AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
DIVISION OF PROFESSIONAL ETHICS
PROFESSIONAL ETHICS EXECUTIVE COMMITTEE
OPEN MEETING MINUTES
JULY 12-13, 2016
SAVANNAH, GA

The Professional Ethics Executive Committee (Committee) held a duly called meeting on July 12, 2016. The meeting convened 8:30 a.m. and concluded at 5:15 p.m.

Attendance:	
Samuel L. Burke, Chair	Greg Guin
Carlos Barrera	Brian S. Lynch
Stanley Berman	William Darrol Mann
Michael Brand	Andrew Mintzer
Tom Campbell	Jarold Mittleider
Richard David	Steven Reed
Robert E. Denham*	James Smolinski
Anna Dourdourekas	Laurie Tish
Jana Dupree	Shelly Van Dyne
Janice Gray	Blake Wilson
Staff:	Ellen Goria, Sr. Manager*
Lisa Snyder, Director	Liese Faircloth, Technical Manager*
James Brackens, VP - Ethics & Practice Quality	Michele Craig, Technical Manager*
Mike Jones, Assistant General Counsel	Brandon Mercer, Technical Manager*
Jason Evans, Sr. Technical Manager	April Sherman, Technical Manager*
Shelley Truman, Coordinator	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	
Dan Dustin, VP State Board Relations, NASBA	
Catherine Allen, Audit Conduct	
Vincent DiBlanda, DT	
Sonja Araujo, PwC	
George Dietz, PwC*	
Edith Yaffe, E&Y*	
Vassilios Karapanos, SEC*	
Karen Liu, SEC*	
*Via Phone	

1. **Definition of Client**
   Mr. Mintzer explained that based on feedback from the Committee in May, the Task Force believes the client and attest client definitions should remain fairly consistent with the extant definitions. He went on to explain that the issues the Task Force continues to discuss relate to situations where the engaging entity and target entity are not the same and the impact this has on independence, confidentiality and which entity should receive the member's work product. For independence, the Task Force believes that independence should be required

with respect to the target entity and that the Conceptual Framework for Independence should be used to evaluate relationships or circumstances that give rise to threats with respect to the engaging entity. With respect to confidentiality, the Task Force believes each entity should be treated as a separate client but that work products should only be required to be provided to the engaging entity.

A member of the Committee raised the concern related to the inconsistency in the Code if the Task Force recommendations were approved. The example given was an entity engages a firm to prepare personal tax returns for its key executives. In this situation, the executives are the target entities. This member believed the firm should only be required to provide their work product (i.e., personal tax returns) to the key executives (target entity) since the service is for their benefit. However, when the service being performed is for the benefit of the engaging entity and not the target entity, the Committee generally believed that the member should not have to obtain specific consent from the target entity before sharing information with the engaging entity. The Committee believed there is an implied consent since the firm would never have been engaged if the engaging entity and the target entity did not have an agreement in place regarding the sharing of information. Mr. Mintzer agreed to have the Task Force discuss these concerns.

With respect to independence, the Committee agreed that the level of independence should differ between the engaging and target entities and should be evaluated using the specific facts and circumstance. The example discussed was whether a member's independence with respect to a target entity should automatically be impaired if a firm provided nonattest services to the engaging entity that impaired independence. Mr. Mintzer appreciated the example and said the Task Force would take it into consideration.

Mr. Mintzer explained that for the November PEEC meeting, the Task Force will take the feedback from the Committee and decide on how best to proceed.

2. **Sale, Transfer or Discontinuance of Practice**

Mr. Barrera presented the revisions recommended by the Task Force based on comments received to the exposure draft. He noted that a concern had been raised with regard to the "presumption of consent after 90 days" since many state boards do not permit implied client consent. He explained that the Task Force recommended specific reference to the rules of the state boards be included as follows: "…unless prohibited by law, including but not limited to the rules and regulations of the applicable state boards of accountancy." The Committee agreed with this revision.

One member raised concern that the client would need to be notified 90 days in advance of the closing date which may not be practical in the case of a sale or acquisition. For example, it was noted that the sale or acquisition might not go through and often, firm personnel are not notified until shortly before the closing date. The Committee discussed whether a shorter period of time might be more appropriate but ultimately agreed that 90 days was a reasonable period of time.

A question was raised as to whether the guidance would apply in a situation where a two partner firm sells their firm to Firm B and become partners of Firm B. The Committee agreed that the guidance should not be required since the partners retain an ownership in Firm B. On

the other hand, if the partners were hired back by Firm B as consultants or contractors (i.e., no ownership interest), the guidance would apply. It was agreed that the applicability of the guidance should be based on whether the member retains any ownership in the acquiring firm. The language in the interpretation was revised to clarify that it applies when the member or member's firm will no longer retain *any* ownership in the firm. It was also agreed to delete "or control of the practice" and only use "control" for purposes of applicability.

It was recommended and agreed to state "not less than 90 days" so that a firm had the ability to provide a longer period of time, such as a 120 day period. One committee member questioned whether client consent could be verbal. The Committee agreed that it should not be too prescriptive and consent could be by any means, including verbal or e-mail.

The Committee discussed when the interpretation should be made effective and agreed that June 30, 2017 would be an appropriate effective date with early adoption encouraged.

It was moved, seconded and unanimously agreed to adopt the interpretation "Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice"as revised by the Committee. It was also moved, seconded and unanimously approved to adopt the revised interpretation, "Disclosing Client Information in Connection With a Review or Acquisition of the Member's Practice."

3. **<u>Commissions and Referral Fees</u>**

Ms. Tish provided an overview of the feedback received from comments to the exposure draft and explained that the Task Force recommended that the interpretation be adopted as exposed. Ms. Tish noted that the Task Force recommends the interpretation be effective for commissions or referral fee arrangements entered into on or after January 31, 2017.

It was moved, seconded and unanimously agreed to adopt the new interpretation under the *Commissions and Referral Fees Rule* as recommended by the Task Force.

4. **<u>Leases</u>**

Mr. Wilson presented the Leases Task Force agenda item to the Committee.

<u>Leases as Business Relationships</u>: Mr. Wilson explained that the Task Force examined leases as business relationships, and noted that a lease is either a finance activity or a business transaction. The PEEC discussed whether leases should be treated similar to other business relationships and therefore, consider materiality in evaluating the impact on independence. The Task Force believed that non-finance leases were not significantly different from normal business relationships, and thus should be evaluated on a conceptual basis; i.e., consider materiality of the lease in evaluating the impact on independence. The PEEC agreed with the Task Force's conclusion.

<u>Materiality</u>: The Task Force agreed with the prior PEEC position that materiality should not be defined, but requested feedback from the PEEC regarding whether additional guidance is necessary on specific factors that should be considered when evaluating materiality. Mr. Burke noted that he struggles with the notion of factors around materiality. To the extent criteria are assigned to materiality, it becomes prescriptive and eliminates professional judgment. Mr. Burke believed PEEC should not list factors to consider, although the PEEC

may consider issuing a FAQ. One member further noted the extant interpretation is prescriptive and expressed preference for something more principles-based.

The Committee discussed the fact that the 2003 Exposure Draft issued by PEEC would have dealt with loans and leases differently. Specifically, a member is prohibited from having an immaterial loan with a non-financial institution client, yet the proposal previously issued by PEEC in 2003 considered materiality of the lease. It was also noted that the extant definition of loan excludes a lease. There was some discussion as to whether the PEEC should reconsider permitting immaterial loans. Ms. Snyder noted that the SEC and most state boards currently prohibit loans from a non-financial institution client (i.e., are consistent with AICPA rules) so the Committee should be mindful of the fact that we would be less restrictive.

Normal Course of Business: Mr. Wilson reviewed Option 2 with the PEEC, which included a requirement that leases be entered into in the normal course of business. Some members expressed concern that this may mean that normal course of business may be interpreted to mean the entity is in that line of business of leasing. Mr. Burke noted that the guidance should be clear that the normal course of business applies only to the normal terms and conditions, and not whether the entity normally does these types of transactions or is in that line of business. The Task Force agreed to discuss this approach and further address the concern.

Criteria for Independence: Mr. Wilson reviewed Option 2 with the PEEC, including the criteria for threats to be at an acceptable level. Mr. Wilson noted the criteria (a) – (d) to the PEEC:

(a) the lease meets the criteria of an operating lease or short term lease (as defined by GAAP);
(b) terms and conditions set forth in the lease are comparable with other leases of a similar nature and are established in the normal course of business
(c) all amounts are paid in accordance with the lease terms or provisions
(d) the lease is immaterial to the lessee, lessor, and the attest client's financial statements

Mr. Wilson asked the Committee if it agreed with the criteria above, and no members objected to the criteria. One member noted that a question could be asked in the exposure draft regarding whether this should be expanded to a question about loans. PEEC requested that the Task Force further discuss Option 2 and formalize the guidance; including addressing the fact that the normal course of business applies only to the normal terms and conditions and not whether the entity normally does these types of transactions, and determine how that should be reflected in any revision.

Reference to GAAP (definition of a lease): Mr. Guin and Mr. Mintzer questioned whether it is necessary to refer to GAAP for purposes of leases, since the standard may yet change again in the future. Ms. Snyder explained that there are a number of places within the Code where reference to GAAP is made, such as for purposes of the term "control". Most members appeared comfortable with the reference to GAAP for purposes of determining the type of lease and did not believe PEEC should have its own definition of a lease.

The Task Force was asked to consider the Committee's feedback and present a revised interpretation at the November meeting.

5. Information Technology and Cloud Services

Ms. VanDyne explained that the Task Force has just begun looking at the Information Systems Design, Implementation, or Integration interpretation and related FAQs to determine what clarifications might be necessary. She explained that the Task Force started by developing descriptions for a number of the terms used in this guidance and will vet these descriptions with two AICPA IT Committees (IMTA Executive Committee and CTIP Credential Committee) to ensure the descriptions are appropriate and will be understood.

6. **Entities Included in State and Local Government (SLG) Financial Statements**

Ms. Miller explained that members of the Task Force have met with the State Auditor community as well as the SLG Expert Panel to seek feedback on the Task Force's conclusions. One such issue that was recently discussed was how investments held for profit motive should be treated in the SLG environment since the extant interpretation does not provide any guidance on this issue. The Task Force believes that the SLG environment doesn't seem to warrant differing treatment for investments held for profit and so is recommending that SLG entities look to the Client Affiliate interpretation for these investments. The main feedback received from the SLG Expert Panel and the State Auditor community was how they would operationalize this especially in the pension plan environment.

7. **IESBA Update**

Ms. Snyder provided an update on the activities of the IESBA. She reported that the Safeguards project and Structure project have made significant progress and are working on Phase II of the projects. With regard to Part C (PAIBs), Ms. Snyder reported that the Task Force is currently drafting guidance on Inducements which will include gifts and hospitality. She noted that the Task Force will not be drafting guidance dealing with bribery and corruption, rather, there will be a requirement to understand the laws and comply with them.

Ms. Snyder discussed the IESBA's proposal on long association/partner rotation and noted that many believed the proposal was overly complicated and confusing, particularly with regard to the rotation requirements of the engagement quality control reviewer. She noted that the rotation requirements should not impact auditors in the U.S. since the SEC rotation requirements would apply to listed entities and are more restrictive than those proposed by the IESBA. With regard to the general provisions of the long association proposal for non-PIEs, Ms. Snyder stated that the AICPA Code does recognize long association as a threat to independence and the PEEC should consider the IESBA standard as it relates to non-PIEs for possible convergence.

8. **Cybersecurity Services**

Ms. Snyder noted that the AICPA is in the process of developing a guide related to the cybersecurity attestation services and the Ethics Division was asked to consider if there was the need for guidance related to the provision of nonattest services related to cybersecurity. Ms. Snyder provided an overview of some examples of nonattest services related to cybersecutiy and whether or not she believed they impaired independence and asked the Committee if a Task Force should be appointed to study these services and develop a recommendation to the Committee. The Committee agreed the issue should be studied further by a Task Force and requested individuals from outside of the Committee who have a strong background with cybersecurity be appointed to the Task Force.

9. **Part C Task Force – IESBA Convergence**

Mr. Berman explained that the Task Force reviewed Sections 320 and 370 of the IESBA Code by paragraph and deliberated the reasonableness of the content for purposes of potentially adopting the guidance into the AICPA Code. He noted that overall, the Task Force broadly supported the guidance for convergence.

Section 320 - Preparation and Presentation of Information

Mr. Evans reviewed Agenda Item 8C with the Committee which contained an analysis of Section 320 by paragraph, noting the recommendations of the Task Force. With respect to the issue of "use of discretion" (see IESBA par. 320.04), one Committee member suggested that the AICPA standard should only refer to "misleading" and not address the use of discretion to "influence contractual or regulatory outcomes inappropriately" as it was confusing and the requirements should only focus on misleading information. It was recommended that the phrase "influencing contractual or regulatory outcomes" be deleted and if the Task Force includes language referring to "influence," it should clarify that it is only addressing situations where the influence is "inappropriate."

Section 370 – Pressure to Breach the Fundamental Principles

Mr. Evans explained that there is no specific guidance in the AICPA Code pertaining to "pressure." Thus, if considered for adoption, the guidance would pertain to pressure to breach compliance with the rules of the AICPA Code, most likely under the Integrity and Objectivity Rule. He noted that Section 370 was supported by the Task Force for adoption in the AICPA Code with minor comments concerning the practicability of some of the suggested actions to be taken by the member when facing pressures.

Mr Evans stated that the Task Force expects to present draft interpretations to the Committee at its November meeting.

10. <u>Non-compliance with Laws and Regulations (NOCLAR) Task Force</u>

Ms. Snyder apprised the Committee of the activities of the Task force. She explained that the Task Force reviewed the IESBA NOCLAR pronouncements, both for professional accountants in public practice (PAPPs) and professional accountants in business (PAIBs), and deliberated the reasonableness of the content for purposes of the AICPA Code.

Ms. Snyder explained that the IESBA NOCLAR standards would permit a professional accountant to override the confidentiality requirement for clients and employers if certain conditions are met and the accountant believed it was in the public interest to disclose the NOCLAR to an outside authority and/or external auditor. She further explained that the IESBA standards specifically state that disclosure would be precluded if the laws or regulations in the jurisdiction prohibited disclosure. Ms. Snyder explained that the Task Force had reviewed research on the client confidentiality and whistle-blower rules of state boards and noted that only eight state boards would permit a licensee to disclose a NOCLAR to an outside authority. She also noted that if the PEEC were to permit such disclosure, it would require a change of the Rule which requires a member ballot. With regard to PAIBs, Ms. Snyder stated that further research would be required to determine if state laws would permit a PAIB to report a NOCLAR of an employer but that the AICPA interpretation on confidentiality of employer information could be revised to permit such disclosure. The PEEC generally agreed that based on the fact that most state boards would prohibit disclosure and the AICPA rules

prohibit disclosure, the AICPA Code should not permit disclosure to an outside authority unless required by law or with the client or employer's consent. With regard to disclosure to the external auditor, Ms. Snyder reported that the Task Force believed disclosure to the audit engagement partner within the firm should be required if an audit client of the firm but disclosure to an auditor outside the firm should not be permitted due to state confidentiality rules. She also noted that the Task Force agreed with the IESBA position that PAIBs should be permitted to disclose a NOCLAR to the company's auditor if doing so was part of the PAIBs obligation to provide all relevant facts when dealing with the auditor. The Committee agreed with the Task Force's recommended positions for disclosure to an auditor.

Ms. Snyder then discussed the IESBA provision that would require the predecessor auditor to disclose a NOCLAR to the proposed successor accountant if approached by the successor accountant. She explained that under AICPA rules, the predecessor accountant could raise a "red flag" by stating that they can only discuss matters if the client provides consent to speak freely on all matters. The Committee was supportive of maintaining the AICPA position and not requiring disclosure to the successor accountant.

The Task Force agreed to draft proposed NOCLAR standards that would incorporate all the IESBA steps with the exception of disclosure and present them to the Committee at its November meeting.

11. <u>Nonattest Services Toolkit</u>

Ms. Dourdourekas provided the Committee with an overview of the toolkit. The Committee was supportive of the toolkit and suggested the Task Force see if a podcast could be done to promote it.

12. <u>Minutes of the Professional Ethics Executive Committee Open Meeting</u>

It was moved, second and unanimously approved to adopt the minutes form the May meeting.