to date for the benefit of the new Committee members. Mr. Mintzer explained that the Task Force was asked to determine if there would be any conflict with other standards if the term "attest client" was

replaced by the term “attest entity”. He explained that after considering the terms used by other standard setters (i.e., IESBA, PCAOB, SEC, GAO, ARSC) the Task Force did not believe the proposed change would cause any conflicts.

Mr. Mintzer explained that since the Commissions and Referral Fees Rule uses the term “client”, it could be unclear how to apply the rule in the new environment especially where the engaging entity (i.e., client) is different than the target entity (i.e., attest entity). For example, he explained that the Task Force does not believe a member should be prohibited from paying a commission to or receiving a commission from an engaging entity that is not also the target entity provided the member does not otherwise provide any of the prohibited attest services outlined in the rule to the engaging entity. Alternatively, he explained that the Task Force believes members should be prohibited from paying a commission to or receiving a commission from a target entity that the member performs any of the prohibited attest services outlined in the rule on, even if the target entity is not the engaging entity. To demonstrate the Task Force’s concern he shared a draft visual aid the Task Force was working on. He explained that to clarify how to apply the rule in these situations, the Task Force recommends an interpretation be added under the Commissions and Referral Fees Rule.

After considering the Task Force’s proposed new interpretation under the Commissions and Referral Fees Rule that would provide application guidance, it was agreed that for the next meeting the Task Force should eliminate the threats and safeguard discussion. The Task Force was also directed to revise the draft interpretation so that the only application guidance contained related to the attest entity and to consider drafting some FAQs to address specific examples such as the examples covered in the visual aid. The Committee noted that including some FAQs might help clarify that what is being proposed is actually less, and not more, restrictive. The Committee also recommended that the definitions of “client” and “attest entity” include cross references to the proposed new interpretation under the Commissions and Referral Fees Rule that would provide application guidance.

The Committee discussed whether a member would be in violation of the Independence Rule if the member violated the Contingent Fee Rule or the Commissions and Referral Fees Rule. Ms. Snyder explained that due to the way the rules are currently drafted, the member would not be in violation of the Independence Rule. While there seemed to be some concern with this conclusion, it was decided that this issue was outside the scope of the Client Task Force and if the Committee wanted to explore it further then a different Task Force should formed to look into it.

Mr. Mintzer explained that the Task Force had not proposed an application interpretation under the Contingent Fees Rule because the Task Force had not identified a situation where the engaging entity would not also be the entity that is paying the contingent fee. Mr. Mintzer asked if any member of the Committee had an example where the contingent fee would not be paid by the engaging entity. The only example identified during the discussion was a situation where a private equity group retains a member to perform an audit of a portfolio company but the member will only be paid if the deal goes through. Mr. Mintzer noted that he believes that this would be a violation of the rule because the member is performing the audit for the private entity group and the rule includes the phrase that “for whom the member performs” an audit. The Committee recommended the Task Force consider developing a FAQ for this situation.

A member of the Committee raised the question as to whether a nonattest service, which is not prohibited, could be performed on a contingent fee basis. The example given was that Company A retains a CPA firm to perform an audit on Company B and pays a fixed fee for that audit. The CPA firm provides Company A with nonattest services, unrelated to Company B, on a contingent fee basis. The Committee was split on whether it would be acceptable to pay for those unrelated nonattest services on a contingent fee basis. Some members of the Committee believed that materiality could be a factor. The Task Force was asked to research this more and look into whether it would conflict with State Boards' rules.

The Committee was asked to forward any additional comments to staff by February 12th.

Mr. Mintzer explained that for the May PEEC meeting, the Task Force will recommend any additional interpretations to the Contingent Fees Rule and the Commissions and Referral Fees Rule. The Task Force will also create some FAQs to better illustrate the impact the proposed revised definitions of client and attest entity will have on the Contingent Fees Rule and the Commissions and Referral Fees Rule.

2. Information Technology and Cloud Services

Ms. Van Dyne explained that the Task Force had revised the draft hosting services interpretation to more clearly describe that hosting services involves the member having custody and/or control of data or records that the attest client uses to conduct its operations. Under this situation, the Task Force believed that the member would have custody or control of the client's assets which is a management responsibly that would impair independence..

Ms. Van Dyne went on to explain that the Task Force had not reached a consensus regarding whether the member had to be engaged to have just custody or control of the data or records or, if the member had to be engaged to have both custody and control of the data or records. After some discussion, the Committee took a straw poll where 14 members agreed that if the member was engaged to have either custody or control of data or records that the attest client uses to conduct its operations, the member would be considered to be providing hosting services that impair independence. A straw poll was also taken to determine if the Committee believed that in order to be providing hosting services, the member needed to be engaged to have both custody and control of the data or records. No members of the Committee voted in favor of this position.

Ms. Van Dyne was asked if the member was engaged to deliver Form K-1s, would the member be considered to be providing hosting services that would impair independence. Ms. Van Dyne explained that if the client had not engaged the member to host the K-1s but rather just to deliver the documents, then the member would not be providing hosting services. It was agreed that the Task Force should t draft item c. in paragraph .03 more broadly so that it would cover situations where the member might use a portal to communicate with third parties on the client's behalf. The Committee also noted that it believed that a member would not be considered to be providing hosting services if the member and attest client exchanged data or records for an attest engagement using a portal. Given this, the Committee requested that the Task Force revise this paragraph so that it was not only limited to portal communications related to permitted non-attest services.

Since the examples in paragraph .03 are situations that would not be considered hosting services, the Committee agreed to remove the reference to independence in paragraph .03

so that the reader did not conclude that there are hosting services that might not result in independence being impaired.

Ms. Van Dyne explained that since members provide various types of services through cloud based solutions, the Task Force recommends that instead of repeating the guidance in the different interpretations, the guidance should appear in the Scope and Applicability of Nonattest Services interpretation. While the Committee did not express any concerns with the location of the guidance, it did request that the Task Force confirm that the phrase "cloud based solution" is the proper term. In addition, the Task Force was asked to consider removing the parenthetical explanation of what would be considered permitted non-attest services.

Finally, Ms. Van Dyne explained that in addition to some additional items for the Committee's feedback, the Task Force planned to request exposure of the hosting services and cloud based services guidance at the May meeting.

3. IESBA Update

Ms. Snyder explained that the IESBA (Board) had issued an exposure draft related to "long association" (i.e., partner rotation). She explained that it was her understanding the exposure draft is only seeking feedback on some very specific issues. The first issue the Board is seeking feedback on is if the cooling off period for the engagement quality control reviewer (EQCR) of the audit of a public interest entity (PIE) that is not a listed entity and whether such period should increase from 2 to 5 years to be consistent with the cooling-off period for the engagement partner. Ms. Snyder explained that another issue the exposure draft is seeking feedback on is whether the IESBA Code should allow the use of an an alternative approach to the cooling-off requirements for PIE where jurisdictions have established different but robust legislative or regulatory safeguards to address the threats to auditor independence created by long association. She noted that the last issue that feedback is being requested on deals with a revised approach to determining how long an individual should cool off after having served either as an engagement partner or as an EQCR, or in a combination of roles, for only part of the seven-year period they have served as a Key Audit Partner.

Ms. Snyder noted that Board approved its changes to Part C of the Code addressing professional accountants in business (PAIBs). She explained that the changes include revisions to extant Section 320 dealing with the preparation and presentation of information, a new Section 370 dealing with pressure to breach the fundamental principles, and related consequential and conforming amendments to other sections of extant Part C. She indicated that while the text of the approved changes will be made available on the IESBA website, the changes will not become effective until after they have been redrafted using the proposed new structure and drafting conventions of the Code. She recommended the Committee appoint a task force to consider the approved changes for purposes of convergence.

Ms. Snyder noted that the Non-Compliance with Laws and Regulations (NOCLAR) guidance is still in the process of being finalized and the Board plans to consider the final proposal at its upcoming March 2016 meeting.

Ms. Snyder explained that the Board is discussing the issue of "downward fee pressure" and noted that an IESBA staff document called Ethical Considerations Relating to Audit Fee Setting in the Context of Downward Fee Pressure is available.

4. Entities Included in State and Local Government Financial Statements

Ms. Miller explained that the existing independence guidance for the state and local government environment was written far before the Client Affiliate interpretation was adopted and that while it makes sense for the guidance for state and local governments to differ because of the different reporting structure, the Task Force is trying to conform to the Client Affiliate interpretation, where possible. Ms. Miller also explained that the Task Force will factor in the change in standards for group audits.

Ms. Miller explained that at the last meeting she reported that the Task Force would explore the possibility of not requiring members to remain independent of immaterial entities by working through examples. She explained that the Task Force began by analyzing situations where members had direct financial interests in various immaterial funds and immaterial component units but soon realized that it was not comfortable with a blanket exception.

Next, she explained that the Task Force discussed whether it could continue to support the provision in the extant interpretation that provides a blanket exception that members do not need to remain independent of an entity when the member explicitly makes reference to another auditor's report. Using the direct financial interest examples, the Task Force concluded that it could no longer support this blanket exception. Rather, the Task Force believes that making reference to another auditor's report is only effective when combined with other factors. Specifically, making reference to another auditor's report is most effective when the primary government has only minimal influence over a fund's or component unit's accounting or financial reporting process and the fund or component unit is either immaterial to the primary government or will not be subject to financial statement attest procedures of the member. When these factors are present, the Task Force proposes that members do not need to be independent of such funds or component units. Alternatively, when one or more of these factors are not present, the conclusion could change so the Task Force is considering a more facts and circumstances approach where members will need to perform an assessment when faced with these situations.

Ms. Miller explained that the Task Force decided to use the factor, "primary government having only *minimal influence"* instead of the "primary government having *significant influence"* because it was more in line with the notion of "financial accountability" which is the term used in the state and local government environment. She explained that the Task Force would appreciate feedback on this term.

One member noted that the guidance proposed so far for "downstream entities" did seem more aligned with the Client Affiliate interpretation but would like the Task Force to see if a blanket exception would be possible for "upstream" and brother-sister entities. Another member recommended that future agenda materials should outline the difference between the Client Affiliate and proposed state and local government guidance. It was noted that the Client Affiliate guidance uses concepts such as, "having control over an entity even when the entity is not included in the financial statements."

Ms. Miller explained that the extant state and local government guidance does not contemplate other accounting methods being used, such as special purpose frameworks and so the Task Force plans to draft the guidance so that it can be applied to any accounting method. She explained that the guidance will stipulate that the member is expected to be independent of entities that are required to be included in the financial statements under any accounting method. Ms. Miller was asked whether the member would need to evaluate

different frameworks at the primary government level and downstream entities. She explained that she would expect the framework that the primary government (the attest entity) used would be the applicable framework to determine which entities were required to be included from a GAAP perspective.

Ms. Miller then walked the Committee through a couple of examples.

One member noted that while she agrees with the criteria the Task Force outlined, she supports the "rebuttal presumption" for every situation since there might be situations where a discreetly presented component unit could be a problem but an enterprise fund might not. One member expressed her opposition to a "rebuttable presumption" that primary governments had only minimal influence over discretely presented component units.

The Task Force was asked to discuss whether the standard should require documentation or just recommend documentation of the member's assessment because there was some concern that if a member failed to document their assessment, their independence would be impaired. The Task Force was asked to consider the position in the non-attest services topic where a member who fails to document their evaluation would be considered in violation of the Compliance with Standards Rule instead of the Independence Rule.

Ms. Miller explained that for the next Committee meeting, she hoped the Task Force will have completed its discussions related to "downstream" entities and be able to report on its preliminary discussions related to "upstream" and brother-sister entities.

5. PEEC Planning Subgroup

Not discussed.

6. Compliance with Standards

Ms. Snyder asked the Committee to provide input regarding the application of the *Compliance With Standards* rule as it relates to performance audits performed in accordance with the GAO's Yellow Book and other services that would not be covered by AICPA professional standards. She explained that a proposed *Q&A: Applicability of AICPA Standards to Performance Audits* drafted by ASB Staff concludes that "*In summary, because the auditing, attestation and consulting standards do not apply to the specific service of conducting a performance audit, a member is not required to follow the SASs, SSAEs nor the SSCS. This, however, does not prohibit an AICPA member from following those standards if a member wishes to do or if such member represents that he is she is following the audit, attestation or consulting standards in the conduct of the performance audit.*"

She explained that at least one firm has questioned whether the *Compliance With Standards* rule would require that all professional services provided by a member must be performed in accordance with professional standards promulgated by bodies designated by Council (i.e., a member can *only* perform services that are covered by such professional standards) or if the rule would only apply when there are standards that are applicable to the services the member is providing.

One member noted that he believes that the rule is intended to mean that a member is only required to comply with standards promulgated by bodies designated by Council if such standards *are applicable* to the service. In cases where there are no such applicable

standards covering the service, the member should not be required to "fit" the service into a particular set of standards.

By a straw poll, seventeen members supported that a working group of Ms. Miller and Messrs. Campbell, Smolinski, Brand and Denham should develop a FAQ that would state that if there are applicable standards that are promulgated by bodies designated by Council, members must comply with such standards; if there are no specific standards applicable to the service performed by the member, the member must comply with the General Standards Rule. Staff agreed to present the FAQ to the Committee at its May meeting.

7. <u>Applicability of Professional Standards for CPAs Preparing Financial Statements for Clients in Non-CPA Firm</u>

Ms. Snyder explained that staff had received an inquiry as to whether or not a member would be considered to be in public practice if the member prepared financial statements as an employee of a non-CPA entity engaged to prepare financial statements for clients. The facts regarding this entity and the engagements were as follows:

- The entity is not a registered CPA firm and the owner is not a CPA or a member.
- The engagement letters are signed by the owner.
- Non-CPA bookkeeping staff prepare the original drafts of the financial statements.
- The member acts as a manager and is responsible for reviewing the financial statements. In this capacity, he makes all changes necessary to the financial statements to ensure that they are complete and accurate.
- The member is a CPA but does not hold out as such.
- The entity provides no reports on the financial statements and does not perform compilations of financial statements.

The member posed the inquiry in order to determine if the he (and the entity) must comply with the recently-issued Statements on Standards for Accounting and Review Services (SSARS) No. 21. Ms. Snyder noted that the SSARS relies upon the Code of Professional Conduct's ("the Code") definition of *public practice,* so staff had reviewed the following applicable Code definitions (from Section .400 of the Code) with the Committee:

- Public practice
- Professional services
- Client
- Firm

Based upon the definition of public practice, the Committee concluded that the member is in the practice of public accounting. The Committee also agreed that, even though the employing entity could be viewed as meeting the definition of the "member's firm" and in public practice based on the wording of the definitions above, it was not the intent of the Committee to consider non-CPA firms that only perform bookkeeping services (i.e., no attest services) as serving in public practice.

Concerning the applicability of SSARS 21, Ms. Snyder suggested that SSARS 21 may not be applicable because the first sentence in SSARS 21 states that the standard applies "when an accountant in public practice is engaged to prepare financial statements." She noted that the firm (which is not in public practice) is engaged to prepare financial statements, but not the member. The Committee declined to conclude, as it believed that the Committee should not interpret the SSARS. Staff was asked to consult with Michael Glynn (staff to the ARSC) regarding how "engaged" might be defined by SSARS.

8. Application of Appendix B, Council Resolution to Certain Attestation Engagements

Ms. Snyder explained that staff received a question regarding whether a non-CPA could take ultimate responsibility for certain attestation engagements (Service Organization Control (SOC), sustainability and cybersecurity engagements) since these engagements often require specialized knowledge often held by non-CPA owners. The Committee agreed that the non-CPA could not sign the attest report so could not accept ultimate responsibly for the attestation engagement. Rather, a CPA would have to accept ultimate responsibility for the engagement. The Committee agreed that the CPA did not need to have the skill set to perform the engagement, rather had to have the competence equivalent to an engagement quality control reviewer who could detect critical mistakes and gaps in evidence.

9. IESBA Exposure Drafts on Safeguards and Structure of the Code

Mr. Evans introduced the topic noting that the International Ethics Standards Board for Accountants (IESBA) released two exposure drafts titled, *Improving the Structure of the Code of Ethics for Professional Accountants* (Structure ED) and *Proposed Revisions to Safeguards in the Code* (Safeguards ED) (collectively, the exposure drafts). Both exposure drafts entail the first phase of two phase projects. Mr. Evans noted the exposure drafts were released in December 2015 and comment letters for both exposure drafts are due on March 21, 2016.

Structure ED

Mr. Evans noted that a variety of stakeholders suggested that the IESBA restructure the IESBA Code to improve understanding and usability. Some stakeholders expressed belief that the IESBA Code contains long and complex sentences which inhibit clarity.

Mr. Evans reminded the Committee that the IESBA released a consultation paper in connection with the project seeking input as to the approach of the restructuring in November 2014. The PEEC's comment letter noted that in general, there was not a great need to clarify the IESBA Code and that the project may require too many resources considering the ongoing projects of the IESBA.

Mr. Evans reviewed the significant matters of the Structure ED with the PEEC, specifically noting the project proposes increased prominence of the requirement to apply the conceptual framework and that the requirements are distinguished by the denotation of an "R" next to each paragraph containing a requirement. The ED proposes that each requirement paragraph is followed by application material to provide guidance and material for consideration when applying requirements. Such paragraphs are denoted by an "A."

The Structure ED also proposes a new Guide to the Code which has substantially new material, however, the goal of the project overall was to clarify the Code without proposing substantive changes. Among the highlights noted, Mr. Evans discussed the proposed structure of the Code as follows:

- Table of contents
- Guide to the Code
- Part A – Introduction to the Code and the fundamental principles
- Part B – Professional Accountants in Business
- Part C – Professional Accountants in Public Practice
- C1 – Independence for audits and reviews

- C2 – Independence for other assurance engagements
- Glossary

Mr. Evans stated that the IESBA's goal in its proposed new title of the IESBA Code is to emphasize that the Code is principles based, yet, still includes requirements. Thus, the IESBA proposes the new title to be: *Code of Ethics Standards for Professional Accountants*.

Safeguards ED
Mr. Evans introduced the Safeguards ED by explaining that the IESBA received concerns from regulators noting that some safeguards in the IESBA Code are not appropriate or are ineffective. Thus, the IESBA designated a Task Force to study the issue.

The Safeguards ED proposes a more explicit and overarching requirement for all professional accountants to apply the conceptual framework to threats to compliance with the fundamental principles. The IESBA also proposes a new requirement for professional accountants to perform an overall assessment of threats and safeguards by reviewing the judgments made and overall conclusions reached.

Mr. Evans noted that the Safeguards ED proposes a new description of an informed third party which is intended to clarify that the test is intended to prompt an objective evaluation of the professional accountant's judgments and conclusions given the facts available at the time as to compliance with the fundamental principles. The definition of acceptable level was also edited to be more affirmative.

The Safeguards ED proposes a new definition for safeguards. The proposed definition eliminates certain extant safeguards including safeguards created by the profession or legislation, safeguards in the work environment and safeguard implemented by the entity. Further, an action taken by a professional accountant can only be referred to as a safeguard if it is effective in reducing threats to compliance with the fundamental principles.

Mr. Evans noted that draft comment letters for the exposure drafts would be circulated to the PEEC before submitting to the IESBA.

There were no comments received concerning the exposure drafts.

10. <u>Minutes of the Professional Ethics Executive Committee Open Meeting</u>
Ms. Dupree requested the minutes be revised to note that she was not in attendance. It was moved, seconded and passed by a vote of 18 with two abstentions to approve the minutes of the October 2015 open meeting as revised.