



# **Professional Ethics Executive Committee**

**July 12-13, 2016 Open Meeting Agenda  
Savannah, GA**

**AICPA Professional Ethics Executive Committee  
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Savannah, GA**

July 12 <sup>th</sup>	Open Meeting Begins	
8:30 – 10:00 a.m.	<b>Definition of Client</b> Mr. Mintzer and Ms. Ziemba will seek the Committee's feedback on the Task Force's proposed direction.	<b>Agenda Item 1A</b> <b>Agenda Item 1B</b>
10:00 – 10:15 a.m.	<b>AM Break</b>	
10:15 – 11:30	<b>Sale, Transfer or Discontinuance of Practice</b> Mr. Barrera and Ms. Snyder will seek the Committee's approval to adopt the proposed new and revised interpretations and seek input on staff's FAQs.	<b>Agenda Item 2A</b> <b>Agenda Item 2B</b> <b>Agenda Item 2C</b> <b>Agenda Item 2D</b> <b>Agenda Item 2E</b>
11:30 – Noon	<b>Commissions and Referral Fees</b> Ms. Tish and Ms. Gorla will seek the Committee's approval to adopt the proposed new interpretation.	<b>Agenda Item 3A</b> <b>Agenda Item 3B</b> <b>Agenda Item 3C</b>
Noon – 1:00 p.m.	<b>LUNCH</b>	
1:00 – 2:30 p.m.	<b>Leases</b> Mr. Wilson and Mr. Mercer will report on the Task Force's activities and seek feedback on the Task Force's direction.	<b>Agenda Item 4A</b> <b>Agenda Item 4B</b> <b>Agenda Item 4C</b> <b>Agenda Item 4D</b> <b>Agenda Item 4E</b> <b>Agenda Item 4F</b>
2:30 – 3:00 p.m.	<b>Information Technology and Cloud Services</b> Ms. VanDyne and Ms. Gorla will update the Committee on its preliminary discussions on IT services including, activities such as customization, configuration, and implementation, installation and integration services.	<b>Agenda Item 5A</b> <b>Agenda Item 5B</b> <b>Agenda Item 5C</b>
3:00 – 3:15 p.m.	<b>Afternoon Break</b>	
3:15 – 4:15 p.m.	<b>Entities Included In State and Local Government (SLG) Financial Statements</b> Ms. Miller and Ms. Gorla will report on the Task Force's activities and seek feedback on the Task Force's direction for SLG affiliates including investments held by SLGs and their affiliates.	<b>Agenda Item 6A</b> <b>Agenda Item 6B</b> <b>Agenda Item 6C</b> <b>Agenda Item 6D</b> <b>Agenda Item 6E</b> <b>Agenda Item 6F</b> <b>Agenda Item 6G</b>
4:15 p.m. – 4:30 p.m.	<b>IESBA Update</b> Ms. Snyder will update the Committee on the June meeting of the IESBA.	
4:30 – 5:00 p.m.	<b>Cyber-Security Services</b> Ms. Snyder and Ms. Gorla will provide the Committee with an overview of some of the cyber-security services that members are providing and ask the Committee if a Task Force should be appointed to study the issue.	<b>Agenda Item 7</b>
July 13 <sup>th</sup>	<i>Open Meeting Reconvenes</i>	
8:30 – 9:15 a.m.	<b>Part C Task Force – IESBA Convergence</b> Mr. Berman and Mr. Evans will discuss the activities of the Task Force and request the Committee's feedback.	<b>Agenda Item 8A</b> <b>Agenda Item 8B</b> <b>Agenda Item 8C</b>
9:15 – 10:15 a.m.	<b>NOCLAR Task Force – IESBA Convergence</b> Mr. Denham and Mr. Evans will discuss the activities of the Task Force and request the Committee's feedback.	<b>Agenda Item 9A</b> <b>Agenda Item 9B</b> <b>Agenda Item 9C</b> <b>Agenda Item 9D</b>
10:15 – 10:30 a.m.	<b>AM Break</b>	

10:30 – 11:00 a.m.	<b>Nonattest Services Toolkit</b> Ms. Gorla will seek the Committee's feedback on this toolkit	<b>Agenda Item 10</b>
11:00 – 11:05 a.m.	<b>Minutes of the Professional Ethics Executive Committee Open Meeting</b> The Committee is asked to approve the minutes from the May 2016 meeting.	<b>Agenda Item 11</b>
Informational Purposes Only	<b>Committee Project Agenda</b> ❖ <i>External Link</i> - <a href="#">Project Agenda</a>	
	<b><i>Open Meeting Concludes</i></b>	
	<b>Future Meeting Dates</b> <ul style="list-style-type: none"> <li>• November 3-4, 2016 – Austin, TX</li> <li>• February 9-10, 2017 – San Juan, PR</li> </ul>	

## Definition of Client

### Task Force Members

Andy Mintzer (Chair), Rick David, Bob Denham, George Dietz, Gregory Guin, Brian Lynch, and Linda McAninch  
Staff: Shannon Ziemba and Ellen Gorla

### Task Force Charge

The Client Task Force (Task Force) is charged with determining what, if any revisions are necessary to the definition of client to conform to the organizational independence requirements in the GAO Yellow Book. Also, determine if criteria “a.” and the phrase “and, if different, the person or entity with respect to which professional services are performed” should remain in the definition.

### Reason for Agenda Item

At the January 2015 Professional Ethics Executive Committee (the Committee) meeting, it was recommended to reorganize the Task Force since all but one member of the Task Force was no longer on the Committee. At that January meeting, the Committee had agreed there were unintended consequences to removing the phrase “the person or entity with respect to which professional services are performed” from the definition of client. The “new” Task Force was charged to evaluate whether there was a need to edit the client definition, add interpretations to applicable rules, or possibly change the applicable rules based on those edits to the definition. The Task Force was also asked to re-evaluate if “professional services” is the best term for purposes of the government employee exception.

At the May 2015 Committee Meeting, the “new” Task Force chaired by Andy Mintzer reported that the Task Force reviewed a spreadsheet which identified every instance that the term client appeared in the Code and found some instances where the term client was used but it appeared the term attest client was more appropriate. The Task Force also solicited feedback from the Committee if the Committee believe attest client was a subset of client or not.

At the July 2015 Committee Meeting, the Task Force received tentative approval of the proposed revised definition of client and attest client.

At the October 2015 meeting, the Committee recommended changing attest client to attest entity, moving the government provision from the attest client definition to the Independence section of the Code, and adding a note in the Code telling members that Commission and Referral Fees Rules also applies to attest entities.

At the February 2016 meeting, the Committee discussed at length whether the violation of the Contingent Fee and the Commissions and Referral Fees Rules should be a violation of the Independence Rule. The Committee also discussed whether the engaging entity, if not the target entity of the audit, could also engage that same member to perform nonattest services for a contingent fee on the engaging entity. The Committee was split on this topic.

At the May 2016 meeting, the Committee asked the Task Force to relook at the definitions and determine if changes really needed to be made and the extent of those changes. The Committee tasked the Task Force with determining if an exception approach or an add-on approach was more appropriate.

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At this meeting, the Task Force is requesting feedback from the Committee related to the proposed revised definition of client, attest client, and revisions and additions to the Code based on the revised definitions.

### **Summary of Issues**

After the last Committee meeting, the Task Force took a fresh look at the definitions and what the issues were that the Task Force was trying to correct through changes to the definitions of client and attest client. The Task Force concluded that the following three concepts needed to be addressed in the Code:

1. The member did not owe the target entity a copy of the report or the member's findings from the professional services performed when engaged by another person or entity.
  - a Hypothetical Scenario: Bank A engaged Firm Y to perform an AUP on Company M related to credit request by Company M. Based on AUP performed by Firm Y, Bank A denies Company M the credit.
    - i Under the current Code, Company M could request from Firm Y the report issued by Firm Y to Bank A. Firm Y would be required to provide that member's work product to Company M since they are a client.
    - ii Task Force believes that Firm Y should not be required to provide any member's work product to Company M under the Records Request interpretation of the Acts Describable Rule.
2. Under the Confidential Client Information Rule, member should be able to disclose to the engaging entity (when it is not also the target entity) any information learned from the target entity that pertains to the professional services the member was engaged to perform without receiving specific consent from that target entity.
  - a The Task Force acknowledges that this transfer of information from the target entity to the engaging entity would most likely be addressed in an agreement between those parties. The Task Force does not believe a member should need to rely on an agreement between the target entity and engaging entity to make sure the member is in compliance with the Code.
  - b If no such agreement were in place between the target and engaging entity (when they are not the same), any confidential information related to the target entity contained in the member's work product provided to the engaging entity could be deemed a violation of the Confidential Client Information Rule. The Task Force does not believe that it should be deemed a violation of the Confidential Client Information Rule
3. If the engaging entity is not the target entity in an financial statement audit, review or compilation engagement, the member need only evaluate, with regards to the engaging entity, circumstances and relationships that may impair independence by using the conceptual framework.
  - a Hypothetical Scenario: Bank A engaged Firm Y to perform an AUP on Company M related to credit request by Company M. Wife of Partner at Firm Y is in a key position at Bank A.
    - i The Task Force believes that the wife of a partner at Firm Y being in a key position at Bank A should not automatically impair Firm Y's independence with regard to this AUP on Company M. The Task Force believes that Firm Y should use the Conceptual Framework for Independence to determine if independence is impaired with regard to this engagement.

The Task Force believes by making changes to the Code based on the above three concepts, it minimally impact the Code and addresses the concerns raised by the Task Force and the Committee.

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### *Definition of Client*

The Task Force recommends that the definition of client should remain essentially how it reads currently with a few changes. The Task Force still recommends that the government provision be moved from the client definition to an interpretation in the Independence section of the Code since the government provision involves independence and attest engagements. The Task Force also recommends adding the word “also” between “and” and “if different”. The Task Force believes this clarifies that a member could have two clients in an engagement – the person or entity who engaged the member and also the person or entity with respect to whom the professional services are performed. As such the Task Force recommends the definition of client read as follows (a marked version of the changes to the definition appear in **Agenda Item 1B**):

**Client** - A person or entity, other than the member’s employer, that engages a member or a member’s firm to perform professional services and also, if different, the person or entity with respect to which a member performs professional services.

See paragraph .05 of the “Simultaneous Employment or Association With an Attest Client” interpretation [1.275.005] for independence guidance related to a member in a government audit organization that performs an attest engagement with respect to the government entity.

<b>Question for the Committee</b>
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|---|
| 1. Does the Committee agree with the proposed revisions to the client definition? |
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### *Definition of Attest Client*

As with the client definition, the Task Force now recommends that the definition of attest client should remain essentially the same with a few minor changes to mirror the client definition and the term will remain attest client. The Task Force believes it would be clearer, if the word “client” in the definition, was replaced with the phrase “any person or entity”. The Task Force also recommends changing “or” to “and also, if different” to mirror client. The Task Force believes the terms should include the same group. The only differences is that attest client pertains only to attest engagements whereas client pertains to all professional services.

As such the Task Force recommends the definition of attest client read as follows (a marked version of the changes to the definition appear in **Agenda Item 1B**)

**Attest client.** A person or entity that engages a *member* to perform an *attest engagement* and also, if different, the person or entity with respect to which a *member* performs an *attest engagement*.

See of the “Client Affiliate” interpretation [1.224.010] for acquisitions and business combinations that involve a *financial statement attest client*. See paragraph .05 of the “Simultaneous Employment or Association With an Attest Client” interpretation [1.275.005] for independence guidance related to a member in a government audit organization that performs an attest engagement with respect to the government entity.

<b>Question for the Committee</b>
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| 1. Does the Committee agree with the proposed revisions to the attest client definition? |
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### *Government Provision*

At the October 2015 Committee meeting, the Committee determined it would be more logical to include the government provision in the Independence section of the Code instead of the client definition. The government provision was added to the Code in order for government auditors to be in compliance with the AICPA's independence rules as long as certain specified criteria are met. The main issue is related to simultaneous employment therefore the Task Force determined the most logical place to place the government provision in the Independence section was in the Simultaneous Employment or Association With an Attest Client [1.275.005].

As such the Task Force recommends adding paragraph .05 and the subheadings to the "Simultaneous Employment or Association With an Attest Client" interpretation [1.275.005] as follows (a marked version of the changes to the definition appear in **Agenda Item 1B**):

#### 1.275.005 Simultaneous Employment or Association With an Attest Client

.01 In this interpretation, simultaneous employment or association with an *attest client* is serving as a director, an officer, an employee, a promoter, an underwriter, a voting trustee, a trustee for any pension or profit-sharing trust of the *attest client*, or in any capacity equivalent to that of a member of management of an *attest client* during the period covered by the *financial statements* or the *period of the professional engagement*.

.02 If a *partner* or professional employee of the *member's firm* is simultaneously employed or associated with an *attest client*, familiarity, management participation, advocacy, or self-review *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraph .02C of ET section 101]

#### *Adjunct Faculty Member*

.03 However, *threats* will be at an *acceptable level* and *independence* will not be *impaired* if a *partner* or professional employee of a *firm* serves as an adjunct faculty member of an educational institution that is an *attest client* of the *firm*, provided that the *partner* or professional employee meets all of the following *safeguards*:

- a. Does not hold a *key position* at the educational institution
- b. Does not participate on the *attest engagement team*
- c. Is not an *individual in a position to influence the attest engagement*
- d. Is employed by the educational institution on a part-time and non-tenure basis
- e. Does not participate in any employee benefit plans sponsored by the educational institution, unless participation is required
- f. Does not assume any management responsibilities or set policies for the educational institution

Upon termination of employment, the *partner* or professional employee should comply with the requirements of the "Former Employment or Association With an Attest Client" interpretation [1.277.010] of the "Independence Rule" [1.200.001]. [Prior reference: paragraph .21 of ET section 101]

.04 *Members* that are simultaneously employed or associated with an *attest client* should consider their obligations as a *member in business* under part 2 of the code. [No prior reference: new content]

*Members in Government Audit Organization*

.05 However, *threats* will be at an *acceptable level* and independence will not be impaired when a *member* in a government audit organization performs an *attest engagement* with respect to the government entity provided the head of the government audit organization is

- a. directly elected by voters of the government entity with respect to which *attest engagements* are performed;
- b. appointed by a legislative body and is subject to removal by a legislative body; or
- c. appointed by someone other than the legislative body, so long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body

Refer to **Agenda Item 1B** for other revisions to the Code based on the relocation of the government provision.

**Question for the Committee**

1. Does the Committee agree with the proposed revisions to the Simultaneous Employment or Association With an Attest Client Interpretation?

*Revisions to the Code Based on the Above Edits to the Client and Attest Client Definitions.*

The Task Force recommends adding the following three interpretations to the Code to address the outstanding issues listed above:

1. To address the member not being obligated to provide the target entity (when not the engaging entity) a copy of their report or other supporting documents, the Task Force recommends adding item c to paragraph .04 of the “Record Requests” interpretation:

1.400.200 Records Requests (in part)

.03 The member should return client-provided records in the member’s custody or control to the client at the client’s request.

.04 Unless a member and the client have agreed to the contrary, when a client makes a request for member-prepared records or a member’s work products that are in the member’s custody or control and that have not previously been provided to the client, the member should respond to the client’s request as follows:

- a. The member should provide member-prepared records relating to a completed and issued work product to the client, except that such records may be withheld if fees are due to the member for that specific work product.
- b. Member’s work products should be provided to the client, except that such work products may be withheld
  - i. if fees are due to the member for the specific work product;
  - ii. if the work product is incomplete;

- iii. if for purposes of complying with professional standards (for example, withholding an audit report due to outstanding audit issues); or
  - iv. if threatened or outstanding litigation exists concerning the engagement or member's work.
- c. **The member should not provide member-prepared records or a member's work product to a person or entity with respect to which the member provided professional services if that person or entity did not also engage the member for those professional services.**

**Question for the Committee**

1. Does the Committee agree with the proposed addition to the Records Request interpretation?

2. To address that the member would not be in violation of the Confidential Client Information Rule if the member discloses confidential information obtained from the target entity to the engaging entity when they are not the same, the Task Force recommends adding paragraph .04 to the "Disclosing Information to Persons or Entities Associated with Clients" interpretation [1.700.030] :

1.700.030      Disclosing Information to Persons or Entities Associated With Clients

- .01 When a *member* is engaged to prepare a married couple's joint tax return, both spouses are considered to be the *member's client*, even if the *member* was engaged by one spouse and deals exclusively with that spouse.
- .02 Accordingly, if the married couple is undergoing a divorce and one spouse directs the *member* to withhold joint tax information from the other spouse, the *member* may provide the information to both spouses, in compliance with the "[Confidential Client Information Rule](#)" [1.700.001], because both are the *member's client*. The *member* should consider reviewing
  - a. the legal implications of such disclosure with an attorney and
  - b. responsibilities under any tax performance standards, such as Section 10.29 of IRS Circular 230. [Prior reference: paragraphs .031–.032 of ET section 391]
- .03 If a *member* provides *professional services* to a company's executives at the request of the company, the *member's* disclosure of *confidential client information* to the company without the consent of the applicable executives would be a violation of the "[Confidential Client Information Rule](#)" [1.700.001], even if the company is not otherwise a *client*. [Prior reference: paragraphs .041–.042 of ET section 391]
- .04 If a member performs professional services with respect to a person or entity (target) and that person or entity did not engage the member, the Confidential Client Information Rule would not prohibit the member from disclosing any information within the scope of the engagement obtained from the target to the person or entity that engaged the member to perform those professional services.**

**Question for the Committee**

1. Does the Committee agree with the proposed addition to the Disclosing Information to Persons or Entities Associated with Clients interpretation?

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2. Does the Committee agree that the information that a member is permitted to disclose should be limited to that information that is within the scope of the engagement?

3. The Task Force is still discussing whether members need to address an independence impairment that he or she may have with the engaging entity who is not the financial statement attest client nor an affiliate of the financial statement attest client. One line of thought is when this situation occurs, that members should evaluate the relationship using the conceptual framework for independence.

**Question for the Committee**

1. Does the Committee believe that members should evaluate a relationship they have with an engaging entity when the engaging entity is not the financial statement attest client nor an affiliate of the financial statement attest client?

**Agenda Item 1B** is a marked version of the revisions recommended by the Task Force and which category or categories the recommended revisions are captured in.

**Questions for Committee**

1. Does the Committee believe that cross-references to the above three interpretations should be added to the definition of attest client and client so the members are aware of these requirements when the engaging entity is not the target entity?

2. Does the Committee believe the Task Force should create some FAQs for the membership to clarify that when the engaging entity is not the target entity then you have two separate clients? For example, a FAQ related to Records Requests when receiving original documents from target entity who should the member return that original document to?

**Action Needed**

The Committee is asked to review and discuss the revised definitions, application of the AICPA Code, and the revised and new interpretations proposed by the Task Force.

**Materials Presented**

**Agenda Item 1B** Complete Listing of the Proposed New Interpretations and Proposed Revised Definitions, Application of the AICPA Code, and Interpretations

Text of Proposed Revised Definition of “Attest Client”  
(Additions appear in boldface italic and deletions are stricken)

**0.400.03** **Attest client.** A ***person or entity*** ~~*client*~~ that engages a *member* to perform an *attest engagement* ~~or~~ ***and also, if different, the person or entity*** with respect to which a *member* performs an *attest engagement*.

See ~~paragraph .03~~ of the “Client Affiliate” interpretation [1.224.010] for acquisitions and business combinations that involve a *financial statement attest client*. ***See paragraph .05 of the “Simultaneous Employment or Association With an Attest Client” interpretation [1.275.005] for independence guidance related to a member in a government audit organization that performs an attest engagement with respect to the government entity.***

*Effective Date*

This definition is effective December 15, 2014.

Text of Proposed Revised Definition of “Client”  
(Additions appear in boldface italic and deletions are stricken)

**0.400.07** **Client.** ~~Any~~ **A** person or entity, other than the *member’s* employer, that engages a *member* or *member’s firm* to perform *professional services* and ***also***, if different, the person or entity with respect to which ***a member performs professional services*** ~~are performed~~. ~~For purposes of this definition, the term employer does not include the following:~~

- ~~a. Person or entity engaged in *public practice*.~~
- ~~b. Federal, state, and local government or component unit thereof, provided that the *member* performing *professional services* with respect to the entity is
  - ~~i. directly elected by voters of the government or component unit thereof with respect to which *professional services* are performed;~~
  - ~~ii. an individual who is (1) appointed by a legislative body and (2) subject to removal by a legislative body; or~~
  - ~~iii. appointed by someone other than the legislative body, so long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body.~~~~

[Prior reference: paragraph .03 of ET section 92]

***See paragraph .05 of the “Simultaneous Employment or Association With an Attest Client” interpretation [1.275.005] for independence guidance related to a member in a government audit organization that performs an attest engagement with respect to the government entity.***

## Text of Proposed Revisions to Interpretations

(Additions appear in boldface italic and deletions are stricken)

Note: The complete text of the interpretations are not included, rather, only the paragraphs where changes are proposed are included.

**1.000.02** Government auditors within a government audit organization who audit federal, state, or local governments or component units thereof, that are structurally located within the government audit organization, are considered in *public practice* with respect to those entities provided the head of the **government** audit organization ~~is meets one of the organizational structures described in paragraph .07b(i-iii) of the “Client” definition [0.400.07].~~

- a. directly elected by voters of the government entity with respect to which attest engagements are performed;**
- b. appointed by a legislative body and is subject to removal by a legislative body; or**
- c. appointed by someone other than the legislative body, so long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body.**

[No prior reference: new content]

**1.224.020.08** However, if a *covered member* or a *covered member’s immediate family* holds a *key position* within the primary government during the *period of the professional engagement* or during the period covered by the *financial statements, 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* by the application of *safeguards*. Accordingly, the *covered member’s independence* would be *impaired*. For purposes of this interpretation, a *covered member* and the *covered member’s immediate family* would not be considered employed by the primary government **if the criteria in the Introduction of Part 1 [1.000.02]** exceptions provided for in paragraph .07b of the “Client” definition [0.400.07] were met. [Prior reference: paragraph .12 of ET section 101]

## Text of Proposed New Paragraphs to Existing Interpretations

(Additions appear in boldface italic)

### 1.275.005 Simultaneous Employment or Association With an Attest Client

.01 In this interpretation, simultaneous employment or association with an *attest client* is serving as a director, an officer, an employee, a promoter, an underwriter, a voting trustee, a trustee for any pension or profit-sharing trust of the *attest client*, or in any capacity equivalent to that of a member of management of an *attest client* during the period covered by the *financial statements* or the *period of the professional engagement*.

.02 If a *partner* or professional employee of the *member’s firm* is simultaneously employed or associated with an *attest client*, familiarity, management participation, advocacy, or self-review *threats* to the *member’s* compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraph .02C of ET section 101]

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.03 However, *threats* will be at an *acceptable level* and *independence* will not be *impaired* if a *partner* or professional employee of a *firm* serves as an adjunct faculty member of an educational institution that is an *attest client* of the *firm*, provided that the *partner* or professional employee meets all of the following *safeguards*:

- a. Does not hold a *key position* at the educational institution
- b. Does not participate on the *attest engagement team*
- c. Is not an *individual in a position to influence the attest engagement*
- d. Is employed by the educational institution on a part-time and non-tenure basis
- e. Does not participate in any employee benefit plans sponsored by the educational institution, unless participation is required
- f. Does not assume any management responsibilities or set policies for the educational institution

Upon termination of employment, the *partner* or professional employee should comply with the requirements of the “Former Employment or Association With an Attest Client” interpretation [1.277.010] of the “Independence Rule” [1.200.001]. [Prior reference: paragraph .21 of ET section 101]

.04 *Members* that are simultaneously employed or associated with an *attest client* should consider their obligations as a *member in business* under part 2 of the code. [No prior reference: new content]

**.05 However, threats will be at an acceptable level and independence will not be impaired when a member in a government audit organization performs an attest engagement with respect to the government entity provided the head of the government audit organization is**

- a. **directly elected by voters of the government entity with respect to which attest engagements are performed;**
- b. **appointed by a legislative body and is subject to removal by a legislative body;**  
**or**
- c. **appointed by someone other than the legislative body, so long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body**

#### 1.400.200 Records Requests (in part)

.03 The member should return client-provided records in the member’s custody or control to the client at the client’s request.

.04 Unless a member and the client have agreed to the contrary, when a client makes a request for member-prepared records or a member’s work products that are in the member’s custody or control and that have not previously been provided to the client, the member should respond to the client’s request as follows:

- a. The member should provide member-prepared records relating to a completed and issued work product to the client, except that such records may be withheld if fees are due to the member for that specific work product.

- b. Member's work products should be provided to the client, except that such work products may be withheld
  - i. if fees are due to the member for the specific work product;
  - ii. if the work product is incomplete;
  - iii. if for purposes of complying with professional standards (for example, withholding an audit report due to outstanding audit issues); or
  - iv. if threatened or outstanding litigation exists concerning the engagement or member's work.
- c. ***The member should not provide member-prepared records or a member's work product to a person or entity with respect to which the member provided professional services if that person or entity did not also engage the member for those professional services.***

#### 1.700.030 Disclosing Information to Persons or Entities Associated With Clients

- .01 When a *member* is engaged to prepare a married couple's joint tax return, both spouses are considered to be the *member's client*, even if the *member* was engaged by one spouse and deals exclusively with that spouse.
- .02 Accordingly, if the married couple is undergoing a divorce and one spouse directs the *member* to withhold joint tax information from the other spouse, the *member* may provide the information to both spouses, in compliance with the "[Confidential Client Information Rule](#)" [1.700.001], because both are the *member's client*. The *member* should consider reviewing
  - a. the legal implications of such disclosure with an attorney and
  - b. responsibilities under any tax performance standards, such as Section 10.29 of IRS Circular 230. [Prior reference: paragraphs .031–.032 of ET section 391]
- .03 If a *member* provides *professional services* to a company's executives at the request of the company, the *member's* disclosure of *confidential client information* to the company without the consent of the applicable executives would be a violation of the "[Confidential Client Information Rule](#)" [1.700.001], even if the company is not otherwise a *client*. [Prior reference: paragraphs .041–.042 of ET section 391]
- .04 ***If a member performs professional services with respect to a person or entity (target) and that person or entity did not engage the member, the Confidential Client Information Rule would not prohibit the member from disclosing any information within the scope of the engagement obtained from the target to the person or entity that engaged the member to perform those professional services.***

### Transfer/Return of Client Files Task Force

#### Task Force Members

Carlos Barrera (Chair), Steve Reed and Greg Guin

Lisa Snyder (Staff) and Ellen Gorla (Staff)

#### Task Force Charge

This Task Force will develop guidance related to a member's obligations concerning the confidentiality and return of client files when the member either sells or discontinues his or her practice or the member acquires a practice.

#### Reason For Agenda

To review the comments received regarding the proposed new interpretation "Transfer of Files and Return of Client Records in Sale, Transfer or Discontinuance of Member's Practice" (**Agenda Item 2B**) and revised interpretation "Disclosing Client Information in Connection with a Review or Acquisition of the Member's Practice" (**Agenda Item 2C**) and adopt the proposals.

**Agenda Item 2E** consolidates the comments received along with links to the individual letters received. Each comment letter has been assigned a number that corresponds to the comment letter summary.

#### Summary of Issues - Transfer of Files and Return of Client Records in Sale, Transfer or Discontinuance of Member's Practice

#### *Application of Interpretation*

[CL 12](#) recommends the Committee clarify if the Transfer of Files and Return of Client Records in Sale, Transfer or Discontinuance of Member's Practice interpretation applies to just individual members such as a sole practitioner or if it should also apply to a member's firm. The Task Force believes the interpretation should apply to both members and member's firms and recommends the following edit to the interpretation to clarify this:

- .01 A member **or member's firm (member)** ~~who~~ ~~that~~ sells or transfers all or part of the member's practice to another person, firm or entity (successor firm) and will no longer retain ownership in, or control of, the practice should do all of the following:

In an effort to further demonstrate their concerns, [CL 12](#) asks how the interpretation should be applied in the following situations:

- A partner is leaving the firm, and the clients assigned to him or her are now transferred to another partner in the firm.
- A partner did not leave the firm; however, another partner now manages his or her clients, and the original partner now manages different clients.
- Only one client is transferred to another partner in the firm.

The Task Force does not believe that the guidance was intended to cover situations where there was no change in ownership of the firm. To help emphasize and clarify this, the Task Force recommends the following FAQ be added to the staff FAQ document:

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### Transfer of Client Files to Another Partner in the Firm

**Question.** When a partner leaves a firm and his or her clients are transferred to another partner in the firm, do the requirements of the “Transfer of Files and Return of Client Records in Sales, Transfer, Discontinuance or Acquisition of Practice” interpretation need to be applied?

**Answer.** No. In such situations the ownership of the firm has not been transferred outside of the firm, rather the clients have only been reassigned to a different partner in the firm. [July 2016]

<b>Question for Committee:</b>
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1. Does the Committee agree with the Task Force’s recommendations?
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### Client Notification – 90 Day Requirement

#### Summary of Feedback

[CL 4](#) recommends that language be added to paragraph .01 of 1.400.205 that requires a member to retain proof of such notification and whether consent was obtained from the client or consent was presumed when the client did not respond within 90 days. Such proof would be retained for the same period as specified in paragraph .02 of the section.

One member of the Society of Louisiana of CPAs Ethics Committee (**Comment #1 of [CL 7](#)**) believes it is not appropriate for the guidance to permit presumed consent, rather the guidance should require written consent be obtained from the client. This commenter believes that if a client does not respond or the member unable to contact or find the client, the client’s information should not be provided.

[CL 4](#) notes that no states currently allow presumed consent. This commenter notes that some require “specific consent” and a few exempt disclosures to “another licensee in connection with a proposed sale or merger of the licensee’s professional practice” (e.g. California).

A number of other commenters expressed concern with the 90-day client notification requirement included in the *Transfer of Files and Return of Client Records in Sale, Transfer or Discontinuance of Member’s Practice* interpretation. Specifically, five commenters believe the 90-day waiting period is not practical in today’s environment.

- [CL 3](#) recommends a 45 day period would be reasonable and then for those clients that don’t respond but whose communications are not undeliverable, a second notice be sent and consent be implied if no response is received after another 45 days.
- [CL 5](#) believes a 30 day period would be sufficient or 60 days at a maximum.
- [CL 6](#) recommends that a better approach be that the proposal be revised to require that the acquiring firm notify the clients as soon as reasonably possible after the closing and, absent specific consent to the transfer, refrain from accessing or using the client records for a period of 90 days. This commenter believes this would achieve the goal of maintaining client confidentiality while not impeding commerce related to accounting firm transactions.
- [CL 10](#) recommends a 30 day period would be appropriate.
- [CL 11](#) recommends members be given an option to use either the 90 day waiting period for presumed consent or to allow the successor firm to take possession of the confidential client information and perform the notification itself while preserving the confidentiality of the client information until permission is received.

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Some of the reasons these commenters believe the 90-day waiting period is unreasonable include the following:

**CL 6** believes that in a typical transaction, the selling firm's client files are an asset to be transferred to the acquiring firm at closing. "Therefore as written, the buyer would need to contact all clients of the target prior to closing and obtain permission." (Note: Staff believes the commenter intended to say the *seller* would need to contact all clients; not the buyer). This commenter believes since the proposal states that absent an affirmative response from the client, the passage of 90 days will be sufficient for the buyer to assume approval of the transfer. This commenter believes it would be necessary for clients to be notified at least 90 days in advance of the proposed closing. This commenter goes on to explain that in today's world, of accounting mergers, a deal is never over until it's over and so is concerned that the impact of advance notice on existing client relationships could be very negative; they believe for this reason most target firms are reluctant to notify clients until very near the closing date.

**CL 10** feels the ED is not practical based on its experience. The confidential nature of the sale or a merger does not allow a ninety-day period to be practical. There is concern surrounding client and staff reactions. The reality for their firm has been that the notification is provided, at the outside, within thirty days prior to the effective date of the sale. **CL 10** goes on to explain that a ninety-day period is too restrictive because it will not allow the transfer of files to occur in a timely manner. Many of the sales or mergers happened close to the end of the year. The ninety-day period will hinder the conversion of files when necessary, for example from one tax software to another tax software. It is critical the files be converted prior to January 1 or the "busy" season starting. It is not practical to backup and send numerous files to the software company at different points in time for conversion. If this becomes necessary, the cost to the buyer and seller will increase. **CL 10** also notes that the ninety-day period also has the potential to negatively impact the service a client receives. Normally, there is a need for computer systems and servers to be replaced. In a firm such as theirs, when there is a wide area network, the files need to be transferred to their data storage servers. This is especially critical when they are acquiring or merging a firm in a new location. Normally, the access to the old servers is limited and the data is placed on their servers. If the staff cannot access the data needed to service the client, the client experience will be negatively impacted and the client will be frustrated.

**CL 11** is concerned about the timing of client notification and transfer of client records in relation to a sale or merger transaction closing date, considering that the transfer of client records typically occurs at the date of closing. This commenter believes that transactions involving the sale or merger of a member's practice are often sensitive in nature, and a member selling or merging his or her practice typically prefers to notify clients only very near the closing date. However, the commenter believes the proposed Interpretation essentially would require the selling/transferring member to notify clients 90 days prior to an estimated closing date so that, in the absence of client response, the 90-day window has passed and the selling/transferring member is in a position to transfer the client records at closing.

This commenter goes on to explain that it believes the potential length of advance notice a firm would need to provide of its sale or merger could have significant negative effects on the relationship between the client and the selling/transferring member. Such notification could place undue stress on the performance of services currently underway, as well as potentially result in the disruption of service, to the detriment of the client. Further, the commenter notes that given that a transaction closing date sometimes can be difficult to precisely predict, in light of many other moving pieces, this requirement

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could present unnecessary challenges and potential delay in executing a sale or merger transaction. Finally, the commenter explains that there could be circumstances in which the death or incapacity of a predecessor member makes it impossible for him or her to notify clients and obtain permission before transferring files to a successor firm.

#### *Task Force Recommendations*

The Task Force continues to believe that the guidance should provide for presumed consent after a period of time, but did not reach a unanimous decision concerning what that time period should be. As such, the Task Force requests the Committee discuss whether it would be appropriate to presume consent at a period less than 90 days. . The Task Force recommends (1) the guidance clarify which clients members should seek consent from (those subject to the sale or transfer); (2) that members are encouraged to retain evidence of consent and (3) when the 90 day period (or other appropriate period) begins. The Task Force's recommendations also make it clear that members don't have to wait the 90 days to transfer the any client files if consent was given. The recommended clarified language reads as follows:

- a. ~~Notify each client in writing of the sale or transfer of the member's practice and obtain~~ **Submit a written request to each client, subject to the sale or transfer, requesting** the client's consent prior to transferring its files to the successor firm and, ~~in addition,~~ notify the client that its consent ~~will~~ **may** be presumed if it does not respond **to the member's request** within 90 days. **The member should not transfer any client files to the successor firm until the client's consent is obtained or until the 90 days has lapsed, whichever is shorter. The member is encouraged to retain evidence of consent, whether obtained from the client or presumed after 90 days.**

#### **Question for Committee:**

1. How much time does the Committee believe should pass before the member may presume consent was given?
2. Does the Committee agree with the Task Force's recommendations?

#### **Client Notification – Form**

[CL 3](#) recommends members be allowed to request consent from clients using email. This commenter noted that while people move, they tend not to change their email accounts so allowing the use of electronic communication may reduce the notices that are unable to be delivered. A similar recommendation was received informally by Staff.

When voting the interpretation out for exposure, this question was briefly discussed and the Committee agreed that the language was broad enough to imply that written notification to clients could include electronic notification. The Task Force recommends that the following FAQ be issued to address these concerns:

#### **Form of Communication**

**Question.** The “Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice” interpretation [1.400.2015] requires certain communications to the client be in writing. Would electronic communications such as email be an acceptable form of communication?

**Answer.** Yes, provided the client uses electronic communication as part of its normal course of business communications. [July 2016]

#### **Question for Committee:**

1. Does the Committee agree with the Task Force's recommendation?

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### **Should be Satisfied**

Five commenters request the Committee provide clarification regarding what is meant by the phrase “should be satisfied” in the requirement that “A member who acquires all or part of a practice from another person, firm, or entity (predecessor firm) **should be satisfied** that all clients of the predecessor firm subject to the acquisition have been notified of the acquisition and have consented to the member’s continuation of professional services and retention of any client files or records the successor firm retains.”

- [CL 5](#) asks if there is a presumption that notification has been made and consents have been acquired or are there steps that need to be taken by the successor to be “satisfied”?
- [CL 6](#) requests that the concept of “satisfied” be more clearly articulated or the terminology changed to something like the firm should use best efforts in complying with the requirements in ET 1.400.205.01 (a).
- **Comment #1 of CL 7** believes be helpful to expand on this notification and provide examples of what the successor firm should do to be “satisfied” that this requirement has been met.
- [CL 11](#) believes there may be practical limitations to the actions the successor firm is able to take to obtain such satisfaction, in particular in cases when the predecessor member was unable to provide such notification (for example, due to death or disability) or when the predecessor member did not retain records of notification or consent. As such, this commenter recommends that the PEEC clarify the intended meaning of the phrase “should be satisfied”, and suggest that it be based in the concept of applying “best efforts” to comply with the stated requirements.
- [CL 12](#) believes it is not clear what the successor’s responsibility is if the predecessor member or firm could not notify the client in order to gain consent for the successor to continue predecessor services and retain that client’s files. In addition, further clarification is needed on the concept of “satisfied.”

Currently the requirement focuses on the notification of the client and not that the client has consented to the transfer of the client files and records. According, the only revision that the Task Force recommends be made to this provision is to make it clear that the obligation of the successor firm is that they be satisfied that the client has *consented* to the continuation of services and retention of files and records. The Task Force believes that members should use their professional judgment to determine how best to apply this requirement given their specific facts and circumstances and was also concerned that if an example was included, members might be inclined to think that is the only way to meet the requirement. The Task Force noted that the phrase “member should be satisfied” is used elsewhere in the Code including the Breaches and the Non-attest services interpretations. The revision that the Task Force recommends be made appear in highlight:

#### **Acquisition of Practice by a Member**

.02 A member who acquires all or part of a practice from another person, firm, or entity (predecessor firm) should be satisfied that all clients of the predecessor firm subject to the acquisition ~~have been notified of the acquisition and~~ have consented to the member’s continuation of professional services and retention of any client files or records the successor firm retains.

<b>Question for the Committee:</b>
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| 1. Does the Committee agree with the Task Force’s recommendation? |
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### ***Illness, Death or Other Extraordinary Unforeseen Circumstance***

Five commenters asked questions related to extraordinary unforeseen circumstances such as illness and death.

- [CL 3](#) believes there could be potential impracticalities with maintaining, in a confidential manner, any client files that are not transferred or are unable to be returned to the client when extraordinary unforeseen circumstances such as catastrophic illness occur. As such, this commenter requests some consideration be given for such scenarios.
- **Comment #4 of [CL 7](#)** notes that the proposal does not address the death of a member, in particular, a sole practitioner. This commenter asks if such a member make some provision for the transfer of client files from his or her estate, or some provision for maintaining the confidentiality of client records after he or she dies? Should the proposal at least include some guidance to a successor firm who might seek to acquire client records from the deceased member's estate?
- [CL 9](#) and [CL 10](#) recommend additional guidance in the final interpretation to address a member's inability to provide notice due to death or disability. The proposed guidance currently requires the member to provide the notice and does not allow for an agent of the member to do so in extenuating circumstances.
- [CL 12](#) believes consideration should be given to situations such as the death of a member, or when either a member or a member's firm files for bankruptcy. In these situations, no firm remains to keep client files in a confidential manner for the applicable retention period. The client files may be maintained by a trustee, the courts, or next of kin.

When discussing this issue the Committee noted that in these types of situations, the onus would typically fall on the heirs, spouse, or executor of the member. Since the Committee does not have jurisdiction over these individuals, guidance related to this issue was deemed not appropriate to include in the Code. The Committee also agreed it would not be appropriate to include an ethics requirement that a member must have a practice continuation agreement in place. In addition, if the member died or was incapacitated, the guidance in the Code could be used by the member's heirs, spouse, or executor for purposes of selling the practice. In cases where clients were not notified, the guidance applicable to the acquiring firm would still apply and the acquiring firm would need to ensure that the clients were notified and consented as described in paragraph .03. It is Staff's understanding that NASBA/AICPA plans to issue non-authoritative guidance to assist heirs, spouses, or executors who are in this situation. Accordingly, the Task Force does not recommend any additions be made to address this issue.

<p><b>Question for the Committee:</b></p>
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| <p>1. Does the Committee believe an addition should be made to address these concerns?</p> |
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### ***Make Arrangements to Return Any Client Records***

[CL 6](#) does not believe members should have to return records to a client that has decided not to move to the successor firm if the client has not requested those records be returned. This commenter believes that as drafted 1.400.205.01 (b) would require such occur.

[CL 12](#) requests that the Committee consider clarifying whether the proposal would extend to records of former clients when there is a sale or discontinuance of a member's practice.

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The Task Force recommends that this provision be clarified that it only extends to those clients that are not subject to the sale or transfer. The revision that the Task Force recommends be made appear in highlight:

- b. With respect to files not **subject to the sale or transferred**, make arrangements to return any client records that the member is required to provide to the client as set forth in the “Records Requests” interpretation [1.400.200] unless the member and client agree to some other arrangement.

**Question for the Committee:**

1. Does the Committee agree with the Task Force’s recommendation?

***Employee or Contractor of Successor Firm***

**Comment #4 of CL 7** asks if 1.400.205 is intended to address circumstances in which the member does not retain ownership or control of the client files, but either becomes an employee of the successor firm or contracts with the successor firm to continue servicing selected clients. If the interpretation is intended to address that situation, the commenter recommends a statement to that effect be added. If not, the commenter request the Committee provide guidance as to the member’s responsibility in those circumstances.

The Task Force believes that the guidance would be applicable in these circumstances and does not recommend any revisions be made.

**Question for The Committee:**

1. Does the Committee agree with the Task Force’s recommendation?

***Editorial Suggestions***

**CL 3** recommends that the phrase “whichever is longer” in paragraphs 1.400.205.01 and 1.400.205.02 be changed to “for the longer of the time periods specified therein.” The Task Force does not recommend this revision be made.

In addition, **CL 12** believes that this interpretation needs clarity for a member to comply appropriately. If a member who uses best efforts to comply with this interpretation might still be considered in violation of the Acts Discreditable Rule, this paragraph should be clear as to why a violation would occur. To address this concern, the Task Force recommends the following highlighted edit:

- .03 A member would be considered in violation of the “Acts Discreditable Rule” [1.400.001] if the member does not comply with **any of** the requirements of this interpretation.

***Delayed Effective Date***

Two commenters believe a delayed effective date would be helpful while one does not. **CL 1** recommends a 2 year delayed effective date so that the AICPA Code and California Board of Accountancy Regulation 54.1(a)(4) are not in conflict. The Board indicated that it typically takes 12-18 months to implement new regulations in CA. **CL 3** suggests a three month delay would be adequate so that members have time to establish firm policies in order to comply with the interpretations. Alternatively, **CL 8** does not believe a delayed effective date is necessary.

**Question for the Committee:**

1. Does the Committee believe there should be a delayed effective date?

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## Summary of Issues: Disclosing Client Information in Connection With a Review or Acquisition of the Member's Practice

[CL 2](#) recommends paragraph .03 of 1.700.050 permit disclosure of the client information obtained as the result of acquiring all or part of another member's professional practice when the member is required by law or judicial order to do so. The Task Force believes this is already addressed since this is an interpretation under the Confidential Client Information Rule" and that rule stipulates that the rule should not be used "to affect in any way the member's obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a member's compliance with applicable laws and government regulations,".

[CL 3](#) does not believe paragraph .03 is necessary. This commenter believes that this area is covered sufficiently in Section 1.700.001 *Confidential Client Information Rule* and extant Interpretation 1.700.050 *Disclosing Client Information in Connection with a Review of the Member's Practice*. When a member or firm obtains a client's files through the acquisition of another member's practice, the client becomes a client of the successor member or firm. The member or members of that firm are bound thereafter by the requirements of Rule 1.700.001. The Task Force believes the proposed new paragraph is helpful and would not recommend removing.

[CL 12](#) notes that the addition of paragraph .03 to Revised Interpretation [1.700.050] ("revised interpretation") references Proposed Interpretation [1.400.205] for guidance on the retention of client files obtained through acquiring a practice. However, Proposed Interpretation [1.400.205] only refers to having consent from the client to continue with professional services and to retain client's files, but does not provide "guidance" on the retention of those files. This commenter suggests providing additional guidance within paragraph .03 itself, rather than referencing Proposed Interpretation [1.400.205]. It is also unclear whether noncompliance with this revised interpretation would also be a violation of the "Acts Discreditable Rule" [1.400.001]. The Task Force recommends that the phrase "on the retention of" in the last sentence of paragraph .03 be replaced with "related to" so that the sentence would read as follows:

Members should refer to the "Transfer of Files and Return of Client Records in Sale, Transfer or Discontinuance **or Acquisition of Member's a Practice *By a Member***" interpretation under the "Acts Discreditable Rule" for guidance ~~on the retention of~~ **related to** client files obtained through acquiring a practice.

### Question for the Committee:

1. Does the Committee agree with the Task Force's recommendations?
2. The Task Force didn't discuss an effective date for this addition. Does the Committee believe a delayed effective date is needed?

### Action Needed

The Committee is asked to adopt the interpretations.

### Materials Presented

<b>Agenda Item 2B</b>	Transfer of Files and Return of Client Records in Sale, Transfer or Discontinuance of Member's Practice
<b>Agenda item 2C</b>	Disclosing Client Information in Connection with a Review or Acquisition of the Member's Practice
<b>Agenda Item 2D</b>	Draft FAQs
<b>Agenda Item 2E</b>	Summary of Comment Letters Received

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## Agenda Item 2B

[Revisions to the Exposed Interpretation Appear in **Highlight**]

### 1.400.205 Transfer of Files and Return of Client Records in Sale, Transfer, **or** Discontinuance **or Acquisition** of **Member's a** Practice

#### **Sale or Transfer of Member's Practice**

.01 A member **or member's firm (member)** ~~who~~ **that** sells or transfers all or part of the member's practice to another person, firm or entity (successor firm) and will no longer retain ownership in, or control of, the practice should do all of the following:

a. ~~Notify each client in writing of the sale or transfer of the member's practice and obtain~~ **Submit a written request to each client, subject to the sale or transfer, requesting** the client's consent prior to transferring its files to the successor firm and, ~~in addition,~~ notify the client that its consent ~~will~~ **may** be presumed if it does not respond **to the member's request** within 90 days. **The member should not transfer any client files to the successor firm until the client's consent is obtained or until the 90 days has lapsed, whichever is shorter. The member is encouraged to retain evidence of consent, whether obtained from the client or presumed after 90 days.**

b. With respect to files not **subject to the sale or transferred**, make arrangements to return any client records that the member is required to provide to the client as set forth in the "Records Requests" interpretation [1.400.200] unless the member and client agree to some other arrangement.

.02 In cases in which the member is unable to contact the client, client files and records not transferred should be retained in a confidential manner and in accordance with the firm's record retention policy ~~and~~ **or as required by** applicable legal or regulatory requirements, whichever is longer. When practicing before the IRS or other taxing authorities or regulatory bodies, members should ensure compliance with any requirements that are more restrictive.

#### **Discontinuance of Member's Practice**

.03 A member who discontinues his or her practice but does not sell or transfer the practice to a successor firm, should do all of the following:

a. Notify each client in writing of the discontinuance of the practice. **The member is encouraged to retain evidence, in accordance with the firm's record retention policy, of notification made to clients. The member is not required to provide notification to former clients of the firm.**

b. Make arrangements to return any client records that the member is required to provide to the client as set forth in the "Records Request" interpretation [1.400.200] unless the member and client agree to some other arrangement.

.04 In cases in which the member is unable to contact the client, client files should be retained in a confidential manner and in accordance with the firm's record retention policy or **as required by** applicable legal or regulatory requirements, whichever is longer. When practicing before the IRS or other taxing authorities or regulatory bodies, members should ensure compliance with any requirements that are more restrictive.

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### **Acquisition of Practice by a Member**

- .05 A member who acquires all or part of a practice from another person, firm, or entity (predecessor firm) should be satisfied that all clients of the predecessor firm subject to the acquisition ~~have been notified of the acquisition and~~ have consented to the member's continuation of professional services and retention of any client files or records the successor firm retains.
- .06 A member would be considered in violation of the "Acts Discreditable Rule" [1.400.001] if the member does not comply with **any of** the requirements of this interpretation.

### **Effective Date**

- .07 [TBD]

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## Agenda Item 2C

[Additions appear in bold italic and deletions are stricken]  
Revisions to the Exposed Interpretation Are **Highlighted**

### **1.700.050 Disclosing Client Information in Connection With a Review or Acquisition of the Member's Practice**

- .01 For purposes of the "Confidential Client Information Rule" [1.700.001], a review of a *member's* professional practice includes a review performed in conjunction with a prospective purchase, sale, or merger of all or part of a *member's* practice. Such reviews may *threaten* a *member's* compliance with the "Confidential Client Information Rule." To reduce the *threat* to an *acceptable level*, a *member* must take appropriate precautions (for example, through a written confidentiality agreement with the prospective purchaser) to help ensure that the prospective purchaser does not disclose any *confidential client information* obtained in the course of the review.
- .02 *Members* who perform such reviews ~~shall~~**should** not use to their advantage or disclose any *confidential client information* that comes to their attention during the review.
- .03 ***Members who obtain client files as the result of acquiring all or part of another member's professional practice should not disclose any confidential client information contained in such files. Members should refer to the "Transfer of Files and Return of Client Records in Sale, Transfer or Discontinuance or Acquisition of Member's a Practice" interpretation under the "Acts Discreditable Rule" for guidance on the retention of related to client files obtained through acquiring a practice.***

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## Agenda Item 2D

### Draft Related FAQs

#### Form of Communication

**Question.** The “Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice” interpretation [1.400.2015] requires certain communications to the client be in writing. Would electronic communications such as email be an acceptable form of communication?

**Answer.** Yes, provided the client uses electronic communication as part of its normal course of business communications. [July 2016]

#### Transfer of Client Files to Another Partner in the Firm

**Question.** When a partner leaves a firm and his or her clients are transferred to another partner in the firm, do the requirements of the “Transfer of Files and Return of Client Records in Sales, Transfer, Discontinuance or Acquisition of Practice” interpretation need to be applied?

**Answer.** No. In such situations the ownership of the firm has not been transferred outside of the firm, rather the clients have only been reassigned to a different partner in the firm. [July 2016]

COMMENT SUMMARY

PROPOSED NEW AND REVISED INTERPRETATIONS

Transfer of Files and Return of Client Records in Sale, Transfer or Discontinuance of Member’s Practice  
 Disclosing Client Information in Connection With a Review or Acquisition of the Member’s Practice

Comment Letter	Feedback Highlights
<p><a href="#"><u>CL 1</u></a> California State Board of Accountancy</p> <p><b>Support</b></p>	<p>CBA Regulation section 54.1(a)(4) provides an exception to prohibited disclosure of confidential information made by a licensee or licensee’s duly authorized representative to another licensee in connection with a proposed sale or merger of the licensee’s professional practice. Since the exposure draft goes beyond the current requirements of CBA Regulations, if the proposals are adopted the CBA regulations may need to be revised to cover these additional areas since CBA Regulation section 58 requires licensees to comply with all applicable professional standards. The areas that may require expansion are:</p> <ul style="list-style-type: none"> <li>• Notification in writing of the sale or transfer of a licensee’s practice</li> <li>• Require arrangements are made to return any client records that the licensee is required to provide to the client</li> <li>• In the case of a discontinuance of a licensee’s practice without a sale or transfer of the practice to a successor firm, the licensee should:                         <ul style="list-style-type: none"> <li>○ Notify each client in writing</li> <li>○ Make arrangements to return clients records</li> </ul> </li> <li>• Ensure the acquiring practice is satisfied the selling firm (predecessor firm) has notified all clients of the sale or transfer</li> </ul> <p>So that a conflict does not exist for CA licensees, recommend a 2 year delayed effective date so that the CBA has adequate time to amend their regulations. They note that it typically takes 12-18 months to implement new regulations.</p>
<p><a href="#"><u>CL 2</u></a> Florida Board of Accountancy</p>	<p>The Board agrees with the proposals and recommends that paragraph .03 of 1.700.050 be revised to permit disclosure of such information when required by law or judicial order.</p>

Comment Letter	Feedback Highlights
<p><b><i>Support with Recommendation</i></b></p>	
<p><b><u>CL 3</u></b> NYSSCPA Ethics Committee</p> <p><b><i>Support with Recommendations</i></b></p>	<p><b>Transfer of Files and Return of Client Records in Sale, Transfer or Discontinuance of Member’s Practice</b></p> <p>The proposed interpretation allows the client 90 days to respond to the member’s written notification of the sale or transfer of the member’s practice. The NYSSCPA believes that a second notification should be sent to clients who do not respond except in those circumstances in which the initial notification was undeliverable. We realize that the addition of such a requirement would extend the member’s uncertainty as to what to do with the records to six months. We do not believe that this is reasonable. Therefore, we suggest that the PEEC consider reducing the timeframe to 45 days with the additional requirement of sending a second notification at the end of that period, except as described above. We believe that 45 days is consistent with the requirements of Section 1.400.200 <i>Records Requests</i> of the <i>Code of Professional Conduct</i> and is a reasonable period of time for the client to respond.</p> <p>As to the form of the written notice, we believe that this requirement should include the use of email communication. While people may move, they tend not to change their email accounts. Allowing the use of email communication may reduce the number of notices that are unable to be delivered.</p> <p>The NYSSCPA generally agrees that a member should maintain, in a confidential manner, any client files that are not transferred or are unable to be returned to the client in accordance with their firm’s record retention policy and applicable legal or regulatory requirements, but requests that the PEEC perhaps give consideration to potential impracticalities caused by extraordinary unforeseen circumstances such as a catastrophic illness.</p> <p>In addition, we suggest that the phrase “whichever is longer” in paragraphs 1.400.205.01 and 1.400.205.02 be changed to “for the longer of the time periods specified therein.”</p>

Comment Letter	Feedback Highlights
	<p>Finally, The NYSSCPA believes that the effective date of the proposed interpretation should be deferred for three months after the end of the month in which the Interpretation appears in the <i>Journal of Accountancy</i> to allow members time to establish firm policies in order to comply with the interpretations.</p> <p><b>Disclosing Client Information in Connection with a Review or Acquisition of the Member’s Practice</b>  The NYSSCPA believes that this area is covered sufficiently in Section 1.700.001 <i>Confidential Client Information Rule</i> and extant Interpretation 1.700.050 <i>Disclosing Client Information in Connection with a Review of the Member’s Practice</i>. When a member or firm obtains a client’s files through the acquisition of another member’s practice, the client becomes a client of the successor member or firm. The member or members of that firm are bound thereafter by the requirements of Rule 1.700.001. We do not believe that this requires additional clarification.</p>
<p><a href="#">CL 4</a> NASBA</p> <p><b><i>Support with Recommendations</i></b></p>	<p><b>Transfer of Files and Return of Client Records in Sale, Transfer or Discontinuance of Member’s Practice</b>  NASBA supports the requirement that a member should provide written notice to clients on the sale, transfer or discontinuation of a member’s practice. They also recommend that language be added to 1.400.205.01 that requires a member to retain proof of such notification and whether consent was obtained from the client or consent was presumed when the client did not respond within 90 days. Such proof would be retained for the same period as specified in paragraph 2 of the section.</p> <p>NASBA also cautions that the proposed assumption of consent premised upon a client’s 90 days of silence might be contrary to the majority of states’ rules on confidentiality. Most states require client consent. Some require “specific consent.” A few exempt disclosures to “another licensee in connection with a proposed sale or merger of the licensee’s professional practice” (e.g. California).</p>

Comment Letter	Feedback Highlights
	None currently provide for implied consent such as proposed in the Exposure Draft.
<p><a href="#"><u>CL 5</u></a> Indiana CPA Society Ethics Committee</p> <p><b><i>Support With Recommendations</i></b></p>	<p>The Committee does not believe it is practical to allow a 90 day waiting period to obtain consent from every client and believes a 30 day period should be sufficient, or 60 days at a maximum. In addition, with respect to paragraph .03 of 1.400.205 the Committee believes it would be helpful to clarify what is mean by the phrase “should be satisfied”. For example, the Committee asks if there is a presumption that notification has been made and consents have been acquired or are there steps that need to be taken by the successor to be “satisfied”?</p>
<p><a href="#"><u>CL 6</u></a> Baker Tilly Virchow Kraus</p> <p><b><i>Support With Recommendations</i></b></p>	<p>In general we agree with the underlying premise of the guidance and the importance of complying with the client confidentiality requirements of ET 1.700.001. However, we do have significant concerns about the timing proposed in the ED. As currently written in 1400.205.01 (a), the proposal states: “...and obtain the client’s consent <b>prior to transferring its files</b> to the successor firm...”</p> <p>In a typical transaction, the selling firm’s client files are an asset to be transferred to the acquiring firm at closing. Therefore as written, the buyer would need to contact all clients of the target prior to closing and obtain permission. Moreover, the proposal states absent an affirmative response from the client, the passage of 90 days will be sufficient for the buyer to assume approval of the transfer. As such, the clients would need to be notified at least 90 days in advance of the proposed closing.</p> <p>In today’s world, of accounting mergers, a deal is never over until it’s over. Moreover, the impact of advance notice on existing client relationships can be very negative. Most target firms are reluctant to notify clients until very near the closing date. We suggest that a better way to approach this would be to require the acquiring firm to notify the clients as soon as reasonably possible after the closing and, absent specific consent to the transfer, refrain from accessing or using the client records for a period of 90 days.</p> <p>We believe this would achieve the goal of maintaining client confidentiality while not impeding commerce related to accounting firm transactions.</p>

Comment Letter	Feedback Highlights
	<p>With respect to the second requirement, in 1.400.205.01 (b), we request clarification as to how a client is defined. If the interpretation is meant to apply only to active clients, then it may be manageable (see further comment below), but if this is meant to include inactive clients, it will be extremely burdensome for firms to comply. Accounting clients come and go and it has been standard practice for firms to retain files related to inactive clients, generally in accordance with their document retention policy, unless a request is made for a return of records. In those cases firms would follow the guidance provided in ET 1.400.200 and return records which are required to be returned. Currently there is no requirement for firms to voluntarily return records if the client terminates its relationship with the firm. We do not believe returning records that have not been requested, just because of the merger transaction and a client's decision not to continue with the acquirer firm, is necessary.</p> <p>As to the concept in ET 1.400.205.03 that an acquirer "...should be satisfied that all clients of the predecessor firm subject to the acquisition have been notified of the acquisition and have consented to the member's continuation of professional services and retention of any client files or records the successor firm retains." We request that the concept of "satisfied" be more clearly articulated or the terminology changed to something like the firm should use best efforts in complying with the requirements in ET 1.400.205.01 (a).</p>
<p><b><u>CL 7</u></b> Society of Louisiana of CPA - Members of the Ethics Committee</p> <p><b><i>Support With Recommendations</i></b></p>	<p><b>Comment # 1</b></p> <p>I am basically in agreement with the ED relating to the Proposed Interpretation "Transfer of Files and Return of Client Records in Sale, Transfer, or Discontinuance of Member's Practice" except as follows:</p> <p><i>I believe that a member that has transferred or sold a practice should notify in writing all clients. I also feel that the member should obtain, in writing, consent to transfer their files and records to a successor firm. However, I believe that if a client does not respond or the member is unable to contact or find that client, that their information should not be transferred. I feel that it is incorrect to presume</i></p>

Comment Letter	Feedback Highlights
	<p><i>that a client consents just because the client has not responded within a 90-day period. Situations could occur where a client is unable to respond within that time period. Failure to obtain written consent from a client of a predecessor firm should require that the records and confidential information not be transferred or disclosed to any other member firm, but should be retained in accordance with the predecessor firm's record retention policy and/or applicable legal or regulatory requirements, whichever is longer.</i></p> <p>Section 1.400.205.03 states "A member who acquires all or part of a practice from another person, firm or entity (predecessor firm) should be satisfied that all clients of the predecessor firm subject to the acquisition have been notified of the acquisition and have consented to the member's continuation of professional services and retention of any client files or records the successor firm retains. <i>I believe it would be helpful to expand on this notification and provide examples of what the successor firm should do to be "satisfied" that this requirement has been met.</i></p> <p><b>Comment # 2</b> I am in agreement with the ED relating to the Revised Interpretation "Disclosing Client Information in Connection With a Review or Acquisition of the Member's Practice."</p> <p><b>Comment # 4</b> <b>1.400.205, Transfer of Files:</b> I generally concur with the proposed standard. However, I wonder if it is intended to address circumstances in which the member does not retain ownership or control of the client files, but either becomes an employee of the successor firm or contracts with the successor firm to continue servicing selected clients. If it is intended to address that situation, a statement to that effect might be appropriate. If not, what would the Committee see as the member's responsibility in those circumstances?</p>

Comment Letter	Feedback Highlights
	<p>Also, the proposal does not address the death of a member, in particular, a sole practitioner. Should such a member make some provision for the transfer of client files from his or her estate, or some provision for maintaining the confidentiality of client records after he or she dies? Should the proposal at least include some guidance to a successor firm who might seek to acquire client records from the deceased member's estate?</p> <p><b>Comment # 5</b>  <b>1.700.050 Disclosing Client Information</b>  I concur with the proposal.</p>
<p><b><u>CL 8</u></b> Texas Society of Certified Public Accountants Professional Standards Committee</p> <p><b>Support</b></p>	<p>Do not believe a delayed effective date is necessary.</p>
<p><b><u>CL 9</u></b> Technical Issues Committee</p> <p><b>Support With Recommendations</b></p>	<p><b>Disclosing client information regarding a transfer of practice:</b> TIC believes it is reasonable to presume client consent to transfer records when the predecessor member does not receive a client response within 90 days. However, TIC anticipates an issue for sole practitioners and their clients when practice continuation events are triggered by death or disability. In these cases, the member may be incapable of providing written notice to his/her clients. Under these conditions, the acquiring member may need to be the person to contact the acquired firm's clients, or a surviving representative (such as a non-CPA spouse or attorney) or agent of the disabled or deceased member may have to provide such notice.</p> <p>TIC recommends additional guidance in the final interpretation to address a member's inability to provide notice due to death or disability. The proposed guidance currently requires the member to provide the notice and does not allow for an agent of the member to do so in extenuating circumstances.</p>

Comment Letter	Feedback Highlights
	<p><b>Disclosing client information in connection with a review or acquisition of the member’s practice:</b> TIC believes it is reasonable to expand the existing confidentiality of client information interpretation to require members who obtain client files as a result of acquiring all or part of a member’s practice to not disclose any confidential client information contained in those files.</p>
<p><a href="#"><u>CL 10</u></a> KerberRose</p> <p><b><i>Support With Recommendations</i></b></p>	<p>KerberRose feels the ED is not practical based on our experience. The confidential nature of the sale or a merger does not allow a ninety-day period to be practical. There is concern surrounding client and staff reactions. The reality for our firm has been that the notification is provided, at the outside, within thirty days prior to the effective date of the sale.</p> <p>A ninety-day period is too restrictive because it will not allow the transfer of files to occur in a timely manner. Many of the sales or mergers happened close to the end of the year. The ninety-day period will hinder the conversion of files when necessary, for example from one tax software to another tax software. It is critical the files be converted prior to January 1 or the “busy” season starting. It is not practical to backup and send numerous files to the software company at different points in time for conversion. If this becomes necessary, the cost to the buyer and seller will increase.</p> <p>The ninety-day period also has the potential to negatively impact the service a client receives. Normally, there is a need for computer systems and servers to be replaced. In a firm such as ours, when there is a wide area network, the files need to be transferred to our data storage servers. This is especially critical when we are acquiring or merging a firm in a new location. Normally, the access to the old servers is limited and the data is placed on our servers. If the staff cannot access the data needed to service the client, the client experience will be negatively impacted and the client will be frustrated.</p>

Comment Letter	Feedback Highlights
	<p><b>Disclosing client information regarding a transfer of practice:</b> KerberRose believes it is reasonable to presume client consent to transfer records when the predecessor member does not receive a client response within 30 days.</p> <p>We anticipate an issue for sole practitioners and their clients when practice continuation events are triggered by death or disability. In these cases, the member may be incapable of providing written notice to his/her clients. In this case, the acquiring member may need to be the person to contact the acquired firm's clients, or a surviving representative (such as a non-CPA spouse or attorney) or agent of the disabled or deceased member may have to provide such notice. The proposed guidance currently requires the member to provide the notice and does not allow for an agent of the member to do so in extenuating circumstances. We suggest guidance be added to address this situation.</p> <p>In addition, we sign confidentiality and nondisclosure agreements as part of the merger or acquisition process. In all cases, due diligence includes reviewing selected files to determine the quality of the work being performed. It is not possible to obtain permission from the client prior to the performance of due diligence. We believe this is outside the scope of the ED as we are not retaining client files at that time. We are simply reviewing the files at the other firm's location.</p> <p><b>Disclosing client information in connection with a review or acquisition of the member's practice:</b> KerberRose believes it is reasonable to expand the existing confidentiality of client information interpretation to require members who obtain client files as a result of acquiring all or part of a member's practice to not disclose any confidential client information contained in those files. This is already common practice in our firm.</p>
<p><a href="#">CL 11</a> Moss Adams</p>	<p>We are concerned about the timing of client notification and transfer of client records in relation to a sale or merger transaction closing date, considering that the transfer of client records typically occurs at the date of closing. Transactions</p>

Comment Letter	Feedback Highlights
<p><b><i>Support With Recommendations</i></b></p>	<p>involving the sale or merger of a member’s practice are often sensitive in nature, and a member selling or merging his or her practice typically prefers to notify clients only very near the closing date. However, the proposed Interpretation essentially would require the selling/transferring member to notify clients 90 days prior to an estimated closing date so that, in the absence of client response, the 90-day window has passed and the selling/transferring member is in a position to transfer the client records at closing.</p> <p>This potential length of advance notice a firm would need to provide of its sale or merger could have significant negative effects on the relationship between the client and the selling/transferring member. Such notification could place undue stress on the performance of services currently underway, as well as potentially result in the disruption of service, to the detriment of the client. Further, given that a transaction closing date sometimes can be difficult to precisely predict, in light of many other moving pieces, this requirement could present unnecessary challenges and potential delay in executing a sale or merger transaction. Finally, there could be circumstances in which the death or incapacity of a predecessor member makes it impossible for him or her to notify clients and obtain permission before transferring files to a successor firm. We recommend that the PEEC allow the successor firm to be an option for accomplishing the notification to the predecessor member’s clients, while preserving the confidentiality of client information until permission is received.</p> <p>In tandem with the requirements pertaining to the predecessor firm, the proposed Interpretation describes the responsibility of a member acquiring all or part of a practice (the successor firm) (1.400.205.03). Specifically, the proposal states that the successor firm “should be satisfied” that clients of the predecessor firm have been notified of the acquisition and have consented to the member’s continuation of professional services and retention of any client files or records the successor firm retains. There may be practical limitations to the actions the successor firm is able to take to obtain such satisfaction, in particular in cases when the predecessor member was unable to provide such</p>

Comment Letter	Feedback Highlights
	<p>notification (for example, due to death or disability) or when the predecessor member did not retain records of notification or consent. We recommend that the PEEC clarify the intended meaning of the phrase “should be satisfied”, and we suggest that it be based in the concept of applying “best efforts” to comply with the stated requirements.</p>
<p><a href="#">CL 12</a> Grant Thornton</p> <p><b><i>Support With Recommendations</i></b></p>	<p><b>Proposed Interpretation [1.400.205]: “Transfer of Files and Return of Client Records in Sale, Transfer or Discontinuance of Member’s Practice”</b></p> <p>A <i>member</i> is defined in the AICPA Code [0.400.31 Definitions] as “a member, associate member, affiliate member, or international associate of the AICPA.” However, Proposed Interpretation [1.400.205] appears to address a single practitioner, and not the sale, transfer, or discontinuance, of a member’s firm’s practice. If this is for a sole practitioners only, it would be best to address upfront in Proposed Interpretation [1.400.205]. It is unclear whether <i>member</i> also means a member’s firm. If so, the implications of how this would affect a large accounting firm should be considered. Guidance may also need to be provided in order to show how a large firm might address the requirements in a timely and practical fashion given the potential volume of information that may need to be identified and communicated, and the number of clients that may need to be addressed.</p> <ul style="list-style-type: none"> <li>• Proposed Interpretation [1.400.205.01] (“proposed interpretation”) addresses selling or transferring all or part of the member’s practice to “another person.” However, it is unclear whether the proposed interpretation will apply when it is a firm, and not an individual member, who has the clients. For example, would the requirements of this interpretation apply under any one of the following situations? <ul style="list-style-type: none"> <li>○ A partner is leaving the firm, and the clients assigned to him or her are now transferred to another partner in the firm.</li> <li>○ A partner did not leave the firm; however, another partner now manages his or her clients, and the original partner now manages different clients.</li> <li>○ Only one client is transferred to another partner in the firm.</li> </ul> </li> <li>• The second paragraph of the proposed interpretation addresses</li> </ul>

Comment Letter	Feedback Highlights
	<p>maintaining client files in a confidential manner when the client could not be contacted and in accordance with the “firm’s record retention policy.” The proposed interpretation addresses a firm’s, and not the member’s, retention policy. Reference to the firm, and not the member, is also noted in Proposed Interpretation [1.400.205.02]. We believe consideration should be given to situations such as the death of a member, or when either a member or a member’s firm files for bankruptcy. In these situations, no firm remains to keep client files in a confidential manner for the applicable retention period. The client files may be maintained by a trustee, the courts, or next of kin.</p> <ul style="list-style-type: none"> <li>• Under Proposed Interpretation [1.400.205.03], it is not clear what the successor’s responsibility is if the predecessor member or firm could not notify the client in order to gain consent for the successor to continue predecessor services and retain that client’s files. In addition, further clarification is needed on the concept of “satisfied.”</li> <li>• Proposed Interpretation [1.400.205.04] considers noncompliance with the requirements a violation of the “Acts Discreditable Rule” [1.400.001]. Grant Thornton recommends that PEEC consider further clarifying Proposed Interpretation [1.400.205.04].</li> <li>• Grant Thornton requests that PEEC consider clarifying whether Proposed Interpretation [1.400.205] does not take into consideration records of former clients when there is a sale or discontinuance of a member’s practice.</li> <li>• In addition, Grant Thornton requests that PEEC consider developing nonauthoritative guidance in the format of a practice aid, examples, or FAQs to assist members in better understanding the application of the proposed and revised interpretations.</li> </ul> <p><b>Revised Interpretation [1.700.050]: “Disclosing Client Information in Connection With a Review or Acquisition of the Member’s Practice”</b>  The addition of paragraph .03 to Revised Interpretation [1.700.050] (“revised</p>

Comment Letter	Feedback Highlights
	<p>interpretation”) references Proposed Interpretation [1.400.205] for guidance on the retention of client files obtained through acquiring a practice. However, Proposed Interpretation [1.400.205] only refers to having consent from the client to continue with professional services and to retain client’s files, but does not provide “guidance” on the retention of those files. We would suggest providing additional guidance within paragraph .03 itself, rather than referencing Proposed Interpretation [1.400.205]. It is also unclear whether noncompliance with this revised interpretation would also be a violation of the “Acts Discreditable Rule” [1.400.001].</p> <p><b>Effective Date</b> Do not believe a delayed effective date is necessary if firms have policies and procedures in place relating to confidential client information.</p>

**Contingent Fees and Commissions and Referral Fees Task Force**

**Task Force Members**

Laurie Tish (Chair), Jana Dupree, Larry Shapiro and Tom Campbell

Ellen Gorla (Staff)

**Task Force Charge**

This Task Force will consider the need to revise the Code to expand the prohibition of acceptance of commissions or contingent fees for all attest engagements.

**Reason For Agenda**

To review the twelve comment letters received regarding the proposed new interpretation “Disclosure of a Commission and Referral Fee” (**Exhibit A**) and adopt the interpretation.

A separate file consolidating the comments received along with links to the individual letters has been prepared. Each comment letter has been assigned a number that corresponds to the comment letter summary.

**Summary of Issues**

***Not Supportive***

Comment #3 of [CL 7](#) believes that a member that has notified a client, whether orally or in writing has met the requirement as established by the AICPA. This individual believes that requiring more written documentation just adds requirements and additional work that is not necessarily cost justified. This individual questions if this additional requirement is really deemed necessary because if it is, then one could certainly argue that we should require considerably more disclosures being in writing. Every time a standard implements a new requirement of written documentation, the cost of an engagement increases. This is one situation that the individual feels does not justify the additional time and money.

The Task Force continues to believe it would be in the public’s interest if the disclosure is made in writing.

**Question for Committee:**  
 1. Does the Committee believe any revisions are necessary for this comment?

***Additional Written Disclosures***

Comment #6 of [CL 7](#) concurs with the proposal but asks why the same requirement to disclose in writing should not apply to disclosure of a conflict of interest and the related permission. This individual believes commissions and referral fees are akin to conflicts of interest and so the rule should be the same in both cases especially if the Committee believes getting things in writing is best practice.

Staff notes that when the Conflicts of Interest interpretation was recently revised, this issue was discussed at length and was decided not to require the conflicts of interest disclosure be in writing.

**Question for Committee:**  
 1. Does the Committee believe the disclosure required by the conflicts of interest interpretation should be done in writing?

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### **Proof**

[CL 4](#) recommends that language be added that requires a member to retain proof of such written disclosure. Such proof would be retained for the same period as required for other client records.

The Task Force notes that the written disclosure may be done in a document that is part of the client records (e.g., engagement letter), and hence would be retained. The Task Force does not believe it is necessary to make this an explicit additional requirement. If, however, the Committee believes it would be helpful to require members obtain proof, it could add language such as the following to the interpretation:

#### **1.520.080 Disclosure of a Commission and Referral Fee**

**.01** The member should make the disclosures required by paragraphs .03 and .04 of the “*Commissions and Referral Fees Rule*” [1.520.001] in writing. **Members are encouraged to retain a copy of the written disclosure in accordance with the firm’s record retention policy or as required by applicable legal or regulatory requirements, whichever is longer.**

**Question for Committee:**

1. Does the Committee believe members should be required to retain proof of written disclosure?

### **Location of Requirement**

[CL 12](#) believes the requirement for the disclosure to be in writing should appear in the Rule not in a separate interpretation. While Staff agrees that would be ideal, the PEEC does not have the ability to revise the Rule, rather can only propose how to interpret the Rule. In order for the Rule to be edited, a membership ballot would be necessary. The Task Force does not believe the change requires a membership ballot.

**Question for Committee:**

2. Does the Committee agree that it does not want to pursue a membership ballot for this guidance?

### **Editorial Suggestion**

[CL 3](#) recommends that the title of the interpretation should be changed to *Disclosure of Commissions and Referral Fees* so that it is consistent with Section 1.520.001 *Commissions and Referral Fees Rule*. The Task Force incorporated this change into the proposal.

**Question for Committee:**

3. Does the Committee believe the title should be changed?

### **Delayed Effective Date**

[CL 2](#) and [CL 12](#) do not believe a delayed effective date is necessary. Alternatively, [CL 3](#) recommends a 3 month delayed effective date to allow members time to establish firm policies in order to comply with the interpretation. [CL 9](#) and [CL 10](#) also recommend a delayed effective date noted that it may take one CPE cycle for a member to learn about the new written disclosure requirement of commission and referral fee arrangements in the states that currently permit verbal disclosure. In addition, [CL 9](#) notes that some states may want or need to update their administrative code to reflect the written requirement.

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The Task Force notes that when the Nonattest Services interpretation was revised back in the early 2000s to incorporate a number of new requirements, including the written documentation requirement, a 3 month delayed effective date was provided. In addition, a 1 year transition period was provided. Following is an excerpt from the Basis for Conclusion document that describes the Committee's rationale:

Given the nature of the revisions to the Interpretation, the Committee decided to adopt an effective date of December 31, 2003 to allow members a three-month period (from date of publication in the *Journal of Accountancy*) to transition to the new rules. Earlier application is permitted. In addition, the Committee decided that members who have arrangements in place on December 31, 2003 to provide their attest clients nonattest services that are effectively prohibited under the Interpretation will have until December 31, 2004 to complete those services provided that the member is in compliance with the preexisting requirements of this Interpretation.

The Task Force recommends that a three month delayed effective date be provided. In speaking with the Journal of Accountancy staff, if the Committee adopts this interpretation at the July meeting, the interpretation will appear in the October Journal of Accountancy. Following is the Task Force's recommendation:

***Effective Date***  
***Effective for commission or a referral fee arrangements entered into on or after January 31, 2017.***

**Question for Committee:**

4. Does the Committee agree with the delayed effective date recommended by the Task Force?

***Action Needed***

The Task Force will develop its recommendations to the

***Materials Presented***

- Agenda Item 3B** Disclosure of Commissions and Referral Fees  
**Agenda Item 3C** Comment Letter Summary

[Revisions From the Exposed Interpretation Appear in Highlight]

**1.520.080 Disclosure of a Commission<sup>s</sup> and Referral Fees<sup>s</sup>**

.01 The member should make the disclosures required by paragraphs .03 and .04 of the “*Commissions and Referral Fees Rule*” [1.520.001] in writing.

***Effective Date***

***.02 Effective for commission or a referral fee arrangements entered in to on or after January 31, 2017.***

COMMENT SUMMARY  
 PROPOSED NEW INTERPRETATION  
 Disclosure of a Commission and Referral Fee

Comment Letter	Feedback Highlights
<p><a href="#"><u>CL 1</u></a> California State Board of Accountancy  <b>Support</b></p>	<p>California Code of Regulations (CBA Regulations) section 56(c) requires written disclosure on letter head of the licensed firm or signed by the licensee.</p>
<p><a href="#"><u>CL 2</u></a> Florida Board of Accountancy  <b>Support</b></p>	<p>The Florida Board of Accountancy does not believe a delayed effective date is necessary.</p>
<p><a href="#"><u>CL 3</u></a> NYSSCPA Ethics Committee  <b>Support with Recommendations</b></p>	<p>The NYSSCPA is in agreement with the PEEC that disclosure should be in writing. However, to be consistent with Section 1.520.001 <i>Commissions and Referral Fees Rule</i>, we believe that the title of the interpretation should be changed to <i>Disclosure of Commissions and Referral Fees</i>.</p> <p>In addition, to allow members time to establish firm policies in order to comply with the interpretation, the ethics committee believes that the effective date should be deferred for three months after the end of the month in which the Interpretation appears in the <i>Journal of Accountancy</i>.</p>
<p><a href="#"><u>CL 4</u></a> NASBA  <b>Support with Recommendation</b></p>	<p>NASBA supports the requirement that commissions and referral fees be disclosed in writing to a member’s client. We recommend that language be added that requires a member to retain proof of such written disclosure. Such proof would be retained for the same period as required for other client records.</p>
<p><a href="#"><u>CL 5</u></a> Indiana CPA Society Ethics Committee  <b>Support</b></p>	<p>The Committee did not have any specific comments on this proposal.</p>

Comment Letter	Feedback Highlights
<p><a href="#">CL 7</a> Society of Louisiana of CPA - Members of the Ethics Committee</p> <p><b>Mixed</b></p>	<p><b>Comment # 3</b> I do not agree with the ED relating to the Explanation for the Proposed Interpretation “Disclosure of a Commission and Referral Fee” due to the following:</p> <p><i>I believe that a member that has notified a client, whether orally or in writing has met the requirement as established by the AICPA. I feel that requiring more written documentation just adds requirements and additional work that is not necessarily cost justified. Naturally, documenting items in written form provides better documentation than orally. However, is this additional requirement really deemed necessary because if it is, then one could certainly argue that we should require considerably more disclosures being in writing. Every time a standard implements a new requirement of written documentation, the cost of an engagement increases. This is one situation that I feel does not justify the additional time and money.</i></p> <p><b>Comment # 6</b> <b>1.520.080 Disclosure of a Commission and Referral Fee</b> I concur with the proposal. However, I wonder why the same requirement to disclose in writing should not apply to disclosure of a conflict of interest and the related permission. As akin as commissions and referral fees are to conflicts of interest, the rule should be the same in both cases. If we believe that getting things in writing is best practice, why shouldn't we require it?</p>
<p><a href="#">CL 8</a> Texas Society of Certified Public Accountants Professional Standards Committee</p> <p><b>Support</b></p>	<p>No specifics provided.</p>
<p><a href="#">CL 9</a> Technical Issues Committee</p>	<p>TIC believes it is reasonable to require permitted commissions and referral fees in writing, as it is already required in many states.</p>

Comment Letter	Feedback Highlights
<p><b>Support</b></p>	<p>TIC believes a delayed effective date may be necessary, as it may take one CPE cycle for a member to learn about the new written disclosure requirement of commission and referral fee arrangements in the states that currently permit verbal disclosure. In addition, some states may want or need to update their administrative code to reflect the written requirement.</p>
<p><a href="#">CL 10</a> KerberRose</p> <p><b>Support</b></p>	<p>We believe it is reasonable to require permitted commissions and referral fees in writing, as it is already required in many states. We believe a delayed effective date may be necessary, so members have an opportunity to learn about the new requirements within a typical CPE cycle.</p>
<p><a href="#">CL 12</a> Grant Thornton</p> <p><b>Support With Recommendation</b></p>	<p>Grant Thornton agrees with PEEC that disclosure of a commission and/or referral fee should be in writing to the person or entity to whom the member recommends or refers a product or service, or when a member who accepts or pays a referral fee discloses such fee to the client. However, we believe that adding the requirement that this disclosure should be in writing does not require the exposure of a new interpretation, but can be added to paragraphs .03 and .04 of the “Commissions and Referral Fees Rule.” [1.520.001].</p> <p>Do not believe a delayed effective date is necessary if firms have policies and procedures in place relating to commissions and referral fees.</p>

## Leases Task Force

### Task Force Members

Blake Wilson (Chair), Bill Mann, Alan Gittelson, David East, Nancy Miller, Chris Cahill  
Staff: Brandon Mercer

### Task Force Charge

Revise the independence guidance based upon the revised accounting standards on leases issued by the Financial Accounting Standards Board (FASB).

### Reason for Agenda Item

At the May 2016 PEEC meeting, the Leases Task Force (the “Task Force”) presented highlights of its preliminary discussions regarding leases and independence and received feedback on its preliminary approach. The Task Force held a conference call in June 2016 to further discuss the feedback received from PEEC and further evaluate the need for revisions to the AICPA Code of Professional Conduct (the “Code”). The purpose of this agenda item is to update PEEC on the Task Force’s discussions and obtain further direction from PEEC on several key issues as noted below and in the Actions Needed section of this agenda.

### Background

The extant AICPA Code addresses leasing arrangements and independence at the Leases Interpretation (1.260.040), which is presented in this agenda and in **Agenda Item 4C**. As noted in the Leases Interpretation, a primary factor in evaluating independence is whether a lease is categorized as a capital lease (impairs independence) or operating lease (does not impair independence). As explained below, the FASB Update changed the accounting treatment of operating leases by moving them to the statement of financial position; previously operating leases were treated as a current operating expense.

### FASB Audit Standards Update No. 2016-02: Leases

In February 2016, FASB issued Audit Standards Update No. 2016-02 *Leases* (the “Update”), which, among other things, contained significant changes to the lessee accounting model for operating leases, while leaving the lessor’s accounting treatment largely unchanged. This and other changes are highlighted for both lessees and lessors below. The Update is effective for fiscal years beginning after December 15, 2018 (public companies) and December 15, 2019 (private companies). In the Update, FASB defines a lease as: *a contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. Control over the use of the identified asset means the customer has both (1) the right to obtain substantially all of the economic benefits from the use of the asset and (2) the right to direct the use of the asset.* Under the FASB Update, lessees will classify leases as short term leases, operating leases, or finance leases. *A short term lease* is a lease with terms of twelve (12) months or less which does not include an option to purchase that the lessee is reasonably certain to exercise (ASU par. 842-20-15-1). If a lease is classified as a short term lease, the lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. *Operating leases* are required to be reported on the balance sheet under the Update. Operating leases are all non-short term leases that do not meet the criteria for finance leases at ASU Paragraph 842-10-25-2 (see below). A “*finance lease*” is a lease that meets one of essentially the same criteria as capital leases under prior GAAP: (a) lease transfers ownership

by end of lease term; (b) lease contains a purchase option that is reasonably certain to be exercised; (c) lease term is a major part [formerly 75%] of the remaining economic life of the asset; (d) the present value of the sum of lease payments and residual value guaranteed by the lessee equals or exceeds substantially all [formerly 90%] of the fair value of the asset; or (e) the asset has no alternative use to the lessor at the end of the lease term. If the lease is classified as finance lease, the lessee is required to recognize a right-of-use asset and a lease liability. Most current capital leases will be finance leases under the Update.

#### AICPA Code – Extant Leases Interpretation and Definition of a Loan

**Agenda Item 4C** presents all instances of the terms “lease,” “leases,” and “leasing” in the AICPA Code. The extant Leases Interpretation indicates that a lease would not impair independence if it meets the criteria of an operating lease and is under comparable terms and all amounts are paid in accordance with the lease. The Leases Interpretation further indicates that a capital lease would be considered a loan and would impair independence:

#### **1.260.040 Leases**

**.01** If a *covered member* enters into a leasing agreement with an *attest client* during the *period of the professional engagement*, the self-interest *threat* would be at an *acceptable level* and *independence* would not be *impaired* if all the following *safeguards* are met:

- a. The lease meets the criteria of an operating lease (as described in GAAP).
- b. The terms and conditions set forth in the lease agreement are comparable with other leases of a similar nature.
- c. All amounts are paid in accordance with the lease terms or provisions.

This paragraph excludes leases addressed by [paragraph .04](#) of the “Loans and Leases with Lending Institutions” interpretation [1.260.020] of the “Independence Rule” [1.200.001].

**.02** *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* by the application of *safeguards*, and *independence* would be *impaired*, if a *covered member* has a lease that meets the criteria of a capital lease (as described in GAAP). Accordingly, *independence* would be *impaired* because the lease would be considered to be a *loan* with an *attest client*. This paragraph excludes a lease that is in compliance with the “[Loans and Leases with Lending Institutions](#)” interpretation [1.260.020] of the “Independence Rule.” [Prior reference: paragraphs .182–.183 of ET section 191]

The AICPA Code defines a loan as follows:

**Loan.** A contractual obligation to pay or right to receive money on demand or on a fixed or determinable date and includes a stated or implied rate of return to the lender. For purposes of this definition, loans include, among other things, a guarantee of a loan, a letter of credit, a line of credit, or a loan commitment. However, for purposes of this definition, a loan would not include debt securities (which are considered a *financial interest*) or lease arrangements. [Prior reference: paragraph .19 of ET section 92]

#### **Summary of Issues**

At its May 2016 meeting, PEEC provided feedback to the Task Force on its progress. PEEC requested that the Task Force take a broad view of leases as business transactions and evaluate the factors that impact independence in a broad sense. The Task Force held a

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conference call in June 2016 to discuss leases and business transactions, among other issues noted below.

#### Necessity for Substantive Revisions to the Leases Interpretation

Some Task Force members noted that although the accounting treatment of some leases has changed, the substance of lease agreements and relationships has not changed. Thus, some members questioned the need for anything other than conforming revisions to the Leases Interpretation. The Update did not change the substance of operating leases, which currently do not impair independence (if under normal terms and conditions and amounts are paid in compliance with the lease). Conforming revisions would add short term leases to the operating lease criteria within the Leases Interpretation and change “capital leases” to “finance leases.” Furthermore, to ensure consistent definitions of a lease with the Update (as requested by PEEC), the term “leasing arrangement” would be changed to “lease (as described in GAAP)”. In this regard, the Task Force requests that PEEC consider Question 1 in the Action Needed section of this agenda and the related sample revisions under Option 1 at **Agenda Item 4B**.

#### Leases and Threats to Independence – Lease Terms and Materiality

PEEC previously requested that the Task Force look broadly at leases as business transactions and examine the various threats to independence, regardless of the accounting treatment of the transaction. The Task Force’s concerns are discussed below.

##### *Leases with Normal Terms Established in the Normal Course of Business*

A significant concern of the Task Force is that the terms of a lease may not be established at arm’s length and that the transaction may be outside the normal course of business. The Task Force agrees with the extant position that the lease terms should be normal terms and conditions. The Task Force also noted that there should be a legitimate business reason for entering the lease, and there should not be undue influence or pressure from either side to enter the transaction for reasons related to the member/client relationship or the financial statements being reported on. For example, a client could be pressured to enter a lease at a higher rent to receive an unqualified opinion, or an auditor could be pressured to renew a lease early at favorable terms to assist client in meeting financial covenants, in exchange for higher audit fees or hiring of the firm from other services.

The Task Force requests that PEEC discuss the Task Force’s view and consider Question 2 in the Action Needed section of this agenda and the related sample revisions under Option 2 at **Agenda Item 4B**. The revision would add terminology requiring that terms be established in the normal course of business.

##### *Leases vs. Business Transactions / Relationships*

In discussing the extant Code treatment of business relationships and transactions other than leases, some Task Force members had the view that all leases are either a financing activity (i.e. loan) or a business relationship. The Code does not specifically prohibit normal business transactions and relationships (other than material cooperative arrangements and material joint closely held investments), such as vendor/customer transactions; therefore members are to utilize the Conceptual Framework approach in evaluating the impact of a business transaction on independence. The Conceptual Framework approach involves an evaluation of the materiality of the transaction or “business arrangement” in determining whether the risk of impairment is significant. As some Task Force members did not view the significant threats caused by leases as different from threats existing in other business relationships or transactions, some

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thought that all non-finance leases could be viewed on a materiality continuum when evaluating the self-interest threat to independence. Having a materiality element in evaluating non-finance leases would be consistent with the treatment of business relationships and other business transactions involving the member and attest client.

The Task Force also did not view a lease as being different from most other vendor / customer relationships and transactions that may involve procurement or purchase contracts over periods of time. The Task Force's general view is that if a transaction is not a finance arrangement and the terms of the transaction are normal terms established in the normal course of business, threats would not be significant unless the transaction is material. Application of this concept to operating leases would be more restrictive than the extant Leases Interpretation, which does not prohibit material operating leases. The Task Force requests that PEEC discuss the view that leases should be treated similarly to other business transactions, which would prohibit material non-finance leases (see Question 3 in Action Needed section, and related sample revisions in Option 2 at **Agenda Item 4B**).

#### *Materiality of a Lease*

The Task Force shared concerns expressed by PEEC regarding the impact of materiality of a lease. The Task Force noted that many quantitative and qualitative factors can impact the materiality of a lease to the lessee and lessor, including the length of the lease term, amount of lease payments, and characteristics of the property being leased. In addition, the Task Force expressed concerns about the materiality of the lease to the financial statements which are being reported on; specifically, an auditor's integrity, objectivity, and professional skepticism may be negatively impacted when auditing a material lease to which the auditor is a party. As discussed above, if a finance lease is considered a loan and impairs independence, it may also be appropriate to evaluate all other leases on a materiality continuum (i.e. material non-finance leases would impair independence). The Task Force requests that PEEC discuss the concept of evaluating all non-finance leases on a materiality continuum, which would effectively prohibit material leases of any type (see Question 3 in Action Needed section).

The Task Force notes that the 2003 Exposure Draft (**Agenda Item 4D**), which proposed revising the Leases Interpretation by eliminating the reference to operating/capital leases and replacing it with a materiality criterion, was not adopted, partially due to concerns of commenters and PEEC members regarding inconsistency with the Loans and Leases Rule and how to measure materiality. PEEC's position is that materiality should not be defined. Task Force members have noted that a list of factors for members to consider may provide some clarity in evaluating the materiality of a lease. Factors may include the term of the lease, the amount of lease payments, the tangible and intangible significance of the leased property, the circumstances surrounding the conception of the lease and any renewals, and the impact on the financial statements. If PEEC moves toward a materiality criterion, the Task Force requests that PEEC discuss the prior concern and whether the Leases Interpretation should provide broad guidance on how to measure materiality of a lease. In this regard, the Task Force requests that PEEC consider question 4 in the Action Needed section of this agenda and provide feedback on whether materiality should be addressed in the Leases Interpretation in this manner.

Regarding the perceived inconsistency between the 2003 proposal and the Loans and Leases Rule (immaterial loans from non-lending institutions prohibited but immaterial leases allowed), the presumption is that non-finance leases are not finance

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arrangements and are thus not to be treated as loans. If a non-finance lease is not a loan, the Task Force's view is that it should not be treated as a loan but as a business transaction and subject to a materiality evaluation.

### **Effective Date**

NA

### **Action Needed**

The Task Force requests that PEEC discuss the issues noted above and the Task Force's preliminary conclusions, and consider the following questions:

1. The Task Force requests that PEEC discuss and consider the necessity for any revision other than conforming revisions to the Leases Interpretation, given the fact that nothing about leases has changed, other than the accounting treatment of some leases that are currently allowed under the Independence Rule. The sample revision appears as Option 1 at **Agenda Item 4B**.
2. Does PEEC agree that leases should be executed in the normal course of business as well as under normal terms and conditions? The related sample revision in Option 2 at **Agenda Item 4B**; the revision would add a requirement that leases be entered into in the normal course of business.
3. Does PEEC agree that the threats to independence are similar for leases and most other business transactions or agreements between the member and the attest client? If so, does PEEC agree that leases should be treated consistently with other business transactions (i.e. material business transactions / leases would impair independence)? Does PEEC think that non-finance leases should be evaluated on a materiality continuum? The Task Force requests that PEEC review the sample revision in Option 2 at **Agenda Item 4B** and provide feedback.
4. Does PEEC agree that a list of various factors should be included in the Leases Interpretation as items to consider when evaluating the materiality of a lease? The Task Force requests that PEEC discuss the concerns raised by commenting members and PEEC related to the 2003 Exposure Draft (**Agenda Item 4D**). If PEEC moves toward a materiality criterion, the Task Force requests that PEEC discuss the prior concern and whether the Leases Interpretation should provide broad guidance on how to measure materiality of a lease. The Task Force also requests that PEEC discuss materiality and the various quantitative and qualitative factors that may impact a non-finance lease's risk to independence, including the materiality of lease payments, term of the lease, significance of the property to the lessee or lessor (both quantitative and qualitative factors).
5. Does PEEC think that the perceived inconsistency of disallowing immaterial loans from attest clients other than lending institutions but allowing immaterial non-finance leases is a significant concern?

### **Communications Plan**

The Task Force will take input from PEEC on the issues noted above and will report progress to PEEC at its November meeting.

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**Materials Presented**

**Agenda Item 4B:** Sample Revisions to the Leases Interpretation

**Agenda Item 4C:** Leases in the Code

**Agenda Item 4D:** 2003 Exposed Revisions

**Agenda Item 4E:** Materiality in the Independence Rule

**Agenda Item 4F:** SEC Codification: Business Relationships

Sample Revisions to the AICPA Code

Additions are **bold underlined**, deletions are ~~struck through~~.

Option 1: Conforming Revisions Only (See Q1 Action Needed)

**1.260.040 Leases**

**.01** If a *covered member* enters into a ~~lease ing agreement~~ (as described in GAAP) with an *attest client* during the *period of the professional engagement*, the self-interest *threat* would be at an *acceptable level* and *independence* would not be *impaired* if all the following *safeguards* are met:

- a. The lease meets the criteria of an operating lease **or short term lease** (as described in GAAP).
- b. The terms and conditions set forth in the lease ~~agreement~~ are comparable with other leases of a similar nature.
- c. All amounts are paid in accordance with the lease terms or provisions.

This paragraph excludes leases addressed by [paragraph .04](#) of the “Loans and Leases with Lending Institutions” interpretation [1.260.020] of the “Independence Rule” [1.200.001].

**.02** *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* by the application of *safeguards*, and *independence* would be *impaired*, if a *covered member* has a lease that meets the criteria of a **finance capital lease** (as described in GAAP). Accordingly, *independence* would be *impaired* because the lease would be considered to be a *loan* with an *attest client*. This paragraph excludes a lease that is in compliance with the “[Loans and Leases with Lending Institutions](#)” interpretation [1.260.020] of the “Independence Rule.” [Prior reference: paragraphs .182–.183 of ET section 191]

Option 2: Conforming Revisions with Language for Normal Course of Business and Materiality

**1.260.040 Leases**

**.01** If a *covered member* enters into a ~~lease ing agreement~~ (as described in GAAP) with an *attest client* during the *period of the professional engagement*, the self-interest *threat* would be at an *acceptable level* and *independence* would not be *impaired* if all the following *safeguards* are met:

- a. The lease meets the criteria of an operating lease **or short term lease** (as described in GAAP).

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b. The terms and conditions set forth in the lease agreement 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.**

This paragraph excludes leases addressed by [paragraph .04](#) of the “Loans and Leases with Lending Institutions” interpretation [1.260.020] of the “Independence Rule” [1.200.001].

**.02** *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* by the application of *safeguards*, and *independence* would be *impaired*, if a *covered member* has a lease that meets the criteria of a **finance** capital lease (as described in GAAP). Accordingly, *independence* would be *impaired* because the lease would be considered to be a *loan* with an *attest client*. This paragraph excludes a lease that is in compliance with the “[Loans and Leases with Lending Institutions](#)” interpretation [1.260.020] of the “Independence Rule.” [Prior reference: paragraphs .182–.183 of ET section 191]

**Leases in AICPA Code**

.29 **Loan.** A contractual obligation to pay or right to receive money on demand or on a fixed or determinable date and includes a stated or implied rate of return to the lender. For purposes of this definition, loans include, among other things, a guarantee of a loan, a letter of credit, a line of credit, or a loan commitment. However, for purposes of this definition, a loan would not include debt securities (which are considered a *financial interest*) or **lease** arrangements.

**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*, or any individual owning 10 percent or more of the *attest client’s* outstanding equity securities or other ownership interests, except as provided for in this interpretation.

.02 *Home mortgages, secured loans, and immaterial unsecured loans.* However, *threats* would be at an *acceptable level* and *independence* would not be *impaired* if a *covered member* or his or her *immediate family* has 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 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* was obtained
  - i. from the *lending institution* prior to its becoming an *attest client*;
  - ii. from a *lending institution* for which *independence* was not required and was later sold to an *attest client*;
  - iii. after May 31, 2002, from a *lending institution attest client* by a borrower prior to 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](http://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 *loan* 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 or other secured *loan* must equal or exceed the outstanding balance during the term of the home mortgage or other secured *loan*. If the estimated fair value of the

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collateral is less than the outstanding balance of the home mortgage or other secured *loan*, the portion that exceeds the estimated fair value of the collateral may not be material to the *covered member's* net worth.

- .03 *Loans to partnerships and other similar entities.* 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
- 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
  - 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*.

- .04 *Other loans and leases.* *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):
- Automobile *loans* and *leases* collateralized by the automobile
  - Loans* fully collateralized by the cash surrender value of an insurance policy
  - Loans* fully collateralized by cash deposits at the same *lending institution* (for example, passbook *loans*)
  - Aggregate outstanding balances from credit cards and overdraft reserve accounts that have a balance of \$10,000 or less after payment of the most recent monthly statement made by the due date or within any available grace period
- .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]
- .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] of the “Independence Rule” [1.200.001].

### 1.260.040 Leases

- .01 If a *covered member* enters into a *leasing* agreement with an *attest client* during the *period of the professional engagement*, the self-interest *threat* would be at an *acceptable level* and *independence* would not be *impaired* if all the following *safeguards* are met:

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- a. The **lease** meets the criteria of an operating **lease** (as described in GAAP).
  - b. The terms and conditions set forth in the **lease** agreement are comparable with other leases of a similar nature.
  - c. All amounts are paid in accordance with the **lease** terms or provisions.

This paragraph excludes **leases** addressed by [paragraph .04](#) of the “Loans and **Leases** With Lending Institutions” interpretation [1.260.020] of the “Independence Rule” [1.200.001].

- .02 *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* by the application of *safeguards*, and *independence* would be *impaired*, if a *covered member* has a **lease** that meets the criteria of a capital **lease** (as described in GAAP). Accordingly, *independence* would be *impaired* because the **lease** would be considered to be a *loan* with an *attest client*. This paragraph excludes a **lease** that is in compliance with the “[Loans and Leases With Lending Institutions](#)” interpretation [1.260.020] of the “Independence Rule.” [Prior reference: paragraphs .182–.183 of ET section 191]

#### **1.260.050 Association With an Entity That Has a Loan To or From an Attest Client**

- .01 If a *covered member* is an officer, a director, or a shareholder of an entity and the entity has a *loan* to or from an *attest client* during the *period of the professional engagement*, a self-interest *threat* to the *covered member's* compliance with the “[Independence Rule](#)” [1.200.001] may exist. *Threats* to compliance with the “[Independence Rule](#)” would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if the *covered member* has *control* over the entity. Accordingly, *independence* would be *impaired* because the **lease** would be considered to be a *loan* with an *attest client*. This paragraph excludes a lending relationship that is permitted under the “[Loans and Leases With Lending Institutions](#)” interpretation [1.260.020] of the “Independence Rule.”
- .02 If any *partner* or professional employee of the *firm* is an officer, a director, or a shareholder of an entity and the entity has a *loan* to or from an *attest client*, *threats* to the *partner's* or professional employee's objectivity may exist. If the *partner* or professional employee is able to exercise *significant influence* over the entity but is not a *covered member* who can *control* the entity (see [paragraph .01](#)), the *partner* or professional employee should consider the “[Conflicts of Interest](#)” interpretation [1.110.010] of the “Integrity and Objectivity Rule” [1.100.001].
- .03 When making the decision about whether to perform a *professional service* and in making disclosure to the appropriate parties, the *member* should consider the “[Confidential Client Information Rule](#)” [1.700.001]. [Prior reference: paragraphs .220–.221 of ET section 191]

2003 Exposure Draft Proposed Revisions

**Member Leasing Property to or From a Client**

.182 *Question*—Would independence be considered to be impaired if a covered member leased **personal or business property, other than automobiles (which would be covered by Interpretation 101-5 [ET section 101.07])**, to or from a client?

.183 *Answer*—Independence would not be considered to be impaired if **all of the following criteria are met:**

- a. ~~The~~ **annual lease payments are immaterial to the lessee and lessor.**
- b. **The leased property is leased under the lessor's normal terms, procedures, and requirements.**
- c. **Payments are kept current at all times.** ~~lease meets the criteria of an operating lease (as described in Generally Accepted Accounting Principles), the terms and conditions set forth in the lease agreement are comparable with other leases of a similar nature, and all amounts are paid in accordance with the terms of the lease.~~

~~Independence would be considered to be impaired if a covered member had a lease that meets the criteria of a capital lease (as described in Generally Accepted Accounting Principles) unless the lease is in compliance with interpretations 101-1.A.4 [ET section 101.02] and 101-5 [ET section 101.07], because the lease would be considered to be a loan to or from the client.~~

**Grandfathered Operating Leases**

***Independence would not be considered to be impaired for operating leases that existed prior to [the effective date of the revision], provided they met the conditions outlined in the guidance in effect at the inception of the lease, the lessee remains current as to all lease terms, and the terms of the lease do not change in any manner not provided for in the original lease agreement.***

“Material” and “Materiality” in the Independence Rule

**Section 0.400 Definitions**

.02 **Affiliate.** The following entities are affiliates of a *financial statement attest client*:

- a. An entity (for example, subsidiary, partnership, or limited liability company [LLC]) that a *financial statement attest client* can *control*.
- b. An entity in which a *financial statement attest client* or an entity *controlled* by the *financial statement attest client* has a *direct financial interest* that gives the *financial statement attest client* *significant influence* over such entity and that is **material** to the *financial statement attest client*.
- c. An entity (for example, parent, partnership, or LLC) that *controls* a *financial statement attest client* when the *financial statement attest client* is **material** to such entity.
- d. An entity with a *direct financial interest* in the *financial statement attest client* when that entity has *significant influence* over the *financial statement attest client*, and the interest in the *financial statement attest client* is **material** to such entity.
- e. A sister entity of a *financial statement attest client* if the *financial statement attest client* and sister entity are each **material** to the entity that *controls* both.
- f. A trustee that is deemed to *control* a trust *financial statement attest client* that is not an investment company.
- g. The sponsor of a single employer employee benefit plan *financial statement attest client*.
- h. Any entity, such as a union, participating employer, or a group association of employers, that has *significant influence* over a multiemployer employee benefit plan *financial statement attest client* and the plan is **material** to such entity.
- i. The participating employer that is the plan administrator of a multiple employer employee benefit plan *financial statement attest client*.
- j. A single or multiple employer employee benefit plan sponsored by either a *financial statement attest client* or an entity *controlled* by the *financial statement attest client*. All participating employers of a multiple employer employee benefit plan are considered sponsors of the plan.
- k. A multiemployer employee benefit plan when a *financial statement attest client* or entity *controlled* by the *financial statement attest client* has *significant influence* over the plan and the plan is **material** to the *financial statement attest client*.
- l. An investment adviser, a general partner, or a trustee of an investment company *financial statement attest client* (fund) if the fund is **material** to the investment adviser, general partner, or trustee that is deemed to have either *control* or *significant influence* over the fund. When considering **materiality**, *members* should consider investments in, and fees received from, the fund.

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Nonauthoritative questions and answers related to the application of the independence rules to affiliates of employee benefit plans are available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/faqs-application-independence-rules-affiliates-of-employee-benefit-plans.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/faqs-application-independence-rules-affiliates-of-employee-benefit-plans.pdf).

[Prior reference: paragraph .20 of ET section 101]

.27 **Key position.** A position in which an individual has

a. primary responsibility for significant accounting functions that support **material** components of the *financial statements*;

b. primary responsibility for the preparation of the *financial statements*; or

c. the ability to exercise influence over the contents of the *financial statements*, including when the individual is a member of the board of directors or similar governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

For purposes of *attest engagements* not involving a *client's financial statements*, a key position is one in which an individual is primarily responsible for, or able to influence, the subject matter of the *attest engagement*, as previously described.

[Prior reference: paragraph .18 of ET section 92]

### **1.210.010 Conceptual Framework for Independence (excerpt only)**

#### ***Introduction***

.02 The code specifies that in some circumstances no *safeguards* can reduce an *independence threat* to an *acceptable level*. For example, the code specifies that a *covered member* may not own even an **immaterial** *direct financial interest* in an *attest client* because there is no *safeguard* to reduce the self-interest *threat* to an *acceptable level*. A *member* may not use the conceptual framework to overcome this prohibition or any other prohibition or requirement in an *independence interpretation*.

### **1.220.010 Network and Network Firms (excerpt only)**

#### ***Characteristics of a Network***

.10 *Sharing profits or costs.* This characteristic exists when entities within the association share profits or costs. Following are examples of profit and cost sharing that would not create a *network*:

a. Sharing **immaterial** costs

b. Sharing costs related to operating the association

c. Sharing costs related to the development of audit methodologies, manuals, and training courses

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d. Arrangements between a *firm* and an otherwise unrelated entity to jointly provide a service or develop a product

### **1.220.020 Alternative Practice Structures (excerpts only)**

.10 In addition, *threats* to compliance with the “[Independence Rule](#)” [1.200.001] would not be at an *acceptable level*, could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* in the following circumstances:

a. Indirect superiors and other public company entities have a **material** relationship with an *attest client* of Newfirm that is prohibited by the “[Overview of Financial Interests](#)” interpretation [1.240.010], the “[Trustee or Executor](#)” interpretation [1.245.010], the “[Loans](#)” interpretation [1.260.010], or the “[Joint Closely Held Investments](#)” interpretation [1.265.020] of the “Independence Rule” (for example, investments, *loans*, and so on). In making the test for **materiality** for financial relationships of an indirect superior, all the financial relationships with an *attest client* held by that person should be aggregated and, to determine **materiality**, assessed in relation to the person’s net worth. In making the **materiality** test for financial relationships of other public company entities, all the financial relationships with an *attest client* held by such entities should be aggregated and, to determine **materiality**, assessed in relation to the consolidated *financial statements* of PublicCo.

b. Any other public company entity over which an indirect superior has direct responsibility has a financial relationship with an *attest client* during the *period of the professional engagement* that is **material** in relation to the other public company entity’s *financial statements*.

c. Financial relationships of indirect superiors or other public company entities allow such persons or entities to exercise significant influence over the *attest client* during the *period of the professional engagement*. In making the test for significant influence, financial relationships of all indirect superiors and other public company entities should be aggregated.

d. Other public company entities or any of their employees are connected with an *attest client* of Newfirm as a promoter, an underwriter, a voting trustee, a director, or an officer during the *period of the professional engagement* or during the period covered by the *financial statements*.

.13 If an *attest client* of Newfirm holds an investment in PublicCo that is **material** to the *attest client* or that allows the *attest client* to exercise significant influence over PublicCo during the *period of the professional engagement*, *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*. Accordingly, *independence* would be *impaired*.

### **1.228.030 Alternative Dispute Resolution**

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.01 A *covered member* may include in an engagement letter a provision to use alternative dispute resolution (ADR) techniques to resolve disputes relating to past services (in lieu of litigation). *Threats* to compliance with the “[Independence Rule](#)” [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired* because the *covered member* and *attest client* would not be in positions of **material** adverse interests due to threatened or actual litigation.

.02 The *covered member* should exercise professional judgment when rendering current services, regardless of the existence of the provision. [Prior reference: paragraphs .190–.191 of ET section 191]

.03 If ADR techniques are initiated to resolve a dispute with the *attest client*, *threats* to compliance with the “[Independence Rule](#)” [1.200.001] would be at an *acceptable level* when the ADR techniques are designed to facilitate negotiation, and the conduct of those negotiations does not place the *covered member* and the *attest client* in positions of **material** adverse interests. *Independence* would not be *impaired* under these circumstances. If, however, the ADR proceedings are sufficiently similar to litigation (as in the case of binding arbitration), an adverse interest *threat* may exist and place the *covered member* and the *attest client* in a position of **material** adverse interests. Under such circumstances, the *member* should apply the guidance under the “[Actual or Threatened Litigation](#)” interpretation [1.290.010] of the “[Independence Rule](#).” [Prior reference: paragraphs .192–.193 of ET section 191]

## **1.240 Financial Interests**

### **1.240.010 Overview of Financial Interests**

.01 If a *covered member* had or was committed to acquire any *direct financial interest* in an *attest client* during the *period of the professional engagement*, the self-interest *threat* to the *covered member’s* compliance with the “[Independence Rule](#)” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraphs .02A(1) and .17 of ET section 101]

.02 If a *covered member* had or was committed to acquire any **material** *indirect financial interest* in an *attest client* during the *period of the professional engagement*, the self-interest *threat* to the *covered member’s* compliance with the “[Independence Rule](#)” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraphs .02A(1) and .17 of ET section 101]

.03 If a *partner* or professional employee of the *firm*, his or her *immediate family*, or any group of such persons acting together owned more than 5 percent of an *attest client’s* outstanding equity securities or other ownership interests during the *period of the professional engagement*, the self-interest *threat* 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* by the

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application of *safeguards*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraph .02B of ET section 101]

.04 Refer to the “[Joint Closely Held Investments](#)” interpretation [1.265.020] for additional guidance.

#### **1.240.020 Unsolicited Financial Interests**

.01 When a *covered member* becomes aware that he or she will receive, or has received, an unsolicited *financial interest* in an *attest client* during the *period of the professional engagement*, such as through a gift or an inheritance, the self-interest *threat* would be at an *acceptable level* and *independence* would not be *impaired* if both of the following *safeguards* are met:

a. The *covered member* disposes of the *financial interest* as soon as practicable but no later than 30 days after the *covered member* has knowledge of and obtains the right to dispose of the *financial interest*.

b. During the period in which the *covered member* does not have the right to dispose of the *financial interest*, the *covered member* does not participate on the *attest engagement team*, and the *direct financial interest* or *indirect financial interest* is not **material** to the *covered member*. [Prior reference: paragraph .17 of ET section 101]

#### **1.240.030 Mutual Funds**

.01 A *covered member* who owns shares in a mutual fund has a *direct financial interest* in the mutual fund. However, whether the underlying investments in the mutual fund are considered to be the *covered member's direct financial interests* or *indirect financial interests* depends on the proportion of the mutual fund's outstanding shares that the *covered member* owns and whether the mutual fund is diversified.

.02 If a *covered member* owns 5 percent or less of the outstanding shares of a diversified mutual fund, the underlying investments would be considered immaterial *indirect financial interests*. Accordingly, the self-interest *threat* would be at an *acceptable level*, and *independence* would not be *impaired*. To determine if the mutual fund is diversified, the *covered member* should consider referring to (a) the mutual fund's prospectus for disclosure regarding fund management's determination regarding diversification and (b) Section 5(b)(1) of the Investment Company Act of 1940.

.03 If a *covered member* owns more than 5 percent of a diversified mutual fund's outstanding shares, or if a *covered member* owns a *financial interest* in a nondiversified mutual fund, the *covered member* should evaluate the mutual fund's underlying investments to determine whether the *covered member* holds a **material** *indirect financial interest* in any of the underlying investments.

.04 The following example illustrates how to determine if the underlying investments are **material** to a *covered member's* net worth. If

- a nondiversified mutual fund owns shares in client company A,

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- the mutual fund's net assets are \$10 million,
  - the *covered member* owns 1 percent of the outstanding shares of the mutual fund, having a value of \$100,000, and
  - the mutual fund has 10 percent of its assets invested in company A,

then the *covered member's indirect financial interest* in company A is \$10,000 (\$100,000 × 10%). The *covered member* would then compare the \$10,000 *indirect financial interest* with his or her net worth, including the net worth of his or her *immediate family*, to determine if the *indirect financial interest* in company A is **material**. [Prior reference: paragraph .17 of ET section 101]

## **1.255 Depository, Brokerage, and Other Accounts**

### **1.255.010 Depository Accounts**

.01 If a *covered member* maintains checking, savings, certificates of deposit, money market, or other depository accounts (depository accounts) at a bank or similar depository institution that is an *attest client* during the *period of the professional engagement*, a self-interest *threat* to the *covered member's* compliance with the "[Independence Rule](#)" [1.200.001] may exist. For specific guidance applicable to any other types of custodial accounts (for example, brokerage accounts), see the "[Brokerage and Other Accounts](#)" interpretation [1.255.020] of the "Independence Rule."

.02 When the *covered member* is a *firm*, the *threat* would be at an *acceptable level*, and *independence* would not be *impaired* if the *firm* concludes that the likelihood is remote that the bank or similar depository institution will experience financial difficulties.

.03 When the *covered member* is an individual, the *threat* would be at an *acceptable level*, and *independence* would not be *impaired* if

- a. the balance in the depository account(s) is fully insured by the appropriate state or federal government deposit insurance agencies or by any other insurer, or
- b. any uninsured amounts, in the aggregate, were not **material** to the *covered member's* net worth, or
- c. if uninsured amounts were considered **material**, any uninsured amounts, in the aggregate, are reduced to an **immaterial** amount no later than 30 days from the date that the uninsured amount becomes **material** to the *covered member's* net worth.

.04 Refer to the "[Member of a Credit Union](#)" interpretation [1.280.040] of the "Independence Rule" [1.200.001] for additional guidance. [Prior reference: paragraphs .140–.141 of ET section 191]

### **1.255.020 Brokerage and Other Accounts**

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.01 If an *attest client* in the financial services industry, such as an insurance company, an investment adviser, a broker-dealer, a bank, or similar depository institution, has custody of a *covered member's* assets other than depository accounts, including retirement plan assets, during the *period of the professional engagement*, a self-interest *threat* to the *covered member's* compliance with the "[Independence Rule](#)" [1.200.001] may exist. For specific guidance applicable to depository accounts held at a bank or similar depository institution, see the "[Depository Accounts](#)" interpretation [1.255.010] of the "Independence Rule."

.02 *Threats* would not be at an *acceptable level* and *independence* would be *impaired* unless the following safeguards are met

- a. The *attest client's* services were rendered under the *attest client's* normal terms, procedures, and requirements.
- b. Any *covered member's* assets subject to the risk of loss are **immaterial** to the *covered member's* net worth.

.03 In determining if there is a risk of loss, the *covered member* should consider losses arising from the *attest client's* insolvency, bankruptcy, or acts of fraud or other illegal acts but should not consider potential losses arising from a market decline in the value of the assets.

.04 When considering the **materiality** of assets subject to the risk of loss, the *covered member* should consider the following:

- a. Protection that state or federal regulators provide for the assets, such as state insurance funds
- b. Private insurance or other forms of protection that the financial services company obtains to protect its customers' assets, such as coverage by the Securities Investor Protection Corporation
- c. Protection from creditors, such as assets held in a pooled separate account or separate escrow accounts [Prior reference: paragraphs .081–.082 of ET section 191]

### **1.260.020 Loans and Leases With Lending Institutions (excerpt only)**

.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*, or any individual owning 10 percent or more of the *attest client's* outstanding equity securities or other ownership interests, except as provided for in this interpretation.

.02 *Home mortgages, secured loans, and immaterial unsecured loans.* However, *threats* would be at an *acceptable level* and *independence* would not be *impaired* if a *covered member* or his or her *immediate family* has 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:

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a. The home mortgage, secured *loan*, or **immaterial** unsecured *loan* was 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* was obtained

i. from the *lending institution* prior to its becoming an *attest client*;

ii. from a *lending institution* for which *independence* was not required and was later sold to an *attest client*;

iii. after May 31, 2002, from a *lending institution attest client* by a borrower prior to 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](http://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 *loan* 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 or other secured *loan* must equal or exceed the outstanding balance during the term of the home mortgage or other secured *loan*. If the estimated fair value of the collateral is less than the outstanding balance of the home mortgage or other secured *loan*, the portion that exceeds the estimated fair value of the collateral may not be **material** to the *covered member's* net worth.

## **1.265 Business Relationships**

### **1.265.010 Cooperative Arrangements With Attest Clients**

.01 If a *member* or his or her *firm* has a cooperative arrangement with an *attest client*, self-interest, familiarity, and undue influence *threats* to the *member* or his or her *firm's* compliance with the "[Independence Rule](#)" [1.200.001] may exist. *Threats* to compliance with the "[Independence Rule](#)" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if, during the *period of the professional engagement*, the cooperative arrangement is **material** to the *firm* or *attest client*. Accordingly, *independence* would be *impaired*.

.02 A cooperative arrangement exists when a *member* or the *member's firm* and an *attest client* jointly participate in a business activity.

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However, a cooperative arrangement would not exist when all of the following *safeguards* are met:

- a. The participation of the *firm* and *attest client* are governed by separate agreements, arrangements, or understandings that do not create rights or obligations between the *firm* and *attest client*.
- b. Neither the *firm* nor the *attest client* assumes responsibility for the other's activities or results.
- c. Neither party has the authority to act as the other's representative or agent.

.03 Examples of cooperative arrangements include the following:

- a. Prime and subcontractor arrangements to provide services or products to a third party
- b. Joint ventures to develop or market products or services
- c. Arrangements to combine one or more of the *firm's* services or products with one or more of the *attest client's* services or products and market the package with references to both parties
- d. Arrangements under which the *firm* acts as a distributor or marketer of the *attest client's* products or services or the *attest client* acts as the distributor or marketer of the *firm's* products or services

.04 Refer to the "[Contingent Fees Rule](#)" [1.510.001] and the "[Commissions and Referral Fees Rule](#)" [1.520.001] for additional guidance. [Prior reference: paragraph .14 of ET section 101]

### **1.265.020 Joint Closely Held Investments**

.01 If a *covered member* has a *joint closely held investment*, a self-interest *threat* to the *covered member's* compliance with the "[Independence Rule](#)" [1.200.001] may exist. *Threats* to compliance with the "[Independence Rule](#)" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if the *covered member* holds a **material** *joint closely held investment* during the *period of the professional engagement*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraph .02A(3) of ET section 101]

.02 A *joint closely held investment* includes a joint interest in a vacation home shared by a *covered member* and an *attest client* (or one of the client's officers or directors, or any owner who has the ability to exercise significant influence over the *attest client*), if the *covered member* and *attest client* (or one of the client's officers or directors or any owner who has the ability to exercise significant influence over the *attest client*) control the investment and the vacation home is **material** to the *covered member*. Such is the case even if the vacation home is solely intended for the personal use of the owners. [Prior reference: paragraphs .184–.185 of ET section 191]

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### **1.270.040 Immediate Family Member Participation in an Employee Benefit Plan With Financial Interests in an Attest Client**

.01 If during the *period of the professional engagement*, an *immediate family member* of a *covered member* is employed at a non-client or employed in a non-key position at an *attest client*, the *immediate family member* may hold a *direct financial interest* or **material** *indirect financial interest* in an *attest client* through participation in an employee benefit plan if *threats* are at an *acceptable level*. *Threats* would be at an *acceptable level*, and *independence* would not be *impaired*, if all of the following *safeguards* were met:

a. The *covered member* neither participates on the *attest engagement team* nor is an *individual in a position to influence the attest engagement*.

b. Such investment is an unavoidable consequence of such participation. Unavoidable consequence means that the *immediate family member* has no other investment options available for selection, including money market or invested cash options, except for selecting an investment option in an *attest client*.

c. In the event that a plan provides an option that permits the *immediate family member* to invest in a nonattest *client* or a non-client investment option that becomes available, the *immediate family member* is required to select the investment option in the non-client or nonattest *client* and dispose of *financial interests* in the *attest client* as soon as practicable but no later than 30 days after such option becomes available. When legal or other similar restrictions exist on an *immediate family member's* right to dispose of a *financial interest* at a particular time, the *immediate family member* need not dispose of the interest until the restrictions have lapsed. For example, an *immediate family member* is not required to dispose of a *financial interest* in an *attest client* if doing so would violate an employer's policies on insider trading. On the other hand, waiting for more advantageous market conditions to dispose of the interest would not fall within this exception. [Prior reference: paragraph .02 of ET section 101]

This paragraph excludes participation in *share-based compensation arrangements* and nonqualified deferred compensation arrangements (see [paragraph .02](#)).

### **1.290.010 Actual or Threatened Litigation**

#### ***1.290.010 Actual or Threatened Litigation***

.01 The relationship between an *attest client's* management and a *covered member* must be characterized by complete candor and full disclosure regarding all aspects of the *attest client's* business operations. In addition, the *covered member* must not be biased so that the *covered member* can exercise professional judgment and objectivity in evaluating management's financial reporting decisions.

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.02 Litigation or the expressed intention to commence litigation between a *covered member* and an *attest client* or its management and, in some cases, other parties during the *period of the professional engagement* may create self-interest or adverse interest *threats* to the *member's* compliance with the "[Independence Rule](#)" [1.200.001]. Accordingly, *covered members* should evaluate all such circumstances in accordance with this interpretation.

.03 Litigation or the expressed intention to commence litigation between a *covered member* and an *attest client* or its management and, in some cases, other parties requires the *covered member* to assess the **materiality** of the litigation to the *covered member*, the *covered member's firm*, and the *attest client*. The *covered member's* assessment should include an evaluation of the nature of the matter(s) underlying the litigation and all other relevant factors.

### ***Litigation Between the Attest Client and Member***

.04 When an *attest client's* present management commences, or expresses an intention to commence, legal action against a *covered member*, the *covered member* and the *attest client's* management may be placed in adversarial positions in which self-interest may affect the *covered member's* objectivity and management's willingness to make complete disclosures.

.05 Accordingly, *independence* may be *impaired* whenever the *covered member* and the *covered member's attest client* or its management are in threatened or actual positions of **material** adverse interests due to threatened or actual litigation.

.06 Situations involving threatened or actual litigation are complex and diverse, making it difficult to identify precise points at which *threats* to the *covered member's* compliance with the "[Independence Rule](#)" [1.200.001] would be at an *acceptable level*. There are situations regarding litigation between *covered members* and *attest clients* in which *threats* to the *covered member's* compliance with the "[Independence Rule](#)" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by *safeguards* and *independence* would be *impaired*. Examples of these situations are:

a. An *attest client's* present management commences litigation alleging deficiencies in audit work performed for the *attest client* or expresses its intention to commence such litigation, and the *covered member* concludes that it is probable that such a claim will be filed.

b. A *covered member* commences litigation against an *attest client's* present management alleging management fraud or deceit.

.07 If threatened or actual litigation is unrelated to the performance of a *client's attest engagement* and is for an amount that is not **material** to the *covered member's firm* or the *attest client*, *threats* to the *covered member's* compliance with the "[Independence Rule](#)" [1.200.001] would be at an *acceptable level*, and *independence* would not be *impaired*. Such claims may

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arise, for example, out of **immaterial** disputes regarding billings for services, results of tax or management services advice, or similar matters.

### ***Litigation by Security Holders***

.08 A *covered member* may also become involved in litigation (primary litigation) in which the *covered member* and the *attest client* or its management are defendants. For example, one or more stockholders may bring a stockholders' derivative action or class-action lawsuit against the *attest client* or its management, the *attest client's* officers, directors, or underwriters, and *covered members*.

.09 Such primary litigation by itself would not *threaten* the *covered member's* compliance with the "[Independence Rule](#)" [1.200.001]. However, if other circumstances exist that may create *threats*, the *covered member* should apply the "[Conceptual Framework for Independence](#)" interpretation [1.210.010] to evaluate whether the *threats* are at an *acceptable level*. For example, *threats* will exist if cross-claims are filed against the *covered member* alleging that the *covered member* is responsible for any deficiencies in work performed for the *attest client* or if the *covered member*, as a defense, alleges that the *attest client's* management engaged in fraud or deceit.

.10 The following are examples of situations in which *threats* to the *covered member's* compliance with the "[Independence Rule](#)" [1.200.001] would not be at an *acceptable level* and could not be reduced to an acceptable level by *safeguards*, thereby *impairing independence*:

a. The *attest client* or its management or directors have filed cross-claims to protect a right to legal redress in the event of a future adverse decision in the primary litigation (or, in lieu of cross-claims, agreements to extend the statute of limitations), and there is a significant risk that the cross-claim will result in a settlement or judgment in an amount that is **material** to the *covered member's firm* or the *attest client*.

b. The *attest client's* underwriter and the *attest client* or its present management assert cross-claims against the *covered member*.

.11 If only the underwriter or officers or directors of other *clients* of the *covered member* file cross-claims against the *covered member*, *threats* to the *covered member's* compliance with the "[Independence Rule](#)" [1.200.001] would be at an *acceptable level* unless other circumstances create *threats* to compliance with the "[Independence Rule](#)."

### ***Other Third-Party Litigation***

.12 A *lending institution* or other creditor, security holder, or insurance company that alleges reliance on the *attest client's financial statements* as a basis for having extended credit or insurance coverage to an *attest client* may commence third-party litigation against the *covered member* to recover their loss. An example is an insurance company commencing litigation either as a result of receiving an assignment of a claim or under subrogation rights against the *covered member* in the *attest client's* name to recover losses that the insurer

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reimbursed to the *attest client*. If the *attest client* is only the nominal plaintiff, *threats* to the *covered member's* compliance with the "[Independence Rule](#)" [1.200.001] would be at an *acceptable level* unless other circumstances exist, such as when the *covered member* alleges, as a defense, that present management engaged in fraud or deceit. The *attest client* is a nominal plaintiff when the insurance company or lender sues in the name of the *attest client* as a result of obtaining subrogation rights or an assignment from the *attest client* and the *attest client* does not have a beneficial interest in the claim.

.13 If the real party in interest in the litigation (for example, the insurance company) is also the *covered member's attest client* (the plaintiff client), *threats* to the *covered member's* compliance with the "[Independence Rule](#)" [1.200.001] may exist if the litigation carries a significant risk of a settlement or judgment in an amount that would be **material** to the *covered member's firm* or the plaintiff client.

Sec. 602.02.e. Business Relationships

Direct and material indirect business relationships, other than as a consumer in the normal course of business, with a client or with persons associated with the client in a decision-making capacity, such as officers, directors or substantial stockholders, will adversely affect the accountant's independence with respect to that client. Such a mutuality or identity of interests with the client would cause the accountant to lose the appearance of objectivity and impartiality in the performance of his audit because the advancement of his interest would, to some extent, be dependent upon the client. In addition to the relationships specifically prohibited by Rule 2-01, joint business ventures, limited partnership agreements, investments in supplier or customer companies, leasing interests, (except for immaterial landlord-tenant relationships) and sales by the accountant of items other than professional services are examples of other connections which are also included within this classification.

The following cases illustrate the types of inquiries received by the staff in this area:

Example 1

*Facts:* A computer firm was engaged exclusively in computer processing income tax return data for professional tax return preparers, including various local offices of many national accounting firms. When the computer company was contemplating making a public offering of its stock, an inquiry was made regarding whether an accounting firm which utilized this computer service could be deemed independent with respect to the audits of the financial statements of the computer firm required for the purpose of the public offering.

*Conclusion:* An accounting firm's independence would be adversely affected if billings for this service from the computer firm to the accounting firm or to the local office which would perform the audit were significant to the accounting firm, its local office, or to the computer firm. Since these computer services are a direct part of the professional tax service rendered by the accounting firm, any material amount of such computer services would create a mutuality of interests that would impair the appearance of objectivity of the accounting firm necessary for the performance of the audit.

Example 2

*Facts:* Five covered persons of an accounting firm owned ten percent of the voting interests in a small business investment company which planned to participate with another small business investment company in a loan to a client of the accounting firm. In conjunction with the loan, the lending companies would receive warrants for five percent of the common stock of the audit client.

*Conclusion:* Independence of the accounting firm would be adversely affected with respect to the audit of the client's financial statements if the covered persons retained their interests in the small business investment company, which would have a creditor relationship with the client and a right to acquire an equity interest as a result of the loan.

Example 3

*Facts:* An accounting firm inquired whether its independence would be adversely affected with respect to a client if the controlling shareholder became a limited partner in a partnership which is controlled by covered persons of the accounting firm in their capacity as general partner.

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*Conclusion:* The accounting firm's independence would be questioned in these circumstances in as much as the joint business venture would impair the appearance of independence of the accounting firm.

#### Example 4

*Facts:* An accounting firm's client, a realtor corporation, was the general partner and ten percent owner in a limited partnership which owned unimproved land held for appreciation in value. The accounting firm also owned a five percent interest in this limited partnership and a covered person in the firm had a two percent interest.

*Conclusion:* The joint investment with the client was viewed as incompatible with the appearance of independence.

#### Example 5

*Facts:* A covered person in a foreign accounting firm that performed the audit of financial statements of a client in the foreign country which was a subsidiary of a company registered with the Commission also owned an industrial equipment company from which the client had ordered an expensive piece of equipment. A large deposit on the purchase commitment was held by the partner's company during the audit engagement. Engaging in commercial transactions with a client does not conflict with the professional standards for independence of accountants in the foreign country.

*Conclusion:* The accounting firm's independence was adversely affected since the partner's commercial company was dependent on the client for a profit on the commercial transaction and was in a debtor position in relation to the client as a result of the large deposit. These factors created a question regarding the objectivity of the firm in conducting the audit.

#### Example 6

*Facts:* Client of an accounting firm was engaged in the business of selling franchises. Two covered persons of this firm had invested approximately five percent of their personal fortunes to buy one-half of the stock of a corporation which held a franchise granted by this client. Except for the payment of a percentage of sales to the franchisor, the franchisee operated independently.

*Conclusion:* The firm could not be considered independent because the covered persons had a material investment in the franchisee which had a close identity in fact and in appearance with the client.

#### Example 7

*Facts:* Covered persons in accounting firm was also a financial vice president and stockholder of a real estate investment trust. In addition, he was a limited partner in a company which manages the trust. A client of his firm had asked him to help them get a loan from the investment trust.

*Conclusion:* Independence for future periods would be adversely affected if the company were to obtain the loan from the real estate investment trust. However, no question would be raised as to periods prior to the commencement of negotiations for the loan.

#### Example 8

*Facts:* Covered persons in the accounting firm had a common investment with stockholders of a prospective client. These covered persons owned approximately 11 percent of Company A and the other investors who owned approximately 78.5 percent of Company A, also owned 22 percent of the prospective client.

*Conclusion:* Independence was adversely affected because the common investment which the covered persons of the firm had with the substantial minority shareholders of

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the prospective client was such a circumstance as could lead a third party to question the firm's objectivity.

#### Example 9

*Facts:* An accounting firm planned to construct office buildings in which it would occupy a relatively small portion of the space and would rent the remainder to other tenants, some of whom might be clients of the firm.

*Conclusion:* The activity of owning and managing real property is more in the nature of a commercial business activity than of a professional service. Rental of a material amount of space to a client would raise a question of independence since the accounting firm would appear to have a material business relationship with the client. Some reasonable tests which would be applied in determining what constitutes a rental of material amount might be the relationship of a single lease to the fees earned in the office located in the building concerned, total lease rentals from all clients to the firm's total fees, and lease rentals from a particular client to the auditing fee paid by that client for the same period.

#### Example 10

*Facts:* Several covered persons of an accounting firm formed a general partnership to build two office buildings which would then be leased to third parties. Would leases entered into between the partnership and present or future clients of the accounting firm impair the firm's independence?

*Conclusion:* The activities conducted by the covered persons through the general partnership would be attributed to the accounting firm for purposes of independence determinations. Therefore, any material business relationship arising between the general partnership and a client of the accounting firm would impair the independence of the accounting firm as auditors for that client and its affiliates.

#### Example 11

*Facts:* An accounting firm had its office in a building which was owned by a client. The accounting firm, which occupied approximately 25 percent of the available office space in the building, was the only tenant other than the client.

*Conclusion:* The fact that the accounting firm was the only other tenant in the client's building and leased a substantial portion of the available office space are circumstances that would lead a reasonable third party to question the firm's objectivity. Therefore, independence was adversely affected.

#### Example 12

*Facts:* Accounting firm planned to rent block time on its computer to a client if the client's computer becomes overburdened.

*Conclusion:* Renting excess computer time to a client, except in emergency or temporary situations, is a business transaction with a client beyond the customary professional relationship and would therefore adversely affect independence.

#### Example 13

*Facts:* A covered person in an accounting firm acquired, and assigned to his minor daughter, a ten percent voting interest in a corporation which owned a retail store franchised from a proposed client that also operated similar stores directly.

*Conclusion:* Independence of the accounting firm would be adversely affected with respect to the audit of the client's financial statements because the covered person was deemed to have a direct interest in a company over which the client may exercise control through the franchise agreement for operation of the retail store. In addition, the

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company had a close identity in fact and appearance with the client through the operation of similar retail stores.

#### Example 14

*Facts:* An accountant and five persons who were the sole stockholders of the proposed registrant acquired a parcel of real estate for the purpose of selling or leasing it to the company. The total purchase price was \$85,000 of which \$26,000 was paid in cash and the balance by a note secured by a mortgage. In addition to providing his portion of the cash payment, the accountant loaned the others \$21,000 on interest bearing notes to cover their share of the down payment. It was also provided that the accountant would receive 25 percent of any profit arising from sale of the property to an outsider.

*Conclusion:* Independence was impaired.

#### Example 15

*Facts:* A covered person, together with certain officers of the registrant, organized a corporation which purchased property from the registrant for \$100,000 giving the registrant \$25,000 cash and a purchase money mortgage for \$75,000.

*Conclusion:* Independence was impaired.

#### Example 16

*Facts:* Certain covered persons of an accounting firm were to become principals in a finance company whose wholly owned insurance agency would place with an insurance company client of the firm all or a substantial part of the insurance on the chattels financed.

*Conclusion:* If the insurance were so placed, the accounting firm would not be considered independent with respect to its insurance company client.

#### Example 17

*Facts:* The wife of a covered person had a 47.5 percent interest in one of the three principal underwriters of a proposed issue by the registrant.

*Conclusion:* Not independent.

#### Example 18

*Facts:* A consultant to an accounting firm was also a director and member of the audit committee of a client served by the accounting firm. The consultant's compensation from each of these two involvements was significant in relation to his total earnings.

*Conclusion:* The apparent conflict of interest which arose from the dual roles of the consultant caused the appearance of the accounting firm's independence to be affected adversely.

#### Example 19

*Facts:* A covered person certifying the financial statements of a registered broker-dealer was a co-signer on the broker's indemnity bond.

*Conclusion:* Independence impaired.

#### Example 22

*Facts:* An accounting firm audited the brokerage operations of a financial concern and planned to perform what it considered to be consultative or advisory work for another branch of the business which marketed an estate planning service. This additional work would consist chiefly of developing individual estate planning packages for customers and making recommendations jointly with management to the customers.

*Conclusion:* The accounting firm's independence would be adversely affected with respect to the audit of the brokerage operations if it performed the additional services

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for another branch of the business, because it would be participating with management in the development and the sale of a product to be marketed by the company.

### IT and Cloud Services Task Force

**Task Force Members:** Shelly VanDyne (Chair), Cathy Allen, Wendy Davis, Mike Schmitz, Katie Jaeb, Ray Roberts, Anna Dourkourekas, Dan O'Daly and John Ford. Staff: Ellen Gorla

#### Task Force Objective

Recommend to PEEC any changes necessary to the nonattest services subtopic in light of current information technology (including cloud) service offerings by members.

#### Reason For Agenda

To provide the Committee with an update on the Task Force's preliminary discussions related to some of various components of an Information systems design, implementation and integration services.

#### Summary of Issues

At the May meeting the Committee was told that the Task Force believes it would be helpful to provide guidance on what "install or integrate" could involve and what would be an "off-the-shelf" accounting package and the amount of customization that could be done to an "off-the-shelf" accounting package without impairing independence. For example, it was explained that Task Force had begun discussing whether something more complex, such as an Oracle implementation where there is a lot of customization or configuration, would be covered.

The focus of the Task Force's discussions since the May meeting has been around trying to more clearly understand what all is entailed when members provide information technology services that involve:

- Configuration
- Customization
  - Involving Modification
  - Involving Enhancements
- Implementation
- Integration
- Interfacing
- Install
- Conversion

To do this, Mr. O'Daly and Mr. Ford, who have robust IT backgrounds, were added to the Task Force. The Task Force plans to develop definitions for each of the above terms and then to develop nonauthoritative guidance to assist members in understanding the independence implications associated with providing these services. The Task Force plans to bring this guidance to the Committee for input at the November meeting.

#### Effective Date

TBD

#### Communication Plan

TBD

#### Materials Presented

##### Agenda Item 5B

Information Systems Design, Implementation, or Integration interpretation

##### Agenda Item 5C

Excerpt of the Nonattest Services FAQs

**1.295.145 Information Systems Design, Implementation, or Integration**

- .02 When a member provides information systems design, implementation, or integration services to an *attest client*, self-review and management participation *threats* to the *covered member's* compliance with the "[Independence Rule](#)" [1.200.001] may exist.
- .03 If the member applies the "[General Requirements for Performing Nonattest Services](#)" interpretation [1.295.040] of the "Independence Rule" [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For example, a member may
  - a. install or integrate an *attest client's* financial information system that the member did not design or develop (for example, an off-the-shelf accounting package).
  - b. assist in setting up the *attest client's* chart of accounts and *financial statement* format with respect to the *attest client's* financial information system.
  - c. design, develop, install, or integrate an *attest client's* information system that is unrelated to the *attest client's financial statements* or accounting records.
  - d. provide training and instruction to an *attest client's* employees on an information and control system.
  - e. perform network maintenance, such as updating virus protection, applying routine updates and patches, or configuring user settings consistent with management's request.
- .04 However, *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* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member
  - a. designs or develops an *attest client's* financial information system.
  - b. makes other than insignificant modifications to source code underlying an *attest client's* existing financial information system.
  - c. supervises *attest client* personnel in the daily operation of an *attest client's* information system.
  - d. operates an *attest client's* network. [Prior reference: paragraph .05 of ET section 101]

Nonauthoritative questions and answers regarding information systems design, implementation, and integration services are available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.pdf).

## INFORMATION TECHNOLOGY SERVICES

1. Why does the Information Systems Design, Implementation, or Integration interpretation indicate that independence would be impaired if a member is operating a client's network?

Operating an attest client's network is considered to be a management responsibility that would violate the General Requirements for Performing Nonattest Services interpretation.

2. Would outsourcing the client's entire network operation and independently operating the client's network impair independence?

Yes.

3. Would performing network maintenance (for example, updating virus protection, applying updates and patches, or configuring user settings, consistent with management's request) impair independence?

No. Performing network maintenance is not considered to be operating the attest client's network and, therefore, would not impair independence provided a client employee with the necessary skill, knowledge, and/or experience is making all decisions and approving all activities. [Added Prior To June 2005]

4. Would assisting an attest client with a server project (for example, install, migrate, or update its network operating system; add equipment and users; or copy data to another computer) impair independence?

No. Provided the member does not make other than insignificant modifications to the source code underlying the attest client's financial information system. [Added Prior To June 2005]

5. Would supervising client personnel in the daily operation of the attest client's financial information system impair independence?

Yes. In this case, the member would be performing management responsibilities (that is, directing or accepting responsibility for the actions of the attest client's employees), which would impair independence. [Added Prior To June 2005]

6. Would assisting an attest client with procuring and securing Internet access impair independence?

No, provided an individual designated by the attest client to oversee the service has the necessary skill, knowledge, and/or experience and makes all decisions concerning the Internet provider and services to be provided.

7. What criteria should a member use to determine whether an attest client's information system is unrelated to its financial statements or accounting records?

Information systems that produce information that is reflected in the amounts and disclosures in the attest client's financial statements, used in determining such amounts and disclosures, or used in effecting internal control over financial reporting are considered to be related to the financial statements and accounting records. However, information

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systems that are used only in connection with controlling the efficiency and effectiveness of operations are considered to be unrelated to the *financial statements* and accounting records. [Added Prior To June 2005]

8. What factors should a **member** consider in determining whether the modifications made to source code underlying an **attest client's** financial information system are other than insignificant?

If the modifications have more than an insignificant effect on the functionality of the software, they should be considered to be other than insignificant. [Added Prior To June 2005]

## TRAINING SERVICES

1. An **attest client** is implementing changes to its financial reporting system or process (for example, implementing International Financial Reporting Standards [IFRSs] or eXtensible Business Reporting Language [XBRL]). Would a **member's independence** be **impaired** if he or she provided training to the **attest client** related to such system or process?

A **member's independence** would not be **impaired** if he or she provides **attest client** personnel with a general understanding of the financial reporting system or process (FRP). If **attest client** personnel already have a general understanding of the FRP, the **member** may provide more specific training to **attest client** personnel on how the system or process applies to the **attest client's** specific circumstances. In providing training services, however, the **member** should ensure that such nonattest services do not involve supervising **attest client** personnel in either the implementation or daily operation of the FRP, or performing other management responsibilities, such as making FRP operational decisions or implementing the internal controls necessary for the FRP to run effectively [Added February 2010].

## PROJECT MANAGEMENT SERVICES

- .01 Would a **member's independence** be **impaired** if he or she managed a project for an **attest client** (such as converting the **client's** FRP from US GAAP to IFRSs or implementing XBRL)?

Yes, accepting responsibility for the management of an **attest client's** project would be considered a management responsibility and as such would **impair** a **member's independence**. This would be true even if the project did not impact the **financial statements**.

**Independence**, however, would not be **impaired** if management makes all decisions related to the project and the **member's** involvement was limited to providing assistance, advice, suggestions and/or recommendations regarding matters that are within their areas of knowledge or experience. Such activities might include (a) providing advice about either the tagging of XBRL-formatted or preparation of IFRSs-based **financial statements**, (b) providing feedback on management's plans, including how management will prioritize its activities, and (c) assisting the **client** with its understanding of the general considerations for the project [Added February 2010.]

- .02 Would a **member's independence** be **impaired** if he or she assisted **attest client** management with its determination of whether or not to proceed with a project (for

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**example, convert its FRP from US GAAP to IFRSs or is implementing XBRL for its financial statements)?**

Provided the member only *assists the attest client* by providing guidance on the conversion or implementation issues and does not make the decision of whether or not to proceed with the project, the *member's independence* would not be *impaired*. For example, such assistance may include (a) helping gather information that management will use to conduct its analysis or (b) providing advice and making recommendations on the assumptions management plans to use in its analysis [Added February 2010.]

## Entities Included In State and Local Government Financial Statements Task Force

### Task Force Members

Nancy Miller (Chair), James Curry, John Good, Lee Klumpp, George Dietz, Flo Ostrum, Anna Dourdourekas, Eric Holbrook, Jack Dailey, Randy Roberts, E. Gorla (Staff), Teresa Bordeaux (Staff), Laura Hyland (Staff), Sue Hicks (Staff)

### Task Force Charge

Consider incorporating the threats and safeguards approach into the Entities Included in State and Local Government Financial Statements interpretation [1.224.020] and determine if a conceptual framework assessment could be utilized to determine when a member needs to be independent of state and local governmental entities for which he or she is not providing financial statement attest services. The Task Force will also clarify who at the firm and which immediate family members the interpretation should extend to and if the interpretation should contain any exceptions. The Task Force will also determine if the final guidance could be extended to the federal government environment.

### Reason For Agenda

The Task Force seeks the Committee's feedback on its direction. If the Committee would like, the discussion can begin with a refresher on the SLG environment which is outlined in **Agenda Item 6G**.

### Summary of Issues

Since the May meeting the Task Force has discussed the remaining downstream issues. A summary of these issues and the Task Force's recommendations follow.

### ***Entities Covered By SLG Interpretation***

The Task Force believes that although the basic terminology of "funds and component units" is appropriate and commonly understood, it may not be clear that departments, agencies, programs, organizational units administered by elected officials, grant reporting and organizational units within component units are covered by the interpretation since they may only make up part of a component unit or fund. To clarify this, the Task Force recommends the following be added to the introduction section of the interpretation:

***For purposes of this interpretation, funds and component units are intended to be broadly defined and can include but are not limited to, departments, agencies, programs, organizational units administered by elected officials, grant reporting and organizational units within component units.***

The impact of adding this provision would mean that the entity wouldn't have to have its own column or be an opinion unit in order for the member apply the making reference exception, rather an entity that rolls up into a column (fund, component unit etc.) could qualify as long as the making reference exception criteria are met. Consider the following example. A member is auditing a city and there is a tourism agency that rolls into the general fund. The tourism agency is audited by another auditor. If the making reference exception criteria was met, the member would not need to be independent of the tourism agency.

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### ***Investments Held By the Primary Government, Funds, Component Units (Including Employee Benefit Plans)***

The Task Force believes that when the primary government, funds or component units (SLG entity) have investments in entities, members should use the “Affiliate” definition and related “Client Affiliate” interpretation to determine when the SLG entity should be an affiliate of the investment and vice versa. To accomplish this, the Task Force believes three changes are needed.

#### *Investments*

The first change is to add the following to the introduction section of the strawman (Agenda Item 5B):

***Members should apply the Client Affiliate interpretation [1.224.010] and related affiliate definition [0.400.02] to investments. An investment is a security or other asset that (a) the entity holds primarily for the purpose of income or profit and (b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash. This includes investments and ownership in equity interest in common stock accounted for using the equity method of accounting as provided for in Cod I50. Equity interests in joint ventures and component units where the intent of the government is to directly enhance its ability to provide governmental services and that do not meet the definition of an investment above are not considered investments for purposes of this interpretation.***

#### *Client Affiliates*

The second change is to revise paragraph .04 of the “Client Affiliates” interpretation (**Agenda Item 6F**) to put members on notice that the interpretation should be applied to investments held by state and local government entities.

***.04 State and local government entities*** ~~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],~~ ***should apply this interpretation to their investments.*** [Prior reference: paragraph .20 of ET section 101]

#### *Government Employee Benefit Plans*

The third change that the Task Force believes is necessary is to address government employee benefit plans. In the government environment, plans are either cost-sharing multiple-employer plans, agent multiple-employer plans or single employer plans.

Cost-sharing multiple-employer plans are similar to multiemployer plans in that there are multiple employers that participate but the assets of these plans are combined and used to pay benefits of any participant. Alternatively, agent multiple-employer plans are similar to multiple employer employee benefit plan in that while there are multiple employers that participate, the assets of each employer are segregated and are used to only pay benefits to their participants not participants of other employers. While there are also single employer plans, often the single employer is the “reporting entity” and all employers in that single reporting entity will participate in these plans. In these instances, these plans tend to be more akin to a cost-sharing multiple employer plan. In the government environment, the ERISA concepts of “sponsor” and “plan administrator” are not used, rather members would likely need to look to the entity(ies) that can influence the plan to determine if they are affiliates. The Task Force is still discussing how best to revise the “Affiliate Definition” for government plans.

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**Action Needed**

The Committee is asked to provide feedback on the Task Force's direction.

**Effective Date**

TBD

**Communication Plan**

While an overall communication plan has yet to be developed, the Task Force plans to continue having open discussions with the AICPA SLG Expert Panel (Expert Panel) members. To date, members of the Task Force have met with the Expert Panel three times. In addition, Ms. Miller, Mr. Roberts and Ms. Goria met with the State Auditor's Standards & Reporting Committee two times.

**Materials Presented**

- Agenda Item 6B** SLG Straw-Man
- Agenda Item 6C** Visual Aid To Demonstrate How To Apply the Downstream Exceptions
- Agenda Item 6D** Plan Is an Attest Client or Is Sponsored by an Attest Client Interpretation [1.250.010]
- Agenda Item 6E** Affiliate Definition
- Agenda Item 6F** Client Affiliates Interpretation [1.224.010]
- Agenda Item 6G** Governmental Crosswalk

**SLG Straw-Man**  
**[Changes Since the May Meeting Appear in Yellow Highlight]**

**1.224.020 Entities Included in State and Local Government Financial Statements**

.01 This interpretation applies to financial statement attest engagements of state and local governmental entities whose basic financial statements include funds and component units that are required under the applicable framework, as defined in AU-C 200.14, (b) and (c), to be included in the reporting entity of a primary government (funds and component units).

.02 For purposes of this interpretation, state and local governmental entities include general purpose governments such as states, counties, cities, towns and villages. State and local governmental entities also include special purpose governments, which perform only one activity or only a few activities. Examples of special purpose governments include, but are not limited to, school districts, public universities and community colleges, utilities, hospitals or other health care organizations, public retirement systems, public transportation systems, public authorities, tribes, and special districts.

**.03 For purposes of this interpretation, funds and component units are intended to be broadly defined and can include but are not limited to, departments, agencies, programs, organizational units administered by elected officials, grant reporting and organizational units within component units.**

**.04 Members should apply the Client Affiliate interpretation [1.224.010] and related affiliate definition [0.400.02] to investments. An investment is a security or other asset that (a) the entity holds primarily for the purpose of income or profit and (b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash. This includes investments and ownership in equity interest in common stock accounted for using the equity method of accounting as provided for in Cod 150. Equity interests in joint ventures and component units where the intent of the government is to directly enhance its ability to provide governmental services and that do not meet the definition of an investment above are not considered investments for purposes of this interpretation.**

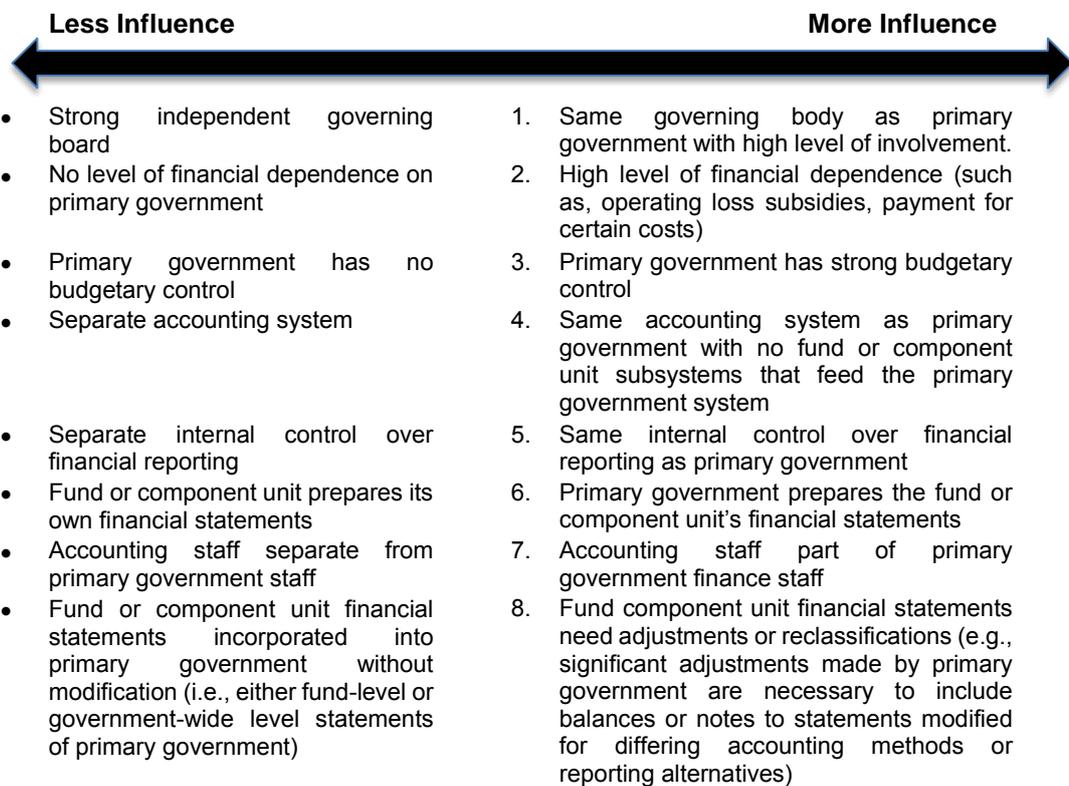
*Auditor of Primary Government*

.05 When performing a financial statement attest engagement for a primary government, covered members should apply the "[Independence Rule](#)" [1.200.001] and related interpretations applicable to the primary government to all funds and component units included or required to be included in the reporting entity under the applicable framework except in the following specific situations.

- a. When the member makes reference to another auditor's report and the primary government has only minimal influence over the accounting or financial reporting process of a fund or component unit:
  - i. Members and member's firms do not need to be independent of a fund or component unit that is immaterial to the primary government.
  - ii. Members and member's firms do not need to be independent of funds or component units that are material to the primary government

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- provided it is reasonable to conclude that the material fund or component unit will not be subject to financial statement attest procedures of the member.
- iii. When a material fund's or component unit's financial information will be subject to the member's financial statement attest procedures, members may use the Conceptual Framework for Independence to evaluate any relationships or circumstances that the member knows or have reason to believe exist that impairs independence under the interpretations of the "Independence Rule" to determine if safeguards can be applied that will eliminate significant threats or reduce them to an acceptable level.
- b. When the primary government excludes a fund or component unit that is required to be included under the applicable framework (excluded fund or component unit), members do not need to be independent of the excluded fund or component unit if the excluded fund or component unit is:
    - i. Immaterial to the primary government.
    - ii. Material to the primary government but the primary government has only minimal influence over the accounting or financial reporting process of the excluded fund or component unit.
  - c. The member and member's firm may provide prohibited nonattest services to the following entities 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 primary government 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. The entities that this provision applies to are:
    - i. Funds and component units that a member makes reference to another auditor's report when the primary government has more than minimal influence over the accounting or financial reporting process of that fund or component unit.
    - ii. Excluded funds or component units that are material to a primary government.
- .06 There is a rebuttable presumption that the primary government has more than minimal influence over the accounting or financial reporting process of a fund or component unit. However, the member can rebut that presumption by considering the factors such as the following that, in the member's professional judgment, demonstrate the primary government has only minimal influence
- a. Primary government does not have the ability to direct the behaviors or actions of the governing board of the fund or component unit.
  - b. Primary government does not have the ability to add or remove members of the governing board of the fund or component unit.
  - c. Primary government does not exert influence that results from:
    - i. the primary government's issuance or full or partial payment of the fund's or component unit's debt,
    - ii. the primary government's financing of some or all of the fund's or component unit's deficits, or
    - iii. the primary government's actions to use or take the fund's or component unit's financial resources
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- d. Primary government does not have budgetary control over the fund or component unit.
  - e. Fund or component unit does not have the same accounting systems as the primary government.
  - f. Fund or component unit does not have the same internal control over financial reporting systems.
  - g. Primary government does not prepare the financial statements for the fund or component unit.
  - h. Accounting or finance staff of the fund or component unit is not the same staff as the primary government.
- .07 The overall facts and circumstances should be considered when using the factors in paragraph .04 to evaluate whether a primary government has more than minimal influence over the accounting or financial reporting process of a fund or component unit. While some factors may indicate influence others may indicate little to no influence. Some factors may be weighted differently depending on the circumstances and the subject matter of any potential impairment. Thus, the consideration of these factors runs along a spectrum. The following illustrates one possible spectrum.



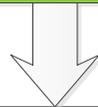
- .08 Members should consider factors such as the following when evaluating whether a fund or component unit's financial statements will be subject to the member's financial statement attest procedures:
- a. Are significant modifications made by the primary government to the fund or component unit's financial statements in order to be included into the primary government's basic financial statements (e.g., adjustments to add fund or component unit financial information into government-wide statements)?
  - b. Are there modifications to the fund or component unit's financial statements made by the primary government to revise the fund or component unit's financial information for accounting methods or reporting alternatives?

# Downstream Exceptions

## Entities Audited By Another Auditor

Funds and Component Units that Auditor of Primary Government Makes Reference to Other Auditors Reports

### Current Interpretation



### Proposed Interpretation

Primary Government Has Only Minimal Influence Over the Accounting or Financial Reporting Process of Entity		Primary Government Has More Than Minimal Influence Over the Accounting or Financial Reporting Process of Entity**
Entity is Immaterial To Primary Government	Entity is Material to Primary Government	
	Entity <b>Will Not</b> Be Subject to Financial Statement Attest Procedures of the Member	Entity <b>Will</b> Be Subject to Financial Statement Attest Procedures of the Member*

## Excluded Entities

Funds and Component Units that the Primary Government Excludes But That Are Required to Be Included Under the Applicable Framework

### Current Interpretation



### Proposed Interpretation

Excluded Entity is Immaterial to Primary Government	Excluded Entity is Material to Primary Government (Will the Exclusion Result in GAAP Departure?)	
	Primary Government Has Only Minimal Influence Over the Accounting or Financial Reporting Process of Excluded Entity	Primary Government Has More Than Minimal Influence Over the Accounting or Financial Reporting Process of Excluded Entity**

\*See paragraph .06 in Strawman for examples of when a member might have to perform financial statement attest procedures on such entity.

\*\*See paragraph .04 in Strawman for discussion about the primary government having more than minimal influence.

- Independence Not Required
- May Use Conceptual Framework To Evaluate Threats
- Independence Required With An Exception Available for Nonattest Services When Reasonable to Conclude Services Will Not Be Subject To Attest Procedures

**1.250.010 Plan Is an Attest Client or Is Sponsored by an Attest Client**

- .01 When a *covered member* participates in an employee benefit plan that is an *attest client* or is sponsored by an *attest client*, during the *period of the professional engagement* or during the period covered by the *financial statements*, the self-interest *threat* to compliance with the “[Independence Rule](#)” [1.200.001] would not be at an *acceptable level*. *Independence* with respect to the employee benefit plan and the sponsor would be *impaired* except in the following specific situations:
- a. *Governmental organization*. When a *covered member* is an employee of a governmental organization that sponsors, cosponsors, or participates with other governmental organizations in a public employee retirement plan (the plan) and the *covered member* is required by law, rule, or regulation to audit the plan, *threats to independence* would be at an *acceptable level* if all of the following *safeguards* are met:
    - i. The *covered member* is required to participate in the plan as a condition of employment.
    - ii. The plan is offered to all employees in comparable employment positions.
    - iii. The *covered member* is not associated with the plan in any capacity prohibited by the “[Simultaneous Employment or Association With an Attest Client](#)” interpretation [1.275.005] of the “Independence Rule.”
    - iv. The *covered member* has no influence or control over the investment strategy, benefits, or other management activities associated with the plan.
  - b. *Former employment or association with the attest client*. The requirements of [paragraph .04](#) of the “Former Employment or Association With an Attest Client” interpretation [1.277.010] must be met. [Prior reference: paragraphs .214–.215 of ET section 191]
- .02 When an *immediate family* member participates as a result of his or her employment, in an employee benefit plan that is an *attest client* or is sponsored by an *attest client*, the requirements of the “[Immediate Family Member Participation in an Employee Benefit Plan That Is an Attest Client or Is Sponsored by an Attest Client \(Other Than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans\)](#)” interpretation [1.270.030] of the “Independence Rule” [1.200.001] must be met. [Prior reference: paragraph .17 of ET section 101]

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## Agenda Item 6E

- Affiliate.** The following entities are affiliates of a *financial statement attest client*
- a. An entity (for example, subsidiary, partnership, or limited liability company [LLC]) that a *financial statement attest client* can control.
  - b. An entity in which a *financial statement attest client* or an entity controlled by the *financial statement attest client* has a *direct financial interest* that gives the *financial statement attest client* significant influence over such entity and that is material to the *financial statement attest client*.
  - c. An entity (for example, parent, partnership, or LLC) that controls a *financial statement attest client* when the *financial statement attest client* is material to such entity.
  - d. An entity with a *direct financial interest* in the *financial statement attest client* when that entity has significant influence over the *financial statement attest client*, and the interest in the *financial statement attest client* is material to such entity.
  - e. A sister entity of a *financial statement attest client* if the *financial statement attest client* and sister entity are each material to the entity that controls both.
  - f. A trustee that is deemed to control a trust *financial statement attest client* that is not an investment company.
  - g. The sponsor of a single employer employee benefit plan *financial statement attest client*.
  - h. Any entity, such as a union, participating employer, or a group association of employers that has significant influence over a multiemployer employee benefit plan *financial statement attest client* and the plan is material to such entity.
  - i. The participating employer that is the plan administrator of a multiple employer employee benefit plan *financial statement attest client*.
  - j. A single, or multiple employer employee benefit plan sponsored by either a *financial statement attest client* or an entity controlled by the *financial statement attest client*. All participating employers of a multiple employer employee benefit plan are considered sponsors of the plan.
  - k. A multiemployer employee benefit plan when a *financial statement attest client* or entity controlled by the *financial statement attest client* has significant influence over the plan and the plan is material to the *financial statement attest client*.
  - l. An investment adviser, a general partner, or a trustee of an investment company *financial statement attest client* (fund) if the fund is material to the investment adviser, general partner, or trustee that is deemed to have either control or significant influence over the fund. When considering materiality, members should consider investments in, and fees received from, the fund.

Nonauthoritative questions and answers related to the application of the independence rules to affiliates of employee benefit plans are available at [www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/faqs-application-independence-rules-affiliates-of-employee-benefit-plans.pdf](http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/faqs-application-independence-rules-affiliates-of-employee-benefit-plans.pdf).

**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. A *covered member* may have a *loan* to or from an 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*.
- .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*

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*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*.

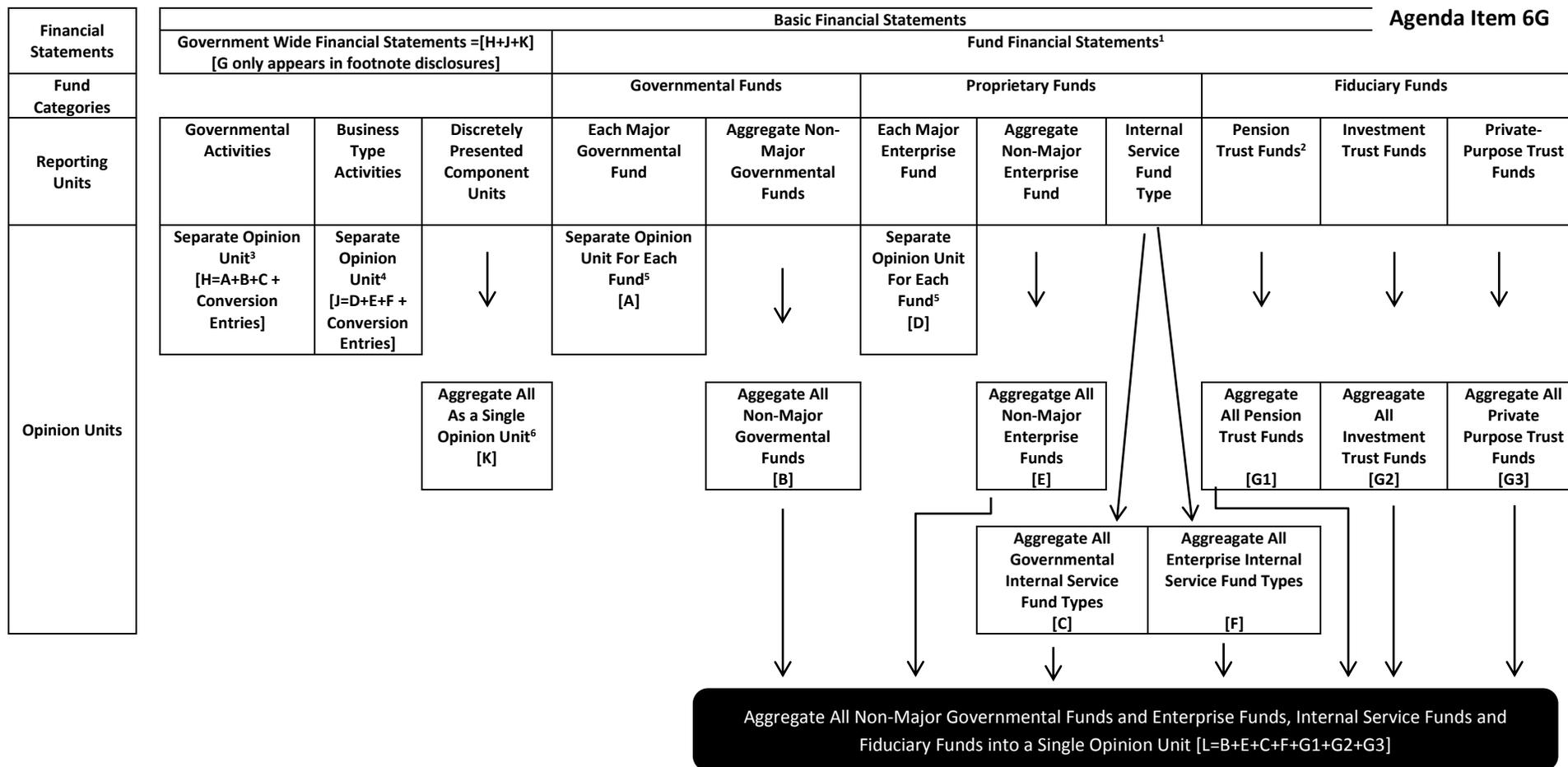
- .04 State and local government entities** This interpretation does not apply to a *financial statement attest client* that is covered by the “[Entities Included in State and Local Government Financial Statements](#)” interpretation [1.224.020] of the “Independence Rule” [1.200.001], **should apply this interpretation to their investments**. [Prior reference: paragraph .20 of ET section 101]
- .05 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 non-client 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.
- .06 *Independence* will not be considered *impaired* with respect to the *financial statement attest client* because a *member* or *member’s firm* has an interest in or relationship with the 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*).
- .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.

#### **Effective Date**

- .09 [Paragraphs .01–.04](#) are effective for engagements covering periods beginning on or after January 1, 2014. Early implementation is allowed.

[See [Revision History Table](#).]

Nonauthoritative questions and answers regarding the application of the independence rules to affiliates of employee benefit plans are available at <a href="http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/faqs-application-independence-rules-affiliates-of-employee-benefit-plans.pdf">http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/faqs-application-independence-rules-affiliates-of-employee-benefit-plans.pdf</a> .
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<sup>1</sup> Fund Financial Statements will generally include Funds and Blended Component Units. Funds are not separate legal entities; they are self-balancing sets of accounts that are segregated for the purpose of reporting a specific activity of the government. For example, an activity that receives significant support from user fees and charges such as a water activity may be reported as an Enterprise Fund. It is possible that blended component units will be included in the governmental and/ or proprietary fund categories. Blended component units are separate legal entities that are so closely related to the primary government such that they are reported just like a fund of the primary government. Component units that are fiduciary in nature are reported as if they were a fiduciary fund of the primary government.

<sup>2</sup> In addition to pension trust funds, this fund includes other employee benefit trust funds.

<sup>3</sup> The Governmental Activities Opinion Unit is generally comprised of all the data reported in the Governmental Funds category, and the internal service funds category (unless their predominant customers are business-type activities), as well as conversion entries (including those to convert governmental fund data to the accrual basis of accounting). Generally, the entries made to create the financial statements of the governmental activities opinion unit from the underlying governmental funds and any applicable internal service funds are far more significant than those made to create the financial statements of the Business Type Activities Opinion Unit from the underlying enterprise funds and any applicable internal service funds

<sup>4</sup> The Business Type Opinion Unit is generally comprised of all the data reported in the Major and Non-Major Enterprise Funds categories, internal services funds where business-type activities are the predominate customers as well as any necessary conversion entries to create the business-type activities financial statements.

<sup>5</sup> The opinion units for the major governmental and enterprise funds are comprised of funds and blended component units. The criteria for determining whether a fund or blended component unit is major is defined by GASB. Each major fund is a separate opinion unit and are presented in the applicable fund financial statement in separate columns. Separate opinions for each major fund.

<sup>6</sup> Aggregate discretely presented component units opinion unit is comprised of separate legal entities where the primary government has financial [control] sufficient to require the inclusion of that entity into the Government Wide Financial Statements because the relationship is not so close that is should be reported as a blended component unit.

## Cybersecurity Services

### Staff

Lisa Snyder and Ellen Gorla

### Reason for Agenda Item

Staff seeks the Committee's direction regarding whether a Task Force should be appointed to determine if independence guidance should be developed related to the provision of nonattest cybersecurity services.

### Summary of Issues

To assist the Committee in understanding the various nonattest services members may be providing in the cybersecurity area, Staff obtained the following list of services from some members:

- 1. Provide general training or information session on cybersecurity issues, for example topics may include**
  - National Institute of Standards and Technology (NIST) guidance
  - Guidance on data privacy and information security controls
  - Guidance on cybersecurity assessments and strategy
  - Incident response planning
  - Security awareness and training
- 2. Conduct a best practice review relating to cybersecurity practices or provide general advisory input on the company's cybersecurity assessment procedures, etc. This could also include benchmarking company's current cybersecurity infrastructure and procedures against NIST Cybersecurity Framework (NIST CSF).**
  - In benchmarking reviews or studies, the objective is to provide general information (which may also include advice or recommendations) to management.
- 3. Provide consulting advice on the client's cybersecurity program. This could include but is not limited to consulting advice on the following:**
  - Providing benchmarking information based on NIST CSF
  - Security strategy and design
  - Information threat analysis
  - Breach incident response procedures
  - Risk-event consulting
  - Anti-phishing consulting
  - PCI Data Security Standards QSA consulting
  - Enterprise security architecture planning
- 4. Provide management recommendations or advise management on the design of a cybersecurity privacy program.**
- 5. Design and implement a cybersecurity privacy program including the implementation of firm's recommendations (controls/procedures, etc.)**

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6. **Develop and design the company's policies, procedures and internal controls relating to cybersecurity threats and practices.**
    - Could include enforcement of the policy as well.
  7. **Document company's policies and procedures relating to cybersecurity practices and procedures.**
  8. **Provide management recommendations or advise management on the company's policies, procedures and internal controls relating to cybersecurity threats and practices, including performing a cyber liability gap assessment**
  9. **Periodically advise the client's project manager as he/she monitors the project's progress in relation to the implementation of their policies, procedures and internal controls.**
  10. **Acting in a project management capacity in implementing the company's cybersecurity program. This could include**
    - Being identified as the project champion
    - Defining company's cybersecurity framework/process/methodology
    - Defining company's implementation plan
    - Managing the current state assessment process/activities (acting in a management capacity)
    - Responding to cybersecurity assessment by developing action steps/plans and handle the deployment of such steps/action plans, including the development the company's strategic plans
    - Monitoring of the company's cybersecurity processes/structure
  11. **Perform cybersecurity services, including but not limited to the following:**
    - Incident response planning and testing in the event of a breach of sensitive data
    - Breach incident response procedures
    - Vulnerability assessments
    - Penetration testing
    - Third-party risk assessment
  12. **Perform forensic incident response investigations and expert testimony.**

**Effective Date**

To be determined.

**Action Needed**

The Committee is asked to decide if a Task Force should be appointed to determine what if any independence guidance should be issued with respect to cybersecurity nonattest services.

**Communications Plan**

To be determined.

## IFAC Convergence – Part C

### Task Force Members

Stanley Berman (Chair), Elizabeth Pittlekow, Joe Schiavo, and Steven Reed. Staff: Jason Evans. Observer: Lisa Snyder

### Task Force Charge

The Task Force is charged with reviewing revisions made to Part C of the International Ethics Standards Board for Accountants' (IESBA) Code. Phase I will focus on Sections 320, *Preparation and Presentation of Information* and 370, *Pressure to Breach the Fundamental Principles*. The Task Force will consider necessary revisions to the AICPA Code for purposes of convergence.

### Reason for Agenda Item

To review and obtain feedback on the Task Force's preliminary deliberations.

### Summary of Issues

#### Background

Given that over half of the world's professional accountants are professional accountants in business (PAIBs) and due to the fundamental role that PAIBs play in financial reporting and facilitate effective governance in organizations, the IESBA established a Working Group to determine whether, in light of reported accounting irregularities, strengthening Part C of the Code would better promote ethical behavior by PAIBs.

As a result of the surveys and studies the Working Group recommended the IESBA consider the following matters:

- The responsibility of PAIBs to produce financial reports that are faithful representations of the economics of transactions, and associated matters;
- Pressure by superiors and others to engage in unethical or illegal acts; and
- Inducements, including facilitation of payments and bribes.

In March, 2013, the IESBA approved a project to address these matters. Phase I of the project was composed of the first two bullets and the final bullet will be covered in Phase II of the project. The newly proposed guidance under Phase 1 was exposed in October 2014 and the IESBA approved the pronouncements in December 2015.

#### IESBA Part C Guidance

The Task Force reviewed sections 320 and 370 as recently adopted into the IESBA Code by paragraph and deliberated the reasonableness of the content in consideration of potentially adopting the language into the AICPA Code. The respective sections can be viewed in Agenda Item 8-B.

#### Section 320

Agenda Item 8C contains an analysis of Section 320 by paragraph noting the commentary of the Task Force. The analysis also contains sections of the AICPA Code that may already cover the

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guidance in Section 320. Overall, the Task Force broadly supported the guidance and noted that it may benefit the Code to consider the language for adoption. Any guidance would most likely be placed under the Integrity and Objectivity Rule.

### **Section 370**

The Task Force noted that there is no specific guidance pertaining to Section 370, *Pressure to Breach to the Fundamental Principles*, of the IESBA Code. Thus, if considered for adoption, the guidance would pertain to pressure to breach compliance with the rules of the AICPA Code. Section 370 was broadly supported by the Task Force for consideration for adoption in the AICPA Code with minor comments concerning the practicability of some of the suggested actions to be taken by the PAIB when facing pressures to breach the fundamental principles. Any guidance would most likely be placed under the Integrity and Objectivity Rule.

#### **Action Needed:**

1. The PEEC is asked to read Agenda Items 8B and 8C and provide feedback concerning the IESBA guidance and the commentary of the Task Force.
2. The PEEC is asked to determine if the Task Force should proceed in considering the guidance for adoption into the Code.
3. If the PEEC believes the guidance is appropriate for potential adoption into the Code, the Committee is asked to provide any relevant feedback or guidance to consider in proceeding, including whether the guidance should be placed under the Integrity and Objectivity Rule.

**IFAC Convergence – Part C – Sections 320 and 370**

**SECTION 320**

**Preparation and Presentation of Information**

320.1 Professional accountants in business at all levels in an employing organization are involved in the preparation and presentation of information both within and outside the employing organization. Stakeholders to whom, or for whom, such information is prepared or presented, include:

- Management and those charged with governance.
- Investors, lenders and other creditors.
- Regulators.

This information may assist stakeholders in understanding and evaluating aspects of the organization's state of affairs and in making decisions concerning the organization. This includes financial and non-financial information that may be made public or used for internal purposes.

Examples include:

- Operating and performance reports.
- Decision support analyses.
- Budgets and forecasts.
- Information provided to the internal and external auditors.
- Risk analyses.
- General and special purpose financial statements.
- Tax returns.
- Reports filed with regulators for legal and compliance purposes.

320.2 Professional accountants in business who are responsible for recording, maintaining, preparing, approving or presenting information shall do so in accordance with the fundamental principles. This includes:

- Presenting the information in accordance with a relevant reporting framework, where applicable.
- Preparing or presenting information in a manner that is intended neither to mislead nor to influence contractual or regulatory outcomes inappropriately.
- Not omitting information with the intention of rendering the information misleading or of influencing contractual or regulatory outcomes inappropriately.

An example of influencing a contractual or regulatory outcome inappropriately is using an unrealistic estimate with the intention of avoiding violation of a contractual

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requirement such as a debt covenant or of a regulatory requirement such as a capital requirement of a financial institution.

This responsibility involves using professional judgment to: Believe this requirement is addressed in AICPA

- Represent the facts accurately and completely in all material respects.
- Describe clearly the true nature of business transactions or activities.
- Classify and record information in a timely and proper manner.

320.3 Preparing or presenting information may require the exercise of discretion in making professional judgments. Preparing or presenting such information in accordance with the fundamental principles requires the professional accountant not to exercise such discretion with the intention of misleading or influencing contractual or regulatory outcomes inappropriately. This includes not using discretion to achieve inappropriate outcomes in one or more of the following ways:

- Determining estimates. For example, determining fair value estimates in order to misrepresent profit or loss.
- Selecting or changing an accounting policy or method among two or more alternatives permitted under the applicable financial reporting framework. For example, selecting a policy for accounting for long-term contracts in order to misrepresent profit or loss.
- Determining the timing of transactions. For example, timing the sale of an asset near the end of the fiscal year in order to mislead.
- Determining the structuring of transactions. For example, structuring financing transactions in order to misrepresent assets and liabilities or classification of cash flows.
- Selecting disclosures. For example, omitting or obscuring information relating to financial or operating risk in order to mislead.

320.4 When performing professional activities, especially those that do not require compliance with a relevant reporting framework, the professional accountant shall use professional judgment to identify and take into account the purpose for which the information is to be used, the context in which it is provided and the audience to whom it is addressed. For example, when preparing or presenting pro forma reports, budgets or forecasts, the inclusion of relevant estimates, approximations and assumptions, where appropriate, would enable those who may rely on such information to form their own judgments. The professional accountant in business may also consider clarifying the intended audience, context and purpose of the information presented.

320.5 A professional accountant who intends to rely on the work of others, either internal or external to the organization, shall use professional judgment to determine what steps to take, if any, to ensure that the obligations set out in paragraph 320.2 are fulfilled. Factors to consider in determining whether reliance on others is reasonable include: reputation,

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expertise, resources available to the individual or organization and whether the other individual is subject to applicable professional and ethical standards. Such information may be gained from prior association with, or from consulting others about, the individual or the organization.

320.6 If the professional accountant knows or has reason to believe that the information with which the professional accountant is associated is misleading, the professional accountant shall take appropriate actions to seek to resolve the matter. Such actions include:

- Consulting the employing organization's policies and procedures (for example, an ethics or whistle-blowing policy) regarding how such matters should be addressed internally.
- Discussing concerns that the information is misleading with the professional accountant's supervisor and/or the appropriate level(s) of management within the professional accountant's organization or those charged with governance and requesting such individuals to take appropriate action to resolve the matter. Such action may include:
  - Having the information corrected.
  - If the information has already been disclosed to the intended users, informing them of the correct information.

In situations where the misleading information may involve a violation of a law or regulation, Section 360 provides guidance relating to non-compliance with laws and regulations.

320.7 If the professional accountant determines that appropriate action has not been taken and continues to have reason to believe that the information is misleading, the professional accountant, while being alert to the fundamental principle of confidentiality, shall consider one or more of the following:

- Consulting with a relevant professional body.
- Consulting with the employing organization's internal and external auditor.
- Determining whether any requirements exist to communicate to third parties, including users of the information, or regulatory authorities.
- Consulting legal counsel.

320.8 If after exhausting all feasible options, the professional accountant determines that appropriate action has not been taken and there is reason to believe that the information is still misleading, the professional accountant shall refuse to be or to remain associated with the information. The professional accountant also may consider resigning from the employing organization.

The professional accountant is also encouraged to document the facts, the accounting principles or other relevant professional standards involved, and the communications and parties with whom these matters were discussed, the courses of action considered, and how the professional accountant attempted to address the matter(s).

- 320.9 Where threats to compliance with the fundamental principles relating to the preparation and presentation of information arise from financial interests, including compensation and incentive linked to financial reporting and decision making, the guidance in Section 340 is relevant.
- 320.10 Where threats to compliance with the fundamental principles relating to the preparation and presentation of information arise from pressure, the guidance in Section 370 is relevant.

## **SECTION 370**

### **Pressure to Breach the Fundamental Principles**

- 370.1 This section addresses pressures that could result in a professional accountant taking actions that breach or cause others to breach the fundamental principles.
- 370.2 A professional accountant in business may face pressure that could create threats, for example, intimidation threats, to compliance with the fundamental principles when undertaking a professional activity. Pressure may be explicit or implicit. Pressure may come from within the organization, for example, from a colleague or superior, from an external individual or organization such as a vendor, customer or lender, or from meeting internal or external targets and expectations.

The professional accountant shall not allow pressure from others to result in a breach of the fundamental principles. The professional accountant also shall not place pressure on others that the professional accountant knows, or has reason to believe, would result in the other individuals breaching the fundamental principles.

- 370.3 Examples of pressure that could result in a breach of the fundamental principles include:
- Pressure related to conflicts of interest:
    - Pressure from a family member bidding to act as a vendor to the professional accountant's employing organization to select them over another prospective vendor.  
The guidance in Section 310 is relevant.
  - Pressure to influence presentation of information:
    - Pressure to report misleading financial results to meet investor, analyst or lender expectations.
    - Pressure from elected officials on public sector accountants to misrepresent programs or projects to voters.
    - Pressure from colleagues to misstate income, expenditure or rates of return to bias decision-making on capital projects and acquisitions.
    - Pressure from superiors to approve or process expenditures that are not legitimate business expenses.
    - Pressure to suppress internal audit reports containing adverse findings.  
The guidance in Section 320 is relevant.

- Pressure to act without sufficient expertise or due care:
  - Pressure from superiors to inappropriately reduce the extent of work performed.
  - Pressure from superiors to perform a task without sufficient skills or training or within unrealistic deadlines.

The guidance in Section 330 is relevant.
- Pressure related to financial interests:
  - Pressure to manipulate performance indicators from superiors, colleagues or others, for example, those who may benefit from participation in compensation or incentive arrangements.

The guidance in Section 340 is relevant.
- Pressure related to inducements:
  - Pressure from others, either internal or external to the employing organization, to offer inducements to inappropriately influence the judgment or decision-making process of an individual or organization.
  - Pressure from colleagues to accept a bribe or other inducement, for example, to accept inappropriate gifts or entertainment from potential vendors in a bidding process.

The guidance in Section 350 is relevant.
- Pressure related to non-compliance with laws and regulations:
  - Pressure to structure a transaction to evade tax.

The guidance in Section 360 is relevant.

370.4 In determining whether the pressure could result in a breach of the fundamental principles, the professional accountant may consider factors including:

- The intent of the individual who is exerting the pressure and the nature and significance of the pressure.
- The application of relevant laws, regulations, and professional standards to the circumstances.
- The culture and leadership of the employing organization including the extent to which it emphasizes the importance of ethical behavior and the expectation that employees will act in an ethical manner. For example, a corporate culture that tolerates unethical behavior may increase the likelihood that the pressure would result in a breach of the fundamental principles.
- Policies and procedures, if any, that the employing organization has established, such as ethics or human resources policies that address pressure.

In considering these and other factors, and being alert to the fundamental principle of confidentiality, the professional accountant in business may consult with:

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- A colleague, superior, human resources personnel, or another professional accountant;
  - Relevant professional or regulatory bodies or industry associations; or
  - Legal counsel.

370.5 If the professional accountant determines that the pressure would result in a breach of the fundamental principles, the professional accountant may consider actions, including:

- Discussing the matter with the individual who is exerting the pressure to seek to resolve it.
- Discussing the matter with the professional accountant's supervisor, if the supervisor is not the individual exerting the pressure.
- Escalating the matter within the employing organization, for example, with higher levels of management, internal or external auditors, or those charged with governance, including independent directors and, when appropriate, explaining any consequential risks to the organization.
- Requesting restructuring or segregating certain responsibilities and duties so that the professional accountant is no longer involved with the individual or entity exerting the pressure, where doing so would eliminate the pressure to breach the fundamental principles. For example, if a professional accountant is pressured in relation to a conflict of interest, the pressure to breach the fundamental principles may be eliminated if the professional accountant avoids being associated with the matter creating the conflict.
- Disclosing the matter in accordance with the employing organization's policies, including ethics and whistleblowing policies, using any established mechanism, such as a confidential ethics hotline.
- Consulting with legal counsel.

370.6 In situations where the professional accountant determines that the pressure to breach the fundamental principles has not been eliminated, the professional accountant shall:

- Decline to undertake or discontinue the professional activity that would result in a breach of the fundamental principles; and
- Consider resigning from the employing organization.

The professional accountant is also encouraged to document the facts, the communications, the courses of action considered, the parties with whom these matters were discussed, and how the matter was addressed.

IFAC Convergence – Part C – Analysis of Section 320

IESBA Paragraph	Corresponding AICPA Literature	Comments
<p>320.1 Professional accountants in business at all levels in an employing organization are involved in the preparation and presentation of information both within and outside the employing organization. Stakeholders to whom, or for whom, such information is prepared or presented, include:</p> <ul style="list-style-type: none"> <li>• Management and those charged with governance.</li> <li>• Investors, lenders and other creditors.</li> <li>• Regulators.</li> </ul> <p>This information may assist stakeholders in understanding and evaluating aspects of the organization’s state of affairs and in making decisions concerning the organization. This includes financial and non-financial information that may be made public or used for internal purposes.</p> <p>Examples include:</p> <ul style="list-style-type: none"> <li>• Operating and performance reports.</li> <li>• Decision support analyses.</li> <li>• Budgets and forecasts.</li> <li>• Information provided to the internal and external auditors.</li> <li>• Risk analyses.</li> <li>• General and special purpose financial statements.</li> <li>• Tax returns.</li> <li>• Reports filed with regulators for legal and</li> </ul>	<p>2.100.001 – The Integrity and Objectivity Rule: In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others</p>	<p>While par 320.1 of the IESBA Code is covered by the Integrity and Objectivity Rule, Interpretation 2.130.010, <i>Knowing Misrepresentations in the Preparation of Financial Records</i> does not cover the guidance. In addition, the noted interpretation is focused on financial statements and records and the IESBA guidance is broader.</p> <p>The Task Force agreed that the guidance is reasonable for possible adoption.</p>

<p>compliance purposes.</p> <p>320.2 Professional accountants in business who are responsible for recording, maintaining, preparing, approving or presenting information shall do so in accordance with the fundamental principles. This includes:</p> <ul style="list-style-type: none"> <li>• Presenting the information in accordance with a relevant reporting framework, where applicable.</li> <li>• Preparing or presenting information in a manner that is intended neither to mislead nor to influence contractual or regulatory outcomes inappropriately.</li> <li>• Not omitting information with the intention of rendering the information misleading or of influencing contractual or regulatory outcomes inappropriately.</li> </ul> <p>An example of influencing a contractual or regulatory outcome inappropriately is using an unrealistic estimate with the intention of avoiding violation of a contractual requirement such as a debt covenant or of a regulatory requirement such as a capital requirement of a financial institution. This responsibility involves using professional judgment to:</p> <ul style="list-style-type: none"> <li>• Represent the facts accurately and completely in all material respects.</li> <li>• Describe clearly the true nature of business transactions or activities.</li> <li>• Classify and record information in a timely and proper manner.</li> </ul>	<p>2.130.010 <i>Knowing Misrepresentations in the Preparation of Financial Statements or Records</i></p> <p>Threats to compliance with the “Integrity and Objectivity Rule” [2.100.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards, and the member would be considered to have knowingly misrepresented facts in violation of the “Integrity and Objectivity Rule,” if the member</p> <ol style="list-style-type: none"> <li>a. makes, or permits or directs another to make, materially false and misleading entries in an entity’s financial statements or records;</li> <li>b. fails to correct an entity’s financial statements or records that are materially false and misleading when the member has the authority to record the entries; or</li> <li>c. signs, or permits or directs another to sign, a document containing materially false and misleading information. [Prior reference: paragraph .02 of ET section 102]</li> </ol> <p>2.320.010 <i>Responsibility for Affirming That Financial Statements Are in Conformity With the Applicable Financial Reporting Framework</i></p> <p>.01 A member shall not state affirmatively that an entity’s financial statements or other financial data are presented in conformity with generally accepted accounting principles (GAAP) if such statements or data contain any</p>	<p>IESBA Par 320.2 is covered somewhat by Interpretation 2.130.010, <i>Knowing Misrepresentations in the Preparation of Financial Statements or Records</i>, of the AICPA Code.</p> <p>The first bullet of IESBA Par 320.2 is covered by Interpretations 2.320.010, <i>Responsibility for Affirming That Financial Statements Are in Conformity With the Applicable Financial Reporting Framework</i> and 2.320.040, <i>Financial Statements Prepared Pursuant to Financial Reporting Frameworks Other Than GAAP</i>.</p> <p>The third bullet concerning omitting information is not specifically addressed by the AICPA Code, however it could be argued that it is covered by the Integrity and Objectivity Rule – 2.100.001.</p> <p>The Task Force agreed that the guidance is reasonable for possible adoption</p>
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	<p>departure from an accounting principle promulgated by a body designated by Council to establish such principles. Members who affirm that financial statements or other financial data are presented in conformity with GAAP should comply with the “Accounting Principles Rule” [2.320.001]. A member’s representation in a letter or other communication that an entity’s financial statements are in conformity with GAAP may be considered an affirmative statement within the meaning of this rule with respect to the member who signed the letter or other communication (for example, the member signed a report to a regulatory authority, a creditor, or an auditor). [Prior reference: paragraph .05 ET section 203]</p> <p><i>2.320.040 Financial Statements Prepared Pursuant to Financial Reporting Frameworks Other Than GAAP</i></p> <p>.01 Reference to GAAP in the “Accounting Principles Rule” [2.320.001] means those accounting principles promulgated by bodies designated by Council, which are listed in appendix A. The bodies designed by Council to promulgate accounting principles are</p> <ol style="list-style-type: none"> <li>a. FASAB,</li> <li>b. FASB,</li> <li>c. GASB, and</li> <li>d. IASB.</li> </ol> <p>.02 Financial statements prepared pursuant to other accounting principles would</p>	
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	<p>be considered financial reporting frameworks other than GAAP within the context of the “Accounting Principles Rule” [2.320.001].</p> <p>.03 However, the “Accounting Principles Rule” [2.320.001] does not preclude a member from preparing or reporting on financial statements that have been prepared pursuant to financial reporting frameworks other than GAAP, such as</p> <ul style="list-style-type: none"> <li>a. financial reporting frameworks generally accepted in another country, including jurisdictional variations of IFRS such that the entity’s financial statements do not meet the requirements for full compliance with IFRS, as promulgated by the IASB;</li> <li>b. financial reporting frameworks prescribed by an agreement or a contract; or</li> <li>c. other special purpose frameworks, including statutory financial reporting provisions required by law or a U.S. or foreign governmental regulatory body to whose jurisdiction the entity is subject.</li> </ul> <p>.04 In such circumstances, however, the financial statements or member’s reports thereon should not purport that the financial statements are in accordance with GAAP and the financial statements or reports on those financial statements, or both, should clarify the financial reporting framework(s) used. [Prior reference: paragraph .06 of ET section 203]</p>	
320.3 Preparing or presenting information may require the exercise of discretion in making professional judgments.	Not specifically addressed in the AIPCA Code.	The Code does not explicitly address issues of discretion.

<p>Preparing or presenting such information in accordance with the fundamental principles requires the professional accountant not to exercise such discretion with the intention of misleading or influencing contractual or regulatory outcomes inappropriately. This includes not using discretion to achieve inappropriate outcomes in one or more of the following ways:</p> <ul style="list-style-type: none"> <li>• Determining estimates. For example, determining fair value estimates in order to misrepresent profit or loss.</li> <li>• Selecting or changing an accounting policy or method among two or more alternatives permitted under the applicable financial reporting framework. For example, selecting a policy for accounting for long-term contracts in order to misrepresent profit or loss.</li> <li>• Determining the timing of transactions. For example, timing the sale of an asset near the end of the fiscal year in order to mislead.</li> <li>• Determining the structuring of transactions. For example, structuring financing transactions in order to misrepresent assets and</li> </ul>		<p>While the Task Force agreed that a PAIB should not intentionally mispresent information, it was agreed that the information may be presented in order to influence decision while remaining within the boundaries of the appropriate reporting framework. The Task Force believes that this guidance may be appropriate for adoption, however, it may need to be edited. For example, the second sentence could read as follows:</p> <p>“Preparing or presenting such information <del>in accordance with the fundamental principles</del> requires the professional accountant not to exercise such discretion with the intention of misleading <del>or influencing</del> contractual or regulatory outcomes inappropriately.”</p> <p>Also, the Task Force agreed the examples within the bullets could be stronger to more clearly define inappropriate presentation of</p>
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<p>liabilities or classification of cash flows.</p> <ul style="list-style-type: none"> <li>Selecting disclosures. For example, omitting or obscuring information relating to financial or operating risk in order to mislead.</li> </ul>		information.
<p>320.4 When performing professional activities, especially those that do not require compliance with a relevant reporting framework, the professional accountant shall use professional judgment to identify and take into account the purpose for which the information is to be used, the context in which it is provided and the audience to whom it is addressed. For example, when preparing or presenting pro forma reports, budgets or forecasts, the inclusion of relevant estimates, approximations and assumptions, where appropriate, would enable those who may rely on such information to form their own judgments. The professional accountant in business may also consider clarifying the intended audience, context and purpose of the information presented</p>	Not specifically addressed in the AICPA Code.	The Task Force agreed that the guidance is reasonable for possible adoption.
<p>320.5 A professional accountant who intends to rely on the work of others, either internal or external to the organization, shall use professional judgment to determine what steps to take, if any, to ensure that the obligations set out in paragraph 320.2 are fulfilled. Factors to consider in determining whether reliance on others is reasonable include: reputation, expertise, resources available to the individual or</p>	Not specifically addressed in the AICPA Code.	The Task Force agreed that the guidance is reasonable for possible adoption.

<p>organization and whether the other individual is subject to applicable professional and ethical standards. Such information may be gained from prior association with, or from consulting others about, the individual or the organization.</p>		
<p>320.6 If the professional accountant knows or has reason to believe that the information with which the professional accountant is associated is misleading, the professional accountant shall take appropriate actions to seek to resolve the matter. Such actions include:</p> <ul style="list-style-type: none"> <li>• Consulting the employing organization’s policies and procedures (for example, an ethics or whistle-blowing policy) regarding how such matters should be addressed internally.</li> <li>• Discussing concerns that the information is misleading with the professional accountant’s supervisor and/or the appropriate level(s) of management within the professional accountant’s organization or those charged with governance and requesting such individuals to take appropriate action to resolve the matter. Such action may include: <ul style="list-style-type: none"> <li>○ Having the information corrected.</li> <li>○ If the information has already been disclosed to the intended users, informing them of the correct information.</li> </ul> </li> </ul> <p>In situations where the misleading information may involve a violation of a law or regulation, Section 360 provides guidance relating to non-</p>	<p>Paragraphs 320.6, 320.7, and 320.8 while not exactly covered by the Code, have similar steps to those in Interpretation, 2.130.020, <i>Subordination of Judgment</i>.</p> <p>.01 The “<a href="#">Integrity and Objectivity Rule</a>” [2.100.001] prohibits a <i>member</i> from knowingly misrepresenting facts or subordinating his or her judgment when performing <i>professional services</i> for an employer or on a volunteer basis. This interpretation addresses differences of opinion between a member and his or her supervisor or any other person within the <i>member’s</i> organization.</p> <p>.02 Self-interest, familiarity, and undue influence <i>threats</i> to the <i>member’s</i> compliance with the “<a href="#">Integrity and Objectivity Rule</a>” [2.100.001] may exist when a <i>member</i> and his or her supervisor or any other person within the <i>member’s</i> organization have a difference of opinion relating to the application of accounting principles; auditing standards; or other relevant professional standards, including standards applicable to tax and consulting services or applicable laws or regulations.</p> <p>.03 A <i>member</i> should evaluate the</p>	<p>The Task Force noted that the language in paragraphs 320.6 through .8 is similar to that in the Subordination of Judgment interpretation. The Task Force did agree that there is useful guidance in the respective IESBA guidance, however, some modifications may need to be made after further consideration. Such considerations include the potential for repetitive language within the Code and the need to obtain balance between the need to not associate that some of the language may be repetitive.</p>

<p>compliance with laws and regulations.</p> <p>320.7 If the professional accountant determines that appropriate action has not been taken and continues to have reason to believe that the information is misleading, the professional accountant, while being alert to the fundamental principle of confidentiality, shall consider one or more of the following:</p> <ul style="list-style-type: none"> <li>• Consulting with a relevant professional body. <ul style="list-style-type: none"> <li>• Consulting with the employing organization's internal and external auditor.</li> <li>• Determining whether any requirements exist to communicate to third parties, including users of the information, or regulatory authorities.</li> <li>• Consulting legal counsel.</li> </ul> </li> </ul> <p>320.8 If after exhausting all feasible options, the professional accountant determines that appropriate action has not been taken and there is reason to believe that the information is still misleading, the professional accountant shall refuse to be or to remain associated with the information. The professional accountant also may consider resigning from the employing organization.</p> <p>The professional accountant is also encouraged to document the facts, the accounting principles or other relevant professional standards involved, and the communications and parties with whom these matters were discussed, the courses of action considered, and how the professional accountant attempted to address the matter(s)</p>	<p>significance of any <i>threats</i> to determine if they are at an <i>acceptable level</i>. <i>Threats</i> are at an <i>acceptable level</i> if the <i>member</i> concludes that the position taken does not result in a material misrepresentation of fact or a violation of applicable laws or regulations. If <i>threats</i> are not at an <i>acceptable level</i>, the <i>member</i> should apply the <i>safeguards</i> in <a href="#">paragraphs .06–.08</a> to eliminate or reduce the threat(s) to an <i>acceptable level</i> so that the <i>member</i> does not subordinate his or her judgment.</p> <p>.04 In evaluating the significance of any identified <i>threats</i>, the <i>member</i> should determine, after appropriate research or consultation, whether the result of the position taken by the supervisor or other person</p> <ol style="list-style-type: none"> <li>a. fails to comply with professional standards, when applicable;</li> <li>b. creates a material misrepresentation of fact; or</li> <li>c. may violate applicable laws or regulations.</li> </ol> <p>.05 If the <i>member</i> concludes that <i>threats</i> are at an <i>acceptable level</i>, the <i>member</i> should discuss his or her conclusions with the person taking the position. No further action would be needed under this interpretation.</p> <p>.06 If the <i>member</i> concludes that the position results in a material misrepresentation of fact or a</p>	
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	<p>violation of applicable laws or regulations, then <i>threats</i> would not be at an <i>acceptable level</i>. In such circumstances, the <i>member</i> should discuss his or her concerns with the supervisor.</p> <p>.07 If the difference of opinion is not resolved after discussing the concerns with the supervisor, the <i>member</i> should discuss his or her concerns with the appropriate higher level(s) of management within the <i>member's</i> organization (for example, the supervisor's immediate superior, senior management, and <i>those charged with governance</i>).</p> <p>.08 If after discussing the concerns with the supervisor and appropriate higher level(s) of management within the <i>member's</i> organization, the <i>member</i> concludes that appropriate action was not taken, then the <i>member</i> should consider, in no specific order, the following <i>safeguards</i> to ensure that <i>threats</i> to the <i>member's</i> compliance with the "<a href="#">Integrity and Objectivity Rule</a>" [2.100.001] are eliminated or reduced to an <i>acceptable level</i>:</p> <p>a. Determine whether the organization's internal policies and procedures have any additional requirements for reporting differences of opinion.</p> <p>b. Determine whether he or she is responsible for communicating to third parties, such as regulatory authorities or the organization's (former organization's) external</p>	
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	<p>accountant. In considering such communications, the <i>member</i> should be cognizant of his or her obligations under the <a href="#">“Confidential Information Obtained From Employment or Volunteer Activities”</a> interpretation [2.400.070] of the “Acts Discreditable Rule” [2.400.001] and the <a href="#">“Obligation of a Member to His or Her Employer’s External Accountant”</a> interpretation [2.130.030] of the “Integrity and Objectivity Rule” [2.100.001].</p> <p>c. Consult with his or her legal counsel regarding his or her responsibilities.</p> <p>d. Document his or her understanding of the facts, the accounting principles, auditing standards, or other relevant professional standards involved or applicable laws or regulations and the conversations and parties with whom these matters were discussed.</p> <p>.09 If the <i>member</i> concludes that no <i>safeguards</i> can eliminate or reduce the <i>threats</i> to an <i>acceptable level</i> or if the <i>member</i> concludes that appropriate action was not taken, then he or she should consider the continuing relationship with the <i>member’s</i> organization and take appropriate steps to eliminate his or her exposure to subordination of judgment.</p> <p>.10 Nothing in this interpretation precludes a <i>member</i> from resigning from the organization at any time. However, resignation may not relieve the <i>member</i> of responsibilities in the situation,</p>	
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	<p>including any responsibility to disclose concerns to third parties, such as regulatory authorities or the employer's (former employer's) external accountant.</p> <p>.11 A <i>member</i> should use professional judgment and apply similar <i>safeguards</i>, as appropriate, to other situations involving a difference of opinion as described in this interpretation so that the <i>member</i> does not subordinate his or her judgment</p>	
320.9 Where threats to compliance with the fundamental principles relating to the preparation and presentation of information arise from financial interests, including compensation and incentive linked to financial reporting and decision making, the guidance in Section 340 is relevant.	N/A	This is a specific reference to Section 340 of the IESBA Code, <i>Financial Interests, Compensation, and Incentives Linked to Financial Reporting and Decision Making</i> .
320.10 Where threats to compliance with the fundamental principles relating to the preparation and presentation of information arise from pressure, the guidance in Section 370 is relevant.	N/A	This is a specific reference to the NOCLAR section in the IESBA Code.

## IFAC Convergence – NOCLAR

### Task Force Members

Bob Denham (Chair), Carlos Barrera, Sam Burke, Greg Guin, Brian Lynch, and Elizabeth Pittlekow. Staff: Jason Evans. Observer: Lisa Snyder

### Task Force Charge

The Task Force is charged with reviewing the International Ethics Standards Board for Professional Accountants' (IESBA) pronouncements entitled Non-Compliance with Laws and Regulations (NOCLAR) and recommend to PEEC revisions to the AICPA Code for purposes of convergence.

### Reason for Agenda Item

To review and provide feedback on the Task Force's preliminary deliberations.

### Summary of Issues

#### **Background**

In 2010, the IESBA approved the NOCLAR project noting that a professional accountant (PA) that may come across a NOCLAR or suspected NOCLAR has a prima facie ethical responsibility to not turn a blind eye to the matter. After the first exposure draft in August 2012, the IESBA held roundtable meetings in Hong Kong, Brussels, and Washington DC to address concerns of the operability of the guidance and potential unintended consequences.

As a result of the feedback received, the IESBA developed revised proposals in the form of a framework for professional accountants to respond to instances of a NOCLAR.

The second exposure draft was released in May 2015. The final pronouncement was approved by the Board in April 2016. Agenda Item 9B contains the final NOCLAR pronouncement.

#### **IESBA NOCLAR Guidance**

The Task Force reviewed the NOCLAR pronouncements recently adopted into the IESBA Code, both for professional accountants in public practice (PAPPs) and professional accountants in business (PAIBs) and deliberated the reasonableness of the content in consideration of potentially adopting the language for purposes of the AICPA Code. The Task Force specifically considered the issues discussed below. The Task Force's preliminary recommendations are provided for the Committee's consideration.

#### **Confidentiality**

The IESBA pronouncements (Pars. 225.4 and 360.4) state that when responding to a NOCLAR the objectives of the PA are:

- (a) To comply with the fundamental principles of integrity and professional behavior;
- (b) By alerting management or, where appropriate, those charged with governance of the client/employing organization, to seek to:

- (i) Enable them to rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or
- (ii) Deter the commission of the non-compliance where it has not yet occurred; and
- (c) To take such further action as appropriate in the public interest.

If management and/or those charged with governance (TCWG) do not respond appropriately to the NOCLAR, one of the possible further actions to consider is to disclose the matter to an appropriate authority even when there is no legal or regulatory requirement to do so for PAPPs and senior PAIBs. The pronouncements state that making such a disclosure is not considered a breach of the duty of confidentiality under Section 140 of the IESBA Code.

#### *AICPA Confidentiality Standards*

Disclosure of a NOCLAR without the client's consent would violate the AICPA's Confidential Client Information Rule (1.700.001) (see Agenda Item 9D). The Rule does provide for certain exceptions, however. For example, the Rule states: "This rule shall not be construed (1) to relieve a member of his or her professional obligations of the "Compliance With Standards Rule" [1.310.001] or the "Accounting Principles Rule" [1.320.001], (2) to affect in any way the member's obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a member's compliance with applicable laws and government regulations..."

U.S. GAAS permits an auditor to disclose certain NOCLARs for public companies if the client does not take appropriate action in order to comply with Section 10A under the U.S. Securities and Exchange Act. Such disclosure would not be in violation of the Rule since it is required in order to comply with law and permitted under professional standards (i.e., GAAS). The Committee should therefore note that unless required by law or professional standards to disclose a NOCLAR to an authority, a member would be in violation of the Rule. If the PEEC wished to permit disclosure of a NOCLAR in other situations, a revision to the Rule would be necessary which requires vote by AICPA membership.

Disclosure of a NOCLAR by a PAIB would breach the *Confidential Information Obtained from Employment or Volunteer Activities Interpretation* (2.400.070) (See Agenda Item 9D). The Interpretation, however, also provides for certain exceptions. The Committee should specifically note the following exceptions:

- c. There is a professional responsibility or right to disclose information, when not prohibited by law, to...
  - i. initiate a complaint with, or respond to any inquiry made by, the Professional Ethics Division or trial board of the AICPA or a duly constituted investigative or disciplinary body of a state CPA society, board of accountancy, or other regulatory body;...
  - iii. comply with professional standards and other ethics requirements;

The exception in c.iii. above would appear to permit a PAIB to disclose a NOCLAR to an authority provided such disclosure was not prohibited by law (e.g., state rules and regulations) and an ethics requirement existed that would permit such disclosure. Accordingly, if the PEEC believed it to be appropriate, a PAIB could disclose a NOCLAR involving his or her employer if there were an ethics standard permitting such disclosure and state law did not prohibit it. In addition, the exception in c.i. would appear to permit a PAIB to initiate a complaint with an authority (i.e., regulatory body) provided it was not prohibited by state law. Any revisions to the Interpretation to address disclosure of a NOCLAR would only require exposure to membership.

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### *State Board Confidentiality Rules and Statutes*

The UAA Model Rules contain the following confidentiality provision:

#### VI. PRINCIPLE: CONFIDENTIALITY

A licensee has an obligation to maintain and respect the confidentiality of information obtained in the performance of all professional activities. Maintaining such confidentiality is vital to the proper performance of the licensee's professional activities.

A licensee shall not use or disclose, or permit others within the licensee's control to use or disclose, any confidential client or employer information without the consent of the client or employer. This obligation continues after the termination of the relationship between the licensee and the client or employer and extends to information obtained by the licensee in Rules-10-6 professional relationships with prospective clients and employers.

This principle shall not be construed to prohibit a licensee from disclosing information as required to meet professional, regulatory or other legal obligations.

Most state boards of accountancy have confidentiality provisions consistent with the UAA provision in their state rules or statutes. The AICPA State Regulation and Legislative Affairs Team has conducted research on behalf of the Task Force to identify those states that have adopted confidentiality provisions, as well as those states that have included an exception to permit a licensee to disclose a NOCLAR to an authority. The results of the research can be found at Agenda item 9C. Based on the research, there appears to be 8 states that provide an exception to the confidentiality requirement and would permit a licensee to disclose a NOCLAR to an authority.

#### *Disclosure to an Authority*

The IESBA NOCLAR standard specifically states that "Disclosure of the matter to an appropriate authority would be precluded if doing so would be contrary to law or regulation." (Pars. 225.33 and 360.28). Accordingly, if a member were licensed or practiced in a state whose rules or statutes prohibited disclosure of a NOCLAR to an authority, such disclosure would be precluded under the IESBA standard. On the other hand, a member who was licensed or practiced in one of the 8 states that provide for an exception could potentially disclose a NOCLAR to an authority under the NOCLAR standard.

The Committee should note that in its comment letters to the IESBA, the PEEC was not supportive of permitting disclosure to an authority, primarily due to concerns about potential legal exposure and "whistle-blower" protection. In response to such concerns, the IESBA included the following as a factor for the PA to consider when determining whether to disclose a NOCLAR to an authority: "Whether there exists robust and credible protection from civil, criminal or professional liability or retaliation afforded by legislation or regulation, such as under whistle-blowing legislation or regulation." In addition, the PEEC commented that such disclosure would likely not be permitted in the U.S. due to state rules and statutes prohibiting disclosure of confidential client/employer information.

The Task Force discussed whether disclosure of a NOCLAR should be permitted to an authority under the circumstances specified in the NOCLAR standard. Due to the limited number of states that would permit such disclosure, the Task Force concluded that the AICPA Code should not permit a PAPP to override client confidentiality and disclose a NOCLAR to an authority. The Task Force further agreed that if it was determined that state laws would permit a PAIB to disclose a NOCLAR to an authority committed by his or her employer, the PEEC should consider whether the AICPA Code would (or should) permit such disclosure under its *Confidential Information*

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*Obtained from Employment or Volunteer Activities Interpretation.* Further research on state rules and statutes regarding confidentiality of employer confidential information is needed before it can be determined the number of states permitting such disclosure.

**Action Needed:**

1. Does the Committee agree that the AICPA Code should not permit disclosure of a NOCLAR committed by a client to an authority without the client's consent (unless required by law)?
2. Does the Committee believe the AICPA Code should permit a PAIB to disclose a NOCLAR committed by his or her employer if research concludes that most state laws would permit such disclosure? If so, does the Committee believe the *Confidential Information Obtained from Employment or Volunteer Activities Interpretation* could be interpreted to currently permit such disclosure?

*Disclosure to Successor Accountant*

Paragraph 225.31 of the NOCLAR standard states that when a PAPP withdraws from an engagement due to management's lack of a proper response to a NOCLAR, the predecessor accountant "shall, on request by the proposed successor accountant, provide all such facts and other information concerning the identified or suspected non-compliance that, in the predecessor accountant's opinion, the proposed successor accountant needs to be aware of before deciding whether to accept the audit appointment."

The AICPA Code states that if a member withdraws from an engagement for example, due to irregularities at a client, the member should suggest the successor ask the client for permission to have the member discuss all matters freely. Accordingly, the AICPA Code would not permit the predecessor accountant to disclose a suspected NOCLAR to the successor without the client's consent:

**1.700.020 Disclosing Information From Previous Engagements**

...02 When a *member* withdraws from an engagement due to, for example, discovery of irregularities in a *client's* tax return, if contacted by the successor, the *member* should suggest that the successor ask the *client* to permit the *member* to discuss all matters freely with the successor. The successor is then on notice of some conflict. .03 The "[Confidential Client Information Rule](#)" [1.700.001] is not intended to help an unscrupulous *client* cover up illegal acts or otherwise hide information by changing CPAs. Due to the possibility of legal implications in such matters, the *member* should seek legal advice on the *member's* status and obligation in the matter.

The Task Force discussed whether the PEEC should consider permitting a member to disclose a NOCLAR to the successor without a client's consent. The Task Force believed that a PAPP should not be permitted to override client confidentiality under such circumstances and agreed the current approach of raising a "red flag" to the successor was more appropriate.

**Action Needed:**

3. Does the Committee agree with the current position in the AICPA Code, or, should there be a requirement to disclose a NOCLAR to the successor accountant?

*Communicating the Matter to the Entity's External Auditor*

The NOCLAR standard (par. 225.46) states that if a PAPP performing non-audit services for a non-audit client of the firm, discovers a NOCLAR, the PAPP should consider disclosing the NOCLAR to the client's external auditor:

If the professional accountant is performing a non-audit service for a client that is not:

- (a) An audit client of the firm or a network firm; or
  - (b) A component of an audit client of the firm or a network firm,
- the professional accountant shall consider whether to communicate the non-compliance or suspected non-compliance to the firm that is the client's external auditor, if any.

The AICPA Code would not permit such disclosure without the client's consent.

With respect to PAIBs, the NOCLAR standard (par. 360.18) states the following:

In addition to responding to the matter in accordance with the provisions of this section, the senior professional accountant shall determine whether disclosure of the matter to the employing organization's external auditor, if any, is needed pursuant to the professional accountant's duty or legal obligation to provide all information necessary to enable the auditor to perform the audit.

The AICPA Code includes the following requirement for PAIBs:

2.130.030 Obligation of a Member to His or Her Employer's External Accountant

.01 The "[Integrity and Objectivity Rule](#)" [2.100.001] requires a *member* to maintain objectivity and integrity in the performance of a *professional service*. When dealing with an employer's external accountant, a *member* must be candid and not knowingly misrepresent facts or knowingly fail to disclose material facts. This would include, for example, responding to specific inquiries for which the employer's external accountant requests written representation.

In addition, the *Confidential Information Obtained from Employment or Volunteer Activities Interpretation* provides for an exception to confidentiality of employer information when:

- c. There is a professional responsibility or right to disclose information, when not prohibited by law, to...iii. comply with professional standards and other ethics requirements; or
- d. Disclosure is permitted on behalf of the employer to...iii. communicate with the employer's external accountant, attorneys, regulators, and other business professionals.

The Task Force discussed whether disclosure of a NOCLAR to the external auditor should be permitted. The Task Force concluded that a PAPP should not be permitted to override client confidentiality to disclose a NOCLAR to the external auditor. With regard to PAIBs, the Task Force supported the IESBA requirement and believed that a senior PAIB should determine whether disclosure of the matter to the employing organization's external auditor is needed pursuant to his or her duty to provide all information necessary to enable the auditor to perform the audit. The Task Force believed this requirement was generally consistent with AICPA Interpretation 2.130.030 as documented above.

**Action Needed:**

- 4. Does the Committee agree that a PAPP performing non-audit services for a client should not be permitted to disclose a NOCLAR to the external auditor?
- 5. Does the Committee agree with the NOCLAR requirement that would permit disclosure of a NOCLAR by a senior PAIB to the company's external auditor? If so, does the Committee believe the PAIB would already be permitted to make such disclosure under the *Obligation of a Member to His or Her Employer's External Accountant* and *Confidential Information Obtained from Employment or Volunteer Activities Interpretations*?

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## **Forensic Services**

In its comment letter to the IESBA, the PEEC expressed concern that forensic services would be scoped in under the NOCLAR standard. The PEEC explained that clients would be reluctant to hire PAPPs to provide such services, if any suspected NOCLAR that is uncovered or confirmed is subject to potential disclosure by the PAPPs to external authorities. The PEEC further commented that it believed forensic services where a client engages the PAPP to investigate known or a suspected NOCLAR is in the public interest and should be exempt from the disclosure provisions of the standard. It was suggested that for such engagements, the PAPP should only be required to report their findings to management and/or those charged with governance; client management and/or those charged with governance should be responsible for taking appropriate action. The IESBA considered these concerns and agreed to add the following language with regards to communication to the client's external auditor (par. 225.47) and disclosure to an authority (par. 225.52):

225.47 Factors relevant to considering the communication in accordance with paragraphs 225.45 and 225.46 include...:

- Whether the purpose of the engagement is to investigate potential non-compliance within the entity to enable it to take appropriate action.

225.52 In considering whether to disclose to an appropriate authority, relevant factors to take into account include:

- Whether the purpose of the engagement is to investigate potential non-compliance within the entity to enable it to take appropriate action.

The IESBA did not exempt these services from the standard but rather decided that the PAPP should take into consideration whether such services were performed to investigate potential non-compliance within the entity in determining whether to disclose a NOCLAR to the external auditor or an appropriate authority. Accordingly, a PAPP providing forensic services for a client must still consider whether disclosure may be an appropriate measure.

The Task Force discussed this matter and concluded that if the Committee agrees that PAPPs should not be permitted to disclose a NOCLAR to an authority or external auditor (as discussed above), then there is no need to exempt such services from the guidance. However, if the Committee believes otherwise, it should consider whether forensic services should be exempt from any AICPA standard.

### **Action Needed:**

6. Does the Committee agree that PAPPs should be prohibited from disclosing a NOCLAR to an authority or external auditor? If not, should forensic services be exempt from the AICPA standard?

### **Materials Presented**

Agenda 9A – This Agenda Item

Agenda 9B – NOCLAR Pronouncements

Agenda 9C – Confidentiality Requirements by State

Agenda 9D - AICPA Confidentiality Standards

**Final Pronouncement**  
[July 2016]

*International Ethics Standards Board  
for Accountants®*

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## Responding to Non-Compliance with Laws and Regulations

**IESBA**

International  
Ethics Standards  
Board for Accountants®

This document was developed and approved by the International Ethics Standards Board for Accountants® (IESBA®).

The IESBA is an independent standard-setting board that develops and issues high-quality ethical standards and other pronouncements for professional accountants worldwide. Through its activities, the IESBA develops the *Code of Ethics for Professional Accountants*™, which establishes ethical requirements for professional accountants.

The objective of the IESBA is to serve the public interest by setting high-quality ethical standards for professional accountants and by facilitating the convergence of international and national ethical standards, including auditor independence requirements, through the development of a robust, internationally appropriate code of ethics.

The structures and processes that support the operations of the IESBA are facilitated by the International Federation of Accountants® (IFAC®).

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# RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS

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## SECTION 225

### Responding to Non-Compliance with Laws and Regulations

#### Purpose

- 225.1 A professional accountant in public practice may encounter or be made aware of non-compliance or suspected non-compliance with laws and regulations in the course of providing a professional service to a client. The purpose of this section is to set out the professional accountant's responsibilities when encountering such non-compliance or suspected non-compliance, and guide the professional accountant in assessing the implications of the matter and the possible courses of action when responding to it. This section applies regardless of the nature of the client, including whether or not it is a public interest entity.
- 225.2 Non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, committed by a client, or by those charged with governance, by management or by other individuals working for or under the direction of a client which are contrary to the prevailing laws or regulations.
- 225.3 In some jurisdictions, there are legal or regulatory provisions governing how professional accountants should address non-compliance or suspected non-compliance which may differ from or go beyond this section. When encountering such non-compliance or suspected non-compliance, the professional accountant has a responsibility to obtain an understanding of those provisions and comply with them, including any requirement to report the matter to an appropriate authority and any prohibition on alerting the client prior to making any disclosure, for example, pursuant to anti-money laundering legislation.
- 225.4 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. When responding to non-compliance or suspected non-compliance, the objectives of the professional accountant are:
- (a) To comply with the fundamental principles of integrity and professional behavior;
  - (b) By alerting management or, where appropriate, those charged with governance of the client, to seek to:
    - (i) Enable them to rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or
    - (ii) Deter the commission of the non-compliance where it has not yet occurred; and
  - (c) To take such further action as appropriate in the public interest.

#### Scope

- 225.5 This section sets out the approach to be taken by a professional accountant who encounters or is made aware of non-compliance or suspected non-compliance with:
- (a) Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the client's financial statements; and
  - (b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the client's financial statements, but compliance with which may

be fundamental to the operating aspects of the client's business, to its ability to continue its business, or to avoid material penalties.

225.6 Examples of laws and regulations which this section addresses include those that deal with:

- Fraud, corruption and bribery.
- Money laundering, terrorist financing and proceeds of crime.
- Securities markets and trading.
- Banking and other financial products and services.
- Data protection.
- Tax and pension liabilities and payments.
- Environmental protection.
- Public health and safety.

225.7 Non-compliance may result in fines, litigation or other consequences for the client that may have a material effect on its financial statements. Importantly, such non-compliance may have wider public interest implications in terms of potentially substantial harm to investors, creditors, employees or the general public. For the purposes of this section, an act that causes substantial harm is one that results in serious adverse consequences to any of these parties in financial or non-financial terms. Examples include the perpetration of a fraud resulting in significant financial losses to investors, and breaches of environmental laws and regulations endangering the health or safety of employees or the public.

225.8 A professional accountant who encounters or is made aware of matters that are clearly inconsequential, judged by their nature and their impact, financial or otherwise, on the client, its stakeholders and the general public, is not required to comply with this section with respect to such matters.

225.9 This section does not address:

- (a) Personal misconduct unrelated to the business activities of the client; and
- (b) Non-compliance other than by the client or those charged with governance, management or other individuals working for or under the direction of the client. This includes, for example, circumstances where a professional accountant has been engaged by a client to perform a due diligence assignment on a third party entity and the identified or suspected non-compliance has been committed by that third party.

The professional accountant may nevertheless find the guidance in this section helpful in considering how to respond in these situations.

### **Responsibilities of the Client's Management and Those Charged with Governance**

225.10 It is the responsibility of the client's management, with the oversight of those charged with governance, to ensure that the client's business activities are conducted in accordance with laws and regulations. It is also the responsibility of management and those charged with governance to identify and address any non-compliance by the client, by an individual charged with governance of the entity, by a member of management, or by other individuals working for or under the direction of the client.

## Responsibilities of Professional Accountants in Public Practice

225.11 Where a professional accountant becomes aware of a matter to which this section applies, the steps that the professional accountant takes to comply with this section shall be taken on a timely basis, having regard to the professional accountant's understanding of the nature of the matter and the potential harm to the interests of the entity, investors, creditors, employees or the general public.

### Audits of Financial Statements

#### *Obtaining an Understanding of the Matter*

225.12 If a professional accountant engaged to perform an audit of financial statements becomes aware of information concerning an instance of non-compliance or suspected non-compliance, whether in the course of performing the engagement or through information provided by other parties, the professional accountant shall obtain an understanding of the matter, including the nature of the act and the circumstances in which it has occurred or may occur.

225.13 The professional accountant is expected to apply knowledge, professional judgment and expertise, but is not expected to have a level of knowledge of laws and regulations that is greater than that which is required to undertake the engagement. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body. Depending on the nature and significance of the matter, the professional accountant may consult on a confidential basis with others within the firm, a network firm or a professional body, or with legal counsel.

225.14 If the professional accountant identifies or suspects that non-compliance has occurred or may occur, the professional accountant shall discuss the matter with the appropriate level of management and, where appropriate, those charged with governance.

225.15 Such discussion serves to clarify the professional accountant's understanding of the facts and circumstances relevant to the matter and its potential consequences. The discussion also may prompt management or those charged with governance to investigate the matter.

225.16 The appropriate level of management with whom to discuss the matter is a question of professional judgment. Relevant factors to consider include:

- The nature and circumstances of the matter.
- The individuals actually or potentially involved.
- The likelihood of collusion.
- The potential consequences of the matter.
- Whether that level of management is able to investigate the matter and take appropriate action.

225.17 The appropriate level of management is generally at least one level above the person or persons involved or potentially involved in the matter. If the professional accountant believes that management is involved in the non-compliance or suspected non-compliance, the professional accountant shall discuss the matter with those charged with governance. The professional accountant may also consider discussing the matter with internal auditors, where applicable. In

the context of a group, the appropriate level may be management at an entity that controls the client.

### *Addressing the Matter*

- 225.18 In discussing the non-compliance or suspected non-compliance with management and, where appropriate, those charged with governance, the professional accountant shall advise them to take appropriate and timely actions, if they have not already done so, to:
- (a) Rectify, remediate or mitigate the consequences of the non-compliance;
  - (b) Deter the commission of the non-compliance where it has not yet occurred; or
  - (c) Disclose the matter to an appropriate authority where required by law or regulation or where considered necessary in the public interest.
- 225.19 The professional accountant shall consider whether the client's management and those charged with governance understand their legal or regulatory responsibilities with respect to the non-compliance or suspected non-compliance. If not, the professional accountant may suggest appropriate sources of information or recommend that they obtain legal advice.
- 225.20 The professional accountant shall comply with applicable:
- (a) Laws and regulations, including legal or regulatory provisions governing the reporting of non-compliance or suspected non-compliance to an appropriate authority. In this regard, some laws and regulations may stipulate a period within which reports are to be made; and
  - (b) Requirements under auditing standards, including those relating to:
    - Identifying and responding to non-compliance, including fraud.
    - Communicating with those charged with governance.
    - Considering the implications of the non-compliance or suspected non-compliance for the auditor's report.

### Communication with Respect to Groups

- 225.21 A professional accountant may:
- (a) For purposes of an audit of group financial statements, be requested by the group engagement team to perform work on financial information related to a component of the group; or
  - (b) Be engaged to perform an audit of a component's financial statements for purposes other than the group audit, for example, a statutory audit.

Where the professional accountant becomes aware of non-compliance or suspected non-compliance in relation to the component in either situation, the professional accountant shall, in addition to responding to the matter in accordance with the provisions of this section, communicate it to the group engagement partner unless prohibited from doing so by law or regulation. This is to enable the group engagement partner to be informed about the matter and to determine, in the context of the group audit, whether and, if so, how it should be addressed in accordance with the provisions in this section.

225.22 Where the group engagement partner becomes aware of non-compliance or suspected non-compliance in the course of an audit of group financial statements, including as a result of being informed of such a matter in accordance with paragraph 225.21, the group engagement partner shall, in addition to responding to the matter in the context of the group audit in accordance with the provisions of this section, consider whether the matter may be relevant to one or more components:

- (a) Whose financial information is subject to work for purposes of the audit of the group financial statements; or
- (b) Whose financial statements are subject to audit for purposes other than the group audit, for example, a statutory audit.

If so, the group engagement partner shall take steps to have the non-compliance or suspected non-compliance communicated to those performing work at components where the matter may be relevant, unless prohibited from doing so by law or regulation. If necessary in relation to subparagraph (b), appropriate inquiries shall be made (either of management or from publicly available information) as to whether the relevant component(s) is subject to audit and, if so, to ascertain to the extent practicable the identity of the auditor. The communication is to enable those responsible for work at such components to be informed about the matter and to determine whether and, if so, how it should be addressed in accordance with the provisions in this section.

#### *Determining Whether Further Action Is Needed*

225.23 The professional accountant shall assess the appropriateness of the response of management and, where applicable, those charged with governance.

225.24 Relevant factors to consider in assessing the appropriateness of the response of management and, where applicable, those charged with governance include whether:

- The response is timely.
- The non-compliance or suspected non-compliance has been adequately investigated.
- Action has been, or is being, taken to rectify, remediate or mitigate the consequences of any non-compliance.
- Action has been, or is being, taken to deter the commission of any non-compliance where it has not yet occurred.
- Appropriate steps have been, or are being, taken to reduce the risk of re-occurrence, for example, additional controls or training.
- The non-compliance or suspected non-compliance has been disclosed to an appropriate authority where appropriate and, if so, whether the disclosure appears adequate.

225.25 In light of the response of management and, where applicable, those charged with governance, the professional accountant shall determine if further action is needed in the public interest.

225.26 The determination of whether further action is needed, and the nature and extent of it, will depend on various factors, including:

- The legal and regulatory framework.
- The urgency of the matter.

- The pervasiveness of the matter throughout the client.
  - Whether the professional accountant continues to have confidence in the integrity of management and, where applicable, those charged with governance.
  - Whether the non-compliance or suspected non-compliance is likely to recur.
  - Whether there is credible evidence of actual or potential substantial harm to the interests of the entity, investors, creditors, employees or the general public.
- 225.27 Examples of circumstances that may cause the professional accountant no longer to have confidence in the integrity of management and, where applicable, those charged with governance include situations where:
- The professional accountant suspects or has evidence of their involvement or intended involvement in any non-compliance.
  - The professional accountant is aware that they have knowledge of such non-compliance and, contrary to legal or regulatory requirements, have not reported, or authorized the reporting of, the matter to an appropriate authority within a reasonable period.
- 225.28 In determining the need for, and nature and extent of, further action, the professional accountant shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at the time, would be likely to conclude that the professional accountant has acted appropriately in the public interest.
- 225.29 Further action by the professional accountant may include:
- Disclosing the matter to an appropriate authority even when there is no legal or regulatory requirement to do so.
  - Withdrawing from the engagement and the professional relationship where permitted by law or regulation.
- 225.30 Where the professional accountant determines that withdrawing from the engagement and the professional relationship would be appropriate, doing so would not be a substitute for taking other actions that may be needed to achieve the professional accountant's objectives under this section. In some jurisdictions, however, there may be limitations as to the further actions available to the professional accountant and withdrawal may be the only available course of action.
- 225.31 Where the professional accountant has withdrawn from the professional relationship pursuant to paragraphs 225.25 and 225.29, the professional accountant shall, on request by the proposed successor accountant, provide all such facts and other information concerning the identified or suspected non-compliance that, in the predecessor accountant's opinion, the proposed successor accountant needs to be aware of before deciding whether to accept the audit appointment. The predecessor accountant shall do so despite paragraph 210.14, unless prohibited by law or regulation. If the proposed successor accountant is unable to communicate with the predecessor accountant, the proposed successor accountant shall take reasonable steps to obtain information about the circumstances of the change of appointment by other

means, such as through inquiries of third parties or background investigations of management or those charged with governance.

- 225.32 As consideration of the matter may involve complex analysis and judgments, the professional accountant may consider consulting internally, obtaining legal advice to understand the professional accountant's options and the professional or legal implications of taking any particular course of action, or consulting on a confidential basis with a regulator or professional body.

#### Determining Whether to Disclose the Matter to an Appropriate Authority

- 225.33 Disclosure of the matter to an appropriate authority would be precluded if doing so would be contrary to law or regulation. Otherwise, the purpose of making disclosure is to enable an appropriate authority to cause the matter to be investigated and action to be taken in the public interest.

- 225.34 The determination of whether to make such a disclosure depends in particular on the nature and extent of the actual or potential harm that is or may be caused by the matter to investors, creditors, employees or the general public. For example, the professional accountant may determine that disclosure of the matter to an appropriate authority is an appropriate course of action if:

- The entity is engaged in bribery (for example, of local or foreign government officials for purposes of securing large contracts).
- The entity is regulated and the matter is of such significance as to threaten its license to operate.
- The entity is listed on a securities exchange and the matter could result in adverse consequences to the fair and orderly market in the entity's securities or pose a systemic risk to the financial markets.
- Products that are harmful to public health or safety would likely be sold by the entity.
- The entity is promoting a scheme to its clients to assist them in evading taxes.

The determination of whether to make such a disclosure will also depend on external factors such as:

- Whether there is an appropriate authority that is able to receive the information, and cause the matter to be investigated and action to be taken. The appropriate authority will depend on the nature of the matter, for example, a securities regulator in the case of fraudulent financial reporting or an environmental protection agency in the case of a breach of environmental laws and regulations.
  - Whether there exists robust and credible protection from civil, criminal or professional liability or retaliation afforded by legislation or regulation, such as under whistle-blowing legislation or regulation.
  - Whether there are actual or potential threats to the physical safety of the professional accountant or other individuals.
- 225.35 If the professional accountant determines that disclosure of the non-compliance or suspected non-compliance to an appropriate authority is an appropriate course of action in the

circumstances, this will not be considered a breach of the duty of confidentiality under Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions. The professional accountant shall also consider whether it is appropriate to inform the client of the professional accountant's intentions before disclosing the matter.

- 225.36 In exceptional circumstances, the professional accountant may become aware of actual or intended conduct that the professional accountant has reason to believe would constitute an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having considered whether it would be appropriate to discuss the matter with management or those charged with governance of the entity, the professional accountant shall exercise professional judgment and may immediately disclose the matter to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach of law or regulation. Such disclosure will not be considered a breach of the duty of confidentiality under Section 140 of this Code.

#### *Documentation*

- 225.37 In relation to an identified or suspected act of non-compliance that falls within the scope of this section, the professional accountant shall, in addition to complying with the documentation requirements under applicable auditing standards, document:
- How management and, where applicable, those charged with governance have responded to the matter.
  - The courses of action the professional accountant considered, the judgments made and the decisions that were taken, having regard to the reasonable and informed third party perspective.
  - How the professional accountant is satisfied that the professional accountant has fulfilled the responsibility set out in paragraph 225.25.
- 225.38 *International Standards on Auditing* (ISAs), for example, require a professional accountant performing an audit of financial statements to:
- Prepare documentation sufficient to enable an understanding of significant matters arising during the audit, the conclusions reached, and significant professional judgments made in reaching those conclusions;
  - Document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place; and
  - Document identified or suspected non-compliance, and the results of discussion with management and, where applicable, those charged with governance and other parties outside the entity.

**Professional Services Other than Audits of Financial Statements***Obtaining an Understanding of the Matter and Addressing It with Management and Those Charged with Governance*

- 225.39 If a professional accountant engaged to provide a professional service other than an audit of financial statements becomes aware of information concerning an instance of non-compliance or suspected non-compliance, the professional accountant shall seek to obtain an understanding of the matter, including the nature of the act and the circumstances in which it has occurred or may be about to occur.
- 225.40 The professional accountant is expected to apply knowledge, professional judgment and expertise, but is not expected to have a level of understanding of laws and regulations beyond that which is required for the professional service for which the accountant was engaged. Whether an act constitutes actual non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body. Depending on the nature and significance of the matter, the professional accountant may consult on a confidential basis with others within the firm, a network firm or a professional body, or with legal counsel.
- 225.41 If the professional accountant identifies or suspects that non-compliance has occurred or may occur, the professional accountant shall discuss the matter with the appropriate level of management and, if the professional accountant has access to them and where appropriate, those charged with governance.
- 225.42 Such discussion serves to clarify the professional accountant's understanding of the facts and circumstances relevant to the matter and its potential consequences. The discussion also may prompt management or those charged with governance to investigate the matter.
- 225.43 The appropriate level of management with whom to discuss the matter is a question of professional judgment. Relevant factors to consider include:
- The nature and circumstances of the matter.
  - The individuals actually or potentially involved.
  - The likelihood of collusion.
  - The potential consequences of the matter.
  - Whether that level of management is able to investigate the matter and take appropriate action.

*Communicating the Matter to the Entity's External Auditor*

- 225.44 If the professional accountant is performing a non-audit service for an audit client of the firm, or a component of an audit client of the firm, the professional accountant shall communicate the non-compliance or suspected non-compliance within the firm, unless prohibited from doing so by law or regulation. The communication shall be made in accordance with the firm's protocols or procedures or, in the absence of such protocols and procedures, directly to the audit engagement partner.
- 225.45 If the professional accountant is performing a non-audit service for an audit client of a network firm, or a component of an audit client of a network firm, the professional accountant shall consider whether to communicate the non-compliance or suspected non-compliance to the

network firm. Where the communication is made, it shall be made in accordance with the network's protocols or procedures or, in the absence of such protocols and procedures, directly to the audit engagement partner.

225.46 If the professional accountant is performing a non-audit service for a client that is not:

- (a) An audit client of the firm or a network firm; or
- (b) A component of an audit client of the firm or a network firm,

the professional accountant shall consider whether to communicate the non-compliance or suspected non-compliance to the firm that is the client's external auditor, if any.

225.47 Factors relevant to considering the communication in accordance with paragraphs 225.45 and 225.46 include:

- Whether doing so would be contrary to law or regulation.
- Whether there are restrictions about disclosure imposed by a regulatory agency or prosecutor in an ongoing investigation into the non-compliance or suspected non-compliance.
- Whether the purpose of the engagement is to investigate potential non-compliance within the entity to enable it to take appropriate action.
- Whether management or those charged with governance have already informed the entity's external auditor about the matter.
- The likely materiality of the matter to the audit of the client's financial statements or, where the matter relates to a component of a group, its likely materiality to the audit of the group financial statements.

225.48 In all cases, the communication is to enable the audit engagement partner to be informed about the non-compliance or suspected non-compliance and to determine whether and, if so, how it should be addressed in accordance with the provisions of this section.

*Considering Whether Further Action Is Needed*

225.49 The professional accountant shall also consider whether further action is needed in the public interest.

225.50 Whether further action is needed, and the nature and extent of it, will depend on factors such as:

- The legal and regulatory framework.
- The appropriateness and timeliness of the response of management and, where applicable, those charged with governance.
- The urgency of the matter.
- The involvement of management or those charged with governance in the matter.
- The likelihood of substantial harm to the interests of the client, investors, creditors, employees or the general public.

- 225.51 Further action by the professional accountant may include:
- Disclosing the matter to an appropriate authority even when there is no legal or regulatory requirement to do so.
  - Withdrawing from the engagement and the professional relationship where permitted by law or regulation.
- 225.52 In considering whether to disclose to an appropriate authority, relevant factors to take into account include:
- Whether doing so would be contrary to law or regulation.
  - Whether there are restrictions about disclosure imposed by a regulatory agency or prosecutor in an ongoing investigation into the non-compliance or suspected non-compliance.
  - Whether the purpose of the engagement is to investigate potential non-compliance within the entity to enable it to take appropriate action.
- 225.53 If the professional accountant determines that disclosure of the non-compliance or suspected non-compliance to an appropriate authority is an appropriate course of action in the circumstances, this will not be considered a breach of the duty of confidentiality under Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions. The professional accountant shall also consider whether it is appropriate to inform the client of the professional accountant's intentions before disclosing the matter.
- 225.54 In exceptional circumstances, the professional accountant may become aware of actual or intended conduct that the professional accountant has reason to believe would constitute an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having considered whether it would be appropriate to discuss the matter with management or those charged with governance of the entity, the professional accountant shall exercise professional judgment and may immediately disclose the matter to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach of law or regulation. Such disclosure will not be considered a breach of the duty of confidentiality under Section 140 of this Code.
- 225.55 The professional accountant may consider consulting internally, obtaining legal advice to understand the professional or legal implications of taking any particular course of action, or consulting on a confidential basis with a regulator or professional body.

#### *Documentation*

- 225.56 In relation to an identified or suspected act of non-compliance that falls within the scope of this section, the professional accountant is encouraged to document:
- The matter.
  - The results of discussion with management and, where applicable, those charged with governance and other parties.
  - How management and, where applicable, those charged with governance have responded to the matter.

- The courses of action the professional accountant considered, the judgments made and the decisions that were taken.
- How the professional accountant is satisfied that the professional accountant has fulfilled the responsibility set out in paragraph 225.49.

**SECTION 360****Responding to Non-Compliance with Laws and Regulations****Purpose**

- 360.1 A professional accountant in business may encounter or be made aware of non-compliance or suspected non-compliance with laws and regulations in the course of carrying out professional activities. The purpose of this section is to set out the professional accountant's responsibilities when encountering such non-compliance or suspected non-compliance, and guide the professional accountant in assessing the implications of the matter and the possible courses of action when responding to it. This section applies regardless of the nature of the employing organization, including whether or not it is a public interest entity.
- 360.2 Non-compliance with laws and regulations ("non-compliance") comprises acts of omission or commission, intentional or unintentional, committed by the professional accountant's employing organization or by those charged with governance, by management, or by other individuals working for or under the direction of the employing organization which are contrary to the prevailing laws or regulations.
- 360.3 In some jurisdictions, there are legal or regulatory provisions governing how professional accountants should address non-compliance or suspected non-compliance which may differ from or go beyond this section. When encountering such non-compliance or suspected non-compliance, the professional accountant has a responsibility to obtain an understanding of those provisions and comply with them, including any requirement to report the matter to an appropriate authority and any prohibition on alerting the relevant party prior to making any disclosure, for example, pursuant to anti-money laundering legislation.
- 360.4 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. When responding to non-compliance or suspected non-compliance, the objectives of the professional accountant are:
- (a) To comply with the fundamental principles of integrity and professional behavior;
  - (b) By alerting management or, where appropriate, those charged with governance of the employing organization, to seek to:
    - (i) Enable them to rectify, remediate or mitigate the consequences of the identified or suspected non-compliance; or
    - (ii) Deter the commission of the non-compliance where it has not yet occurred; and
  - (c) To take such further action as appropriate in the public interest.

**Scope**

- 360.5 This section sets out the approach to be taken by a professional accountant who encounters or is made aware of non-compliance or suspected non-compliance with:
- (a) Laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the employing organization's financial statements; and
  - (b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the employing organization's financial statements, but

compliance with which may be fundamental to the operating aspects of the employing organization's business, to its ability to continue its business, or to avoid material penalties.

- 360.6 Examples of laws and regulations which this section addresses include those that deal with:
- Fraud, corruption and bribery.
  - Money laundering, terrorist financing and proceeds of crime.
  - Securities markets and trading.
  - Banking and other financial products and services.
  - Data protection.
  - Tax and pension liabilities and payments.
  - Environmental protection.
  - Public health and safety.
- 360.7 Non-compliance may result in fines, litigation or other consequences for the employing organization that may have a material effect on its financial statements. Importantly, such non-compliance may have wider public interest implications in terms of potentially substantial harm to investors, creditors, employees or the general public. For the purposes of this section, an act that causes substantial harm is one that results in serious adverse consequences to any of these parties in financial or non-financial terms. Examples include the perpetration of a fraud resulting in significant financial losses to investors, and breaches of environmental laws and regulations endangering the health or safety of employees or the public.
- 360.8 A professional accountant who encounters or is made aware of matters that are clearly inconsequential, judged by their nature and their impact, financial or otherwise, on the employing organization, its stakeholders and the general public, is not required to comply with this section with respect to such matters.
- 360.9 This section does not address:
- (a) Personal misconduct unrelated to the business activities of the employing organization; and
  - (b) Non-compliance other than by the employing organization or those charged with governance, management, or other individuals working for or under the direction of the employing organization.

The professional accountant may nevertheless find the guidance in this section helpful in considering how to respond in these situations.

### **Responsibilities of the Employing Organization's Management and Those Charged with Governance**

- 360.10 It is the responsibility of the employing organization's management, with the oversight of those charged with governance, to ensure that the employing organization's business activities are conducted in accordance with laws and regulations. It is also the responsibility of management and those charged with governance to identify and address any non-compliance by the employing organization or by an individual charged with governance of the entity, by a member

of management, or by other individuals working for or under the direction of the employing organization.

### **Responsibilities of Professional Accountants in Business**

- 360.11 Many employing organizations have established protocols and procedures (for example, an ethics policy or internal whistle-blowing mechanism) regarding how non-compliance or suspected non-compliance by the employing organization should be raised internally. Such protocols and procedures may allow for matters to be reported anonymously through designated channels. If these protocols and procedures exist within the professional accountant's employing organization, the professional accountant shall consider them in determining how to respond to such non-compliance.
- 360.12 Where a professional accountant becomes aware of a matter to which this section applies, the steps that the professional accountant takes to comply with this section shall be taken on a timely basis, having regard to the professional accountant's understanding of the nature of the matter and the potential harm to the interests of the employing organization, investors, creditors, employees or the general public.

### **Responsibilities of Senior Professional Accountants in Business**

- 360.13 Senior professional accountants in business ("senior professional accountants") are directors, officers or senior employees able to exert significant influence over, and make decisions regarding, the acquisition, deployment and control of the employing organization's human, financial, technological, physical and intangible resources. Because of their roles, positions and spheres of influence within the employing organization, there is a greater expectation for them to take whatever action is appropriate in the public interest to respond to non-compliance or suspected non-compliance than other professional accountants within the employing organization.

#### *Obtaining an Understanding of the Matter*

- 360.14 If, in the course of carrying out professional activities, a senior professional accountant becomes aware of information concerning an instance of non-compliance or suspected non-compliance, the professional accountant shall obtain an understanding of the matter, including:
- (a) The nature of the act and the circumstances in which it has occurred or may occur;
  - (b) The application of the relevant laws and regulations to the circumstances; and
  - (c) The potential consequences to the employing organization, investors, creditors, employees or the wider public.
- 360.15 A senior professional accountant is expected to apply knowledge, professional judgment and expertise, but is not expected to have a level of understanding of laws and regulations beyond that which is required for the professional accountant's role within the employing organization. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body. Depending on the nature and significance of the matter, the professional accountant may cause, or take appropriate steps to cause, the matter to be investigated internally. The professional accountant may also consult on a confidential basis with others within the employing organization or a professional body, or with legal counsel.

*Addressing the Matter*

- 360.16 If the senior professional accountant identifies or suspects that non-compliance has occurred or may occur, the professional accountant shall, subject to paragraph 360.11, discuss the matter with the professional accountant's immediate superior, if any, to enable a determination to be made as to how the matter should be addressed. If the professional accountant's immediate superior appears to be involved in the matter, the professional accountant shall discuss the matter with the next higher level of authority within the employing organization.
- 360.17 The senior professional accountant shall also take appropriate steps to:
- (a) Have the matter communicated to those charged with governance to obtain their concurrence regarding appropriate actions to take to respond to the matter and to enable them to fulfill their responsibilities;
  - (b) Comply with applicable laws and regulations, including legal or regulatory provisions governing the reporting of non-compliance or suspected non-compliance to an appropriate authority;
  - (c) Have the consequences of the non-compliance or suspected non-compliance rectified, remediated or mitigated;
  - (d) Reduce the risk of re-occurrence; and
  - (e) Seek to deter the commission of the non-compliance if it has not yet occurred.
- 360.18 In addition to responding to the matter in accordance with the provisions of this section, the senior professional accountant shall determine whether disclosure of the matter to the employing organization's external auditor, if any, is needed pursuant to the professional accountant's duty or legal obligation to provide all information necessary to enable the auditor to perform the audit.

*Determining Whether Further Action Is Needed*

- 360.19 The senior professional accountant shall assess the appropriateness of the response of the professional accountant's superiors, if any, and those charged with governance.
- 360.20 Relevant factors to consider in assessing the appropriateness of the response of the senior professional accountant's superiors, if any, and those charged with governance include whether:
- The response is timely.
  - They have taken or authorized appropriate action to seek to rectify, remediate or mitigate the consequences of the non-compliance, or to avert the non-compliance if it has not yet occurred.
  - The matter has been disclosed to an appropriate authority where appropriate and, if so, whether the disclosure appears adequate.
- 360.21 In light of the response of the senior professional accountant's superiors, if any, and those charged with governance, the professional accountant shall determine if further action is needed in the public interest.
- 360.22 The determination of whether further action is needed, and the nature and extent of it, will depend on various factors, including:
- The legal and regulatory framework.

- The urgency of the matter.
  - The pervasiveness of the matter throughout the employing organization.
  - Whether the senior professional accountant continues to have confidence in the integrity of the professional accountant's superiors and those charged with governance.
  - Whether the non-compliance or suspected non-compliance is likely to recur.
  - Whether there is credible evidence of actual or potential substantial harm to the interests of the employing organization, investors, creditors, employees or the general public.
- 360.23 Examples of circumstances that may cause the senior professional accountant no longer to have confidence in the integrity of the professional accountant's superiors and those charged with governance include situations where:
- The professional accountant suspects or has evidence of their involvement or intended involvement in any non-compliance.
  - Contrary to legal or regulatory requirements, they have not reported the matter, or authorized the matter to be reported, to an appropriate authority within a reasonable period.
- 360.24 In determining the need for, and nature and extent of any further action needed, the senior professional accountant shall exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at the time, would be likely to conclude that the professional accountant has acted appropriately in the public interest.
- 360.25 Further action by the professional accountant may include:
- Informing the management of the parent entity of the matter if the employing organization is a member of a group.
  - Disclosing the matter to an appropriate authority even when there is no legal or regulatory requirement to do so.
  - Resigning from the employing organization.
- 360.26 Where the senior professional accountant determines that resigning from the employing organization would be appropriate, doing so would not be a substitute for taking other actions that may be needed to achieve the professional accountant's objectives under this section. In some jurisdictions, however, there may be limitations as to the further actions available to the professional accountant and resignation may be the only available course of action.
- 360.27 As consideration of the matter may involve complex analysis and judgments, the senior professional accountant may consider consulting internally, obtaining legal advice to understand the professional accountant's options and the professional or legal implications of taking any particular course of action, or consulting on a confidential basis with a regulator or professional body.

#### Determining Whether to Disclose the Matter to an Appropriate Authority

- 360.28 Disclosure of the matter to an appropriate authority would be precluded if doing so would be contrary to law or regulation. Otherwise, the purpose of making disclosure is to enable an appropriate authority to cause the matter to be investigated and action to be taken in the public interest.

360.29 The determination of whether to make such a disclosure depends in particular on the nature and extent of the actual or potential harm that is or may be caused by the matter to investors, creditors, employees or the general public. For example, the senior professional accountant may determine that disclosure of the matter to an appropriate authority is an appropriate course of action if:

- The employing organization is engaged in bribery (for example, of local or foreign government officials for purposes of securing large contracts).
- The employing organization is a regulated entity and the matter is of such significance as to threaten its license to operate.
- The employing organization is listed on a securities exchange and the matter could result in adverse consequences to the fair and orderly market in the employing organization's securities or pose a systemic risk to the financial markets.
- Products that are harmful to public health or safety would likely be sold by the employing organization.
- The employing organization is promoting a scheme to its clients to assist them in evading taxes.

The determination of whether to make such a disclosure will also depend on external factors such as:

- Whether there is an appropriate authority that is able to receive the information, and cause the matter to be investigated and action to be taken. The appropriate authority will depend upon the nature of the matter, for example, a securities regulator in the case of fraudulent financial reporting or an environmental protection agency in the case of a breach of environmental laws and regulations.
- Whether there exists robust and credible protection from civil, criminal or professional liability or retaliation afforded by legislation or regulation, such as under whistle-blowing legislation or regulation.
- Whether there are actual or potential threats to the physical safety of the professional accountant or other individuals.

360.30 If the senior professional accountant determines that disclosure of the matter to an appropriate authority is an appropriate course of action in the circumstances, this will not be considered a breach of the duty of confidentiality under Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions.

360.31 In exceptional circumstances, the senior professional accountant may become aware of actual or intended conduct that the professional accountant has reason to believe would constitute an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having considered whether it would be appropriate to discuss the matter with management or those charged with governance of the entity, the professional accountant shall exercise professional judgment and may immediately disclose the matter to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach of law or regulation. Such disclosure will not be considered a breach of the duty of confidentiality under Section 140 of this Code.

*Documentation*

360.32 In relation to an identified or suspected act of non-compliance that falls within the scope of this section, the senior professional accountant is encouraged to have the following matters documented:

- The matter.
- The results of discussions with the professional accountant's superiors, if any, and those charged with governance and other parties.
- How the professional accountant's superiors, if any, and those charged with governance have responded to the matter.
- The courses of action the professional accountant considered, the judgments made and the decisions that were taken.
- How the professional accountant is satisfied that the professional accountant has fulfilled the responsibility set out in paragraph 360.21.

### **Responsibilities of Professional Accountants Other than Senior Professional Accountants in Business**

360.33 If, in the course of carrying out professional activities, a professional accountant becomes aware of information concerning an instance of non-compliance or suspected non-compliance, the professional accountant shall seek to obtain an understanding of the matter, including the nature of the act and the circumstances in which it has occurred or may occur.

360.34 The professional accountant is expected to apply knowledge, professional judgment and expertise, but is not expected to have a level of understanding of laws and regulations beyond that which is required for the professional accountant's role within the employing organization. Whether an act constitutes non-compliance is ultimately a matter to be determined by a court or other appropriate adjudicative body. Depending on the nature and significance of the matter, the professional accountant may consult on a confidential basis with others within the employing organization or a professional body, or with legal counsel.

360.35 If the professional accountant identifies or suspects that non-compliance has occurred or may occur, the professional accountant shall, subject to paragraph 360.11, inform an immediate superior to enable the superior to take appropriate action. If the professional accountant's immediate superior appears to be involved in the matter, the professional accountant shall inform the next higher level of authority within the employing organization.

360.36 In exceptional circumstances, the professional accountant may decide that disclosure of the matter to an appropriate authority is an appropriate course of action. If the professional accountant does so pursuant to paragraph 360.29, this will not be considered a breach of the duty of confidentiality under Section 140 of this Code. When making such disclosure, the professional accountant shall act in good faith and exercise caution when making statements and assertions.

## Documentation

360.37 In relation to an identified or suspected act of non-compliance that falls within the scope of this section, the professional accountant is encouraged to have the following matters documented:

- The matter.
- The results of discussions with the professional accountant's superior, management and, where applicable, those charged with governance and other parties.
- How the professional accountant's superior has responded to the matter.
- The courses of action the professional accountant considered, the judgments made and the decisions that were taken.

**CONSEQUENTIAL AND CONFORMING CHANGES  
TO OTHER SECTIONS OF THE CODE  
(MARK-UP FROM EXTANT CODE)**

**SECTION 100**

**Introduction and Fundamental Principles**

...

*Fundamental Principles*

100.5 A professional accountant shall comply with the following fundamental principles:

...

- (e) Professional Behavior – to comply with relevant laws and regulations and avoid any ~~action~~ conduct that discredits the profession.

...

*Conflicts of Interest*

...

*Ethical Conflict Resolution*

...

100.23 If a significant conflict cannot be resolved, a professional accountant may consider obtaining professional advice from the relevant professional body or from legal advisors. The professional accountant generally can obtain guidance on ethical issues without breaching the fundamental principle of confidentiality if the matter is discussed with the relevant professional body on an anonymous basis or with a legal advisor under the protection of legal privilege. ~~Instances in which the professional accountant may consider obtaining legal advice vary. For example, a professional accountant may have encountered a fraud, the reporting of which could breach the professional accountant's responsibility to respect confidentiality. The professional accountant may consider obtaining legal advice in that instance to determine whether there is a requirement to report.~~

100.24 If, after exhausting all relevant possibilities, the ethical conflict remains unresolved, a professional accountant shall, ~~where possible unless prohibited by law~~, refuse to remain associated with the matter creating the conflict. The professional accountant shall determine whether, in the circumstances, it is appropriate to withdraw from the engagement team or specific assignment, or to resign altogether from the engagement, the firm or the employing organization.

*Communicating with Those Charged with Governance*

100.25 When communicating with those charged with governance in accordance with the provisions of this Code, the professional accountant or firm shall determine, having regard to the nature and importance of the particular circumstances and matter to be communicated, the appropriate person(s) within the entity's governance structure with whom to communicate. If the professional accountant or firm communicates with a subgroup of those charged with governance, for

example, an audit committee or an individual, the professional accountant or firm shall determine whether communication with all of those charged with governance is also necessary so that they are adequately informed.

100.26 In some cases, all of those charged with governance are involved in managing the entity, for example, a small business where a single owner manages the entity and no one else has a governance role. In these cases, if matters are communicated with person(s) with management responsibilities, and those person(s) also have governance responsibilities, the matters need not be communicated again with those same person(s) in their governance role. The professional accountant or firm shall nonetheless be satisfied that communication with person(s) with management responsibilities adequately informs all of those with whom the professional accountant or firm would otherwise communicate in their governance capacity.

## SECTION 140

### Confidentiality

...

140.7 As a fundamental principle, confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the professional accountant. Nevertheless, ¶the following are circumstances where professional accountants are or may be required to disclose confidential information or when such disclosure may be appropriate:

- (a) Disclosure is permitted by law and is authorized by the client or the employer;
- (b) Disclosure is required by law, for example:
  - (i) Production of documents or other provision of evidence in the course of legal proceedings; or
  - (ii) Disclosure to the appropriate public authorities of infringements of the law that come to light; and
- (c) There is a professional duty or right to disclose, when not prohibited by law:
  - (i) To comply with the quality review of a member body or professional body;
  - (ii) To respond to an inquiry or investigation by a member body or regulatory body;
  - (iii) To protect the professional interests of a professional accountant in legal proceedings; or
  - (iv) To comply with technical and professional standards, ~~and including ethical~~s requirements.

## SECTION 150

### Professional Behavior

150.1 The principle of professional behavior imposes an obligation on all professional accountants to comply with relevant laws and regulations and avoid any ~~action-conduct~~ that the professional accountant knows or should know may discredit the profession. This includes ~~actions-conduct~~ that a reasonable and informed third party, weighing all the specific facts and circumstances available to the professional accountant at that time, would be likely to conclude adversely affects the good reputation of the profession.

...

## SECTION 210

### Professional Appointment

#### *Client Acceptance and Continuance*

210.1 Before accepting a new client relationship, a professional accountant in public practice shall determine whether acceptance would create any threats to compliance with the fundamental principles. Potential threats to integrity or professional behavior may be created from, for example, ~~questionable~~ issues associated with the client (its owners, management or activities). ~~210.2 Client issues~~ that, if known, could threaten compliance with the fundamental principles. These include, for example, client involvement in illegal activities (such as money laundering), dishonesty, ~~or~~ questionable financial reporting practices or other unethical behavior.

210.23 A professional accountant in public practice shall evaluate the significance of any threats and apply safeguards when necessary to eliminate them or reduce them to an acceptable level.

Examples of such safeguards include:

- Obtaining knowledge and understanding of the client, its owners, managers and those responsible for its governance and business activities; or
- Securing the client's commitment to address the questionable issues, for example, through improving corporate governance practices or internal controls.

210.34 Where it is not possible to reduce the threats to an acceptable level, the professional accountant in public practice shall decline to enter into the client relationship.

210.45 ~~It is recommended that a professional accountant in public practice periodically review acceptance decisions for recurring client engagements. Potential threats to compliance with the fundamental principles may have been created after acceptance that would have caused the professional accountant to decline the engagement had that information been available earlier. A professional accountant in public practice shall, therefore, periodically review whether to continue with a recurring client engagement. For example, a threat to compliance with the fundamental principles may be created by a client's unethical behavior such as improper earnings management or balance sheet valuations. If a professional accountant in public practice identifies a threat to compliance with the fundamental principles, the professional accountant shall evaluate the significance of the threats and apply safeguards when necessary to eliminate the threat or reduce it to an acceptable level. Where it is not possible to reduce the threat to an acceptable~~

level, the professional accountant in public practice shall consider terminating the client relationship where termination is not prohibited by law or regulation.

### *Engagement Acceptance*

210.56 The fundamental principle of professional competence and due care imposes an obligation on a professional accountant in public practice to provide only those services that the professional accountant in public practice is competent to perform. Before accepting a specific client engagement, a professional accountant in public practice shall determine whether acceptance would create any threats to compliance with the fundamental principles. For example, a self-interest threat to professional competence and due care is created if the engagement team does not possess, or cannot acquire, the competencies necessary to properly carry out the engagement.

210.67 A professional accountant in public practice shall evaluate the significance of threats and apply safeguards, when necessary, to eliminate them or reduce them to an acceptable level. Examples of such safeguards include:

- Acquiring an appropriate understanding of the nature of the client's business, the complexity of its operations, the specific requirements of the engagement and the purpose, nature and scope of the work to be performed.
- Acquiring knowledge of relevant industries or subject matters.
- Possessing or obtaining experience with relevant regulatory or reporting requirements.
- Assigning sufficient staff with the necessary competencies.
- Using experts where necessary.
- Agreeing on a realistic time frame for the performance of the engagement.
- Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted only when they can be performed competently.

210.78 When a professional accountant in public practice intends to rely on the advice or work of an expert, the professional accountant in public practice shall determine whether such reliance is warranted. Factors to consider include: reputation, expertise, resources available and applicable professional and ethical standards. Such information may be gained from prior association with the expert or from consulting others.

### *Changes in a Professional Appointment*

210.89 A professional accountant in public practice who is asked to replace another professional accountant in public practice, or who is considering tendering for an engagement currently held by another professional accountant in public practice, shall determine whether there are any reasons, professional or otherwise, for not accepting the engagement, such as circumstances that create threats to compliance with the fundamental principles that cannot be eliminated or reduced to an acceptable level by the application of safeguards. For example, there may be a threat to professional competence and due care if a professional accountant in public practice accepts the engagement before knowing all the pertinent facts.

210.910 A professional accountant in public practice shall evaluate the significance of any threats. ~~Depending on the nature of the engagement, this may require direct communication with the existing accountant to establish the facts and circumstances regarding the proposed change so that the professional accountant in public practice can decide whether it would be appropriate to accept the engagement. For example, the apparent reasons for the change in appointment may not fully reflect the facts and may indicate disagreements with the existing accountant that may influence the decision to accept the appointment.~~ 210.11 Safeguards shall be applied when necessary to eliminate any threats or reduce them to an acceptable level. Examples of such safeguards include:

- When replying to requests to submit tenders, stating in the tender that, before accepting the engagement, contact with the existing or predecessor accountant will be requested so that inquiries may be made as to whether there are any professional or other reasons why the appointment should not be accepted;
- Asking the ~~existing-predecessor~~ accountant to provide known information on any facts or circumstances that, in the ~~existing-predecessor~~ accountant's opinion, the proposed successor accountant needs to be aware of before deciding whether to accept the engagement. ~~For example, the apparent reasons for the change in appointment may not fully reflect the facts and may indicate disagreements with the existing-predecessor accountant that may influence the decision to accept the appointment.~~; or
- Obtaining necessary information from other sources.

210.10 When the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, a professional accountant in public practice shall, unless there is satisfaction as to necessary facts by other means, decline the engagement.

210.112 A professional accountant in public practice may be asked to undertake work that is complementary or additional to the work of the existing accountant. Such circumstances may create threats to professional competence and due care resulting from, for example, a lack of or incomplete information. The significance of any threats shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. An example of such a safeguard is notifying the existing accountant of the proposed work, which would give the existing accountant the opportunity to provide any relevant information needed for the proper conduct of the work.

210.123 An existing or predecessor accountant is bound by confidentiality. Whether that professional accountant is permitted or required to discuss the affairs of a client with a proposed accountant will depend on the nature of the engagement and on:

- (a) Whether the client's permission to do so has been obtained; or
- (b) The legal or ethical requirements relating to such communications and disclosure, which may vary by jurisdiction.

Circumstances where the professional accountant is or may be required to disclose confidential information or where such disclosure may otherwise be appropriate are set out in Section 140 of Part A of this Code.

210.134 A professional accountant in public practice will generally need to obtain the client's permission, preferably in writing, to initiate discussion with an existing or predecessor accountant. Once that permission is obtained, the existing or predecessor accountant shall comply with relevant ~~legal~~

laws and ~~other~~ regulations governing such requests. Where the existing or predecessor accountant provides information, it shall be provided honestly and unambiguously. If the proposed accountant is unable to communicate with the existing or predecessor accountant, the proposed accountant shall take reasonable steps to obtain information about any possible threats by other means, such as through inquiries of third parties or background investigations of senior management or those charged with governance of the client.

210.14 In the case of an audit of financial statements, a professional accountant shall request the predecessor accountant to provide known information regarding any facts or other information that, in the predecessor accountant's opinion, the proposed successor accountant needs to be aware of before deciding whether to accept the engagement. Except for the circumstances involving identified or suspected non-compliance with laws and regulations set out in paragraph 225.31:

(a) If the client consents to the predecessor accountant disclosing any such facts or other information, the predecessor accountant shall provide the information honestly and unambiguously; and

(b) If the client fails or refuses to grant the predecessor accountant permission to discuss the client's affairs with the proposed successor accountant, the predecessor accountant shall disclose this fact to the proposed successor accountant, who shall carefully consider such failure or refusal when determining whether or not to accept the appointment.

## **SECTION 270**

### **Custody of Client Assets**

.....

270.3 As part of client and engagement acceptance procedures for services that may involve the holding of client assets, a professional accountant in public practice shall make appropriate inquiries about the source of such assets and consider legal and regulatory obligations. For example, if the assets were derived from illegal activities, such as money laundering, a threat to compliance with the fundamental principles would be created. In such situations, the professional accountant ~~may consider seeking legal advice~~ shall comply with the provisions of section 225.

**Effective Date**

This pronouncement is effective as of July 15, 2017. Early adoption is permitted.

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Client Confidentiality

Agenda Item 9C

State	Permits Disclosure When Required by Law	Permits Disclosure of NOCLAR	Citation	Language
AL	Yes	No	30X6.04	(1) Confidential Client Information. A registrant shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client.(a) This rule shall not be construed 1. to relieve registrant of his obligation under Rules 30X6.03(2) and 30X6.03(3), 2. to affect in any way his compliance with a validly issued subpoena or summons enforceable by order of a court, 3. to prohibit review of a practitioner's professional practices as a part of voluntary quality review, or, 4. to preclude him from responding to any inquiry made by the ethics division or Trial Board of the American Institute of CPAs, by a duly constituted investigative or disciplinary body of a State CPA Society or PA Association, or under State statutes.
AK	No	No	Sec. 08.04.662.	(a) A license holder, a permit holder, a practice privilege holder, an out-of-state exemption holder, or a partner, an officer, a shareholder, a member, or an employee of a license holder, a permit holder, an out-of-state exemption holder, or a practice privilege holder, may not reveal information communicated to the license holder, permit holder, out-of-state exemption holder, or practice privilege holder by a client about a matter concerning which the client has employed the license holder, permit holder, out-of-state exemption holder, or practice privilege holder in a professional capacity. This section does not apply to (1) information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements; (2) the release of information the client has authorized the license holder, permit holder, out-of-state exemption holder, or practice privilege holder to reveal; (3) information revealed as part of the discovery of evidence related to a court or administrative proceeding or introduced in evidence in a court or administrative proceeding; (4) information revealed in ethical investigations conducted by private professional organizations; or (5) information revealed in the course of a quality review under AS 08.04.426. (b) Client information obtained by the board under (a)(3) - (5) of this section is confidential and is not a public record for purposes of AS 40.25.110 - 40.25.140.
AZ	No	No	R4-1-455.02.	A. Confidential client information: A certified public accountant, public accountant, or firm shall not disclose confidential information obtained in the course of a professional engagement except with the consent of the client. This requirement shall not be construed to: 1. Relieve a certified public accountant, public accountant, or firm of the obligations under R4-1-455.01(B) and (C); 2. Affect the certified public accountant's, public accountant's, or firm's compliance with a validly issued subpoena or summons enforceable by order of a court; 3. Prohibit review of a certified public accountant's, public accountant's, or firm's professional practices as a part of a peer or quality review conducted under Board decision or authority; or 4. Preclude a certified public accountant, public accountant, or firm from responding to an inquiry made by the Board under state statutes.
AR	Yes	Yes	Rule 301	A licensee shall not without the consent of his or her client disclose any confidential information pertaining to his or her client obtained in the course of performing professional services. <b>This Rule does not</b> (A) relieve a licensee of any obligations under Rules 202 and 203, (B) affect in any way a licensee's obligation to comply with a validly issued subpoena or summons enforceable by order of court, or prohibit a licensee's compliance with applicable laws and government regulations, (C) prohibit review of a licensee's professional practice under Board authorization, or <b>(D) preclude a licensee from initiating a complaint with, or responding to any inquiry made by the Board or any investigative or disciplinary body established by law or formally recognized by the Board.</b> Members of the Board and professional practice reviewers shall not use to their own advantage or disclose any confidential client information which comes to their attention in carrying out those activities. This prohibition shall not restrict licensee's exchange of information in connection with the investigative or disciplinary proceedings described in (D) above or the professional practice reviews described in (C) above.
CA	Yes	No	5063.3	(a) No confidential information obtained by a licensee, in his or her professional capacity, concerning a client or a prospective client shall be disclosed by the licensee without the written permission of the client or prospective client, except the following: (1) Disclosures made by a licensee in compliance with a subpoena or a summons enforceable by order of a court. (2) Disclosures made by a licensee regarding a client or prospective client to the extent the licensee reasonably believes it is necessary to maintain or defend himself or herself in a legal proceeding initiated by the client or prospective client. (3) Disclosures made by a licensee in response to an official inquiry from a federal or state government regulatory agency. (4) Disclosures made by a licensee or a licensee's duly authorized representative to another licensee in connection with a proposed sale or merger of the licensee's professional practice. (5) Disclosures made by a licensee to either of the following: (A) Another licensee to the extent necessary for purposes of professional consultation. (B) Organizations that provide professional standards review and ethics or quality control peer review. (6) Disclosures made when specifically required by law. (7) Disclosures specified by the board in regulation. (b) In the event that confidential client information may be disclosed to persons or entities outside the United States of America in connection with the services provided, the licensee shall inform the client in writing and obtain the client's written permission for the disclosure.

CO	Yes	Yes	9.8	<p>A. General Rule. A Licensee shall not without the specific consent of their Client or employer disclose or use for their own benefit any personal or business related information pertaining to a Client or the employer of the Licensee, which information is obtained from any source or developed by the Licensee in the course of employment or performing Professional Services. Such information is deemed confidential. Information obtained as part of a proposed acquisition or in evaluating the acquisition or merger of an accounting practice shall not be disclosed or used to the Licensee's benefit.</p> <p>B. Acceptable Disclosures. <b>Rule 9.8.A shall not apply:</b> 1. If information is disclosed with the specific consent of the Client or the employer of the Licensee. 2. If information is disclosed pursuant to a subpoena or summons issued with respect to the Licensee or an entity with which the Licensee is associated, where the subpoena or summons has been determined to be legally enforceable; or if information is disclosed to permit a Licensee's compliance with applicable laws and government rules and regulations. 3. If information is disclosed as part of the public record in a civil law suit (legal action) between the Licensee and the Client or employer. 4. If information is disclosed in the course of a Peer Review of a Licensee's Professional Services. Professional practice reviewers shall not disclose any confidential Client information which comes to their attention from Licensees in carrying out their responsibilities, except that they may furnish such information in response to a formal request from an investigative or disciplinary body of the kind referred to in paragraph 5 of this Rule 9.8.B. 5. If information is disclosed as part of the process of initiating a complaint with, or responding to an inquiry made by, the Board and the disclosure to the Board is in accordance with statutes regarding accountant-client privilege or the Client waives the privilege; or <b>if information is disclosed as part of the process of initiating a complaint with or responding to an investigative or disciplinary body established by law or formally recognized by the Board.</b> Members of the Board shall not disclose or use for their own benefit any confidential Client information that comes to their attention from Licensees in disciplinary proceedings or otherwise in carrying out their responsibilities. 6. If information is disclosed pursuant to a signed nondisclosure agreement as part of an acquisition or merger or proposed acquisition or merger of an accounting practice.</p>
CT	No	No	Sec. 20-281j.	<p>Except by permission of the client engaging a licensee under sections 20-279b to 20-281m, inclusive, or the heirs, successors or personal representatives of such client, a licensee or any partner, officer, shareholder or employee of a licensee shall not voluntarily disclose information communicated to him by the client relating to and in connection with services rendered to the client by the licensee in the practice of public accountancy. Such information shall be deemed confidential, provided that nothing herein shall be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements or as prohibiting disclosures in court proceedings, in investigations or proceedings under section 20-280b or 20-280c in ethical investigations conducted by private professional organizations, or in the course of quality reviews.</p>
CNMI	No	No	Section 17	<p>Except by permission of the client engaging a licensee under this Act, or the heirs, successors, or personal representatives of such client, a licensee or any partner, officer, member, manager, shareholder, or employee of a licensee shall not voluntarily disclose information communicated to the licensee by the client relating to and in connection with services rendered to the client by the licensee in the practice of public accountancy. Such information shall be deemed confidential, provided, however, that nothing herein shall be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements or as prohibiting disclosures in court proceedings, in investigations or proceedings under Section 10 or 11 of this Act, in ethical investigations conducted by private professional organizations, or in the course of quality reviews.</p>
DE	Yes	No	2.1	<p>A certified public accountant, or a public accountant holding a certificate or permit issued by this Board, agrees to comply with the Rules of Conduct contained in the Code of Professional Ethics of the American Institute of Certified Public Accountants. All changes in the Rules and Interpretations made by the American Institute of Certified Public Accountants (AICPA) shall automatically be made a part of these Rules and Regulations unless specifically rejected by the Board.</p>
D.C.	No	No	2512.1 & 2512.2	<p><b>2512.1</b> A licensee shall not disclose, without the consent of his or her client, any confidential information pertaining to the client that the licensee obtained in the course of performing professional services.</p> <p><b>2512.2</b> The provisions of this section do not do the following:  (a) Relieve a licensee of any obligations under § 2511; (b) Affect in any way a licensee's obligation to comply with a validly issued subpoena or summons enforceable by order of a court of competent jurisdiction; (c) Prohibit disclosures during a quality review of a licensee's professional services; (d) Preclude a licensee from responding to any inquiry made by the Board or any investigative or disciplinary body established by law or formally recognized by the Board; or (e) Relieve a licensee from any obligations incurred under the Sarbanes-Oxley Act of 2002, approved July 30, 2002 (Pub. L. 107-204, 116 Stat. 745 (2002)), and any rules or regulations promulgated pursuant thereto not already reflected within this chapter.</p>

FL	No	Yes	473.316(4) & (5)	<p>(2) A client has a privilege to refuse to disclose, and to prevent any other person from disclosing, the contents of confidential communications with an accountant when such other person learned of the communications because they were made in the rendition of accounting services to the client. This privilege includes other confidential information obtained by the accountant from the client for the purpose of rendering accounting advice. ***</p> <p>(4) <b>There is no accountant-client privilege under this section when: (a) The services of the accountant were sought or obtained to enable or aid anyone to commit or plan to commit what the client knew or should have known was a crime or fraud.</b> (b) A communication is relevant to an issue of breach of duty by the accountant to her or his client or by the client to her or his accountant. (c) A communication is relevant to a matter of common interest between two or more clients, if the communication was made by any of them to an accountant retained or consulted in common when offered in a civil action between the clients.</p> <p>(5) Communications are not privileged from disclosure in any disciplinary investigation or proceeding conducted pursuant to this act by the department or before the board or in any judicial review of such a proceeding. In any such proceeding, a certified public accountant or public accountant, without the consent of her or his client, may testify with respect to any communication between the accountant and the accountant's client or be compelled, pursuant to a subpoena of the department or the board, to testify or produce records, books, or papers. Such a communication disclosed to the board and records of the board relating to the communication shall for all other purposes and proceedings be a privileged communication in all of the courts of this state.</p>
GA	No	No	§ 43-3-29 & 20-12-.11	<p><b>§ 43-3-32.</b></p> <p>(b) All communications between a certified public accountant or public accountant or employee of such certified public accountant or public accountant acting in the scope of such employment and the person for whom such certified public accountant, public accountant, or employee shall have made any audit or other investigation in a professional capacity and all information obtained by a certified public accountant, public accountant, or such an employee in his professional capacity concerning the business and affairs of clients shall be deemed privileged communications in all courts or in any other proceedings whatsoever; and no such certified public accountant, public accountant, or employee shall be permitted to testify with respect to any of such matters, except with the written consent of such person or client or such person's or client's legal representative, provided that nothing in this subsection shall be construed as prohibiting a certified public accountant, public accountant, or such an employee from: (1) Disclosing any data required to be disclosed by the standards of the accounting profession in rendering an opinion on the presentation of financial statements or in making disclosure where the practices or diligence of the accountant in preparing, or in expressing an opinion upon, such financial statements are contested; (2) Disclosing any data where the professional services of the accountant are being contested by or against the client for whom such services were performed or any representative or assignee of such client; (3) Disclosing any data to other certified public accountants, public accountants, or employees thereof in connection with practice reviews and ethics reviews sponsored by professional groups, the purpose of which reviews is to survey such accountant's business practices, audits, and work papers or to review ethical considerations concerning such accountant; or (4) Disclosing any data pertaining to an application, investigation by the board, or hearing on its behalf, so long as such data shall be received by the board in camera and shall not be disclosed to the public; and provided, further, that no disclosure provided for in this paragraph shall constitute a</p>
Guam	No	No	§35117	<p>Except by permission of the client for whom a licensee performs services or the heirs, successors, or personal representatives of such client, a licensee under this Chapter, shall not voluntarily disclose information communicated to the licensee by the client relating to and in connection with services rendered to the client by the licensee. Such information shall be deemed confidential, provided, however, that nothing herein shall be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements or as prohibiting disclosures in court proceedings, in investigations or proceedings under §35110 or §35111 of this Chapter, in ethical investigations conducted by private professional organizations, or in the course of peer reviews, or to other persons active in the organization performing services for that client on a need to know basis or to persons in the entity who need this information for the sole purpose of assuring quality control.</p>
HI	No	No	§16-71-63	<p>(a) A licensee, without the consent of the client, shall not disclose any confidential information pertaining to the client obtained in the course of performing professional services. (b) Subsection (a) shall not: (1) Relieve a licensee of any obligations under section 16-71-62(b) and (c); (2) Affect in any way a licensee's obligation to comply with a validly issued subpoena or summons enforceable by order of a court; (3) Prohibit disclosures in the course of a quality review of a licensee's professional services; or (4) Preclude a licensee from responding to any inquiry made by the board or any investigative or disciplinary body established by law or formally recognized by the board. (c) Members of the board and professional practice reviewers shall not disclose any confidential client information which comes to their attention from licensees in disciplinary proceedings or otherwise in carrying out their responsibilities, except that they may furnish the information to an investigative or disciplinary body of the kind referred to in subsection (b).</p>
ID	Yes	No	402.02	<p>02. Exemptions. <b>Nothing in these rules shall be construed as prohibiting the disclosure of information that is required to be disclosed:</b></p> <p>a. In reporting on the examination of financial statements; b. In investigations by the Board or other accounting regulatory agency; c. In ethical investigations conducted in private professional organizations; d. In the course of peer reviews; e. To other persons active in the organization performing services for that client on a need to know basis; f. To persons in the entity who need this information for the sole purpose of assuring quality control; or g. <b>By any act of law.</b></p>
IL	Yes	No	Section 1420.200 (b)	<p>b) The Division hereby incorporates by reference the AICPA Code of Professional Conduct (2015, no later editions or amendments included), 1211 Avenue of the Americas, New York NY 10036-8775, as its minimum standards for professional conduct.</p>

IN	Yes	No	872 IAC 1-2-1	<p>Sec. 1.(b) No licensee of the board shall violate the following standards for the competent practice of accounting appropriate to establish and maintain a high standard of integrity and dignity in the profession of public accountancy, which are incorporated by reference as if fully set out in this rule: (1) The following pronouncements on professional standards set forth in the AICPA Professional Standards, Volumes 1 and 2 (June 1, 2011), subject to the exceptions listed in subsection (c) (applicable to certified public accountants and certified public accountant firms only): (A) U.S. Auditing - AICPA, including the following: (i) Statement on Auditing Standards - Introduction. (ii) The General Standards. (iii) The Standards of Field Work. (iv) The First, Second, and Third Standards of Reporting. (v) The Fourth Standard of Reporting. (vi) Other Types of Reports. (vii) Special Topics. (viii) Compliance Auditing. (ix) Special Reports of the Committee on Auditing Procedure. (B) Statements on Standards for Attestation Engagements. (C) Statements on Standards for Accounting and Review Services. (D) <b>Code of Professional Conduct</b>. (E) Statements on Standards for Valuation Services. (F) Statement on Standards for Consulting Services. (G) Tax Services. Indiana Administrative Code Page 14 INDIANA BOARD OF ACCOUNTANCY (H) Personal Financial Planning.</p> <p>***</p>
IA	Yes	Yes	542.17	<p>A licensee shall not voluntarily disclose information communicated to the licensee by a client relating to and in connection with services rendered to the client by the licensee, except with the permission of the client, or an heir, successor, or personal representative of the client. Such information is deemed to be confidential. However, this section shall not be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements or as prohibiting disclosures in a court proceeding, in an investigation or proceeding under this chapter or chapter 272C, in an ethical investigation conducted by a private professional organization, in the course of a peer review, to another person active in the licensee's firm performing services for that client on a need-to-know basis, to persons associated with the investigative entity who need this information for the sole purpose of assuring quality control, or as otherwise required by law. <b>This section does not preclude a licensee from filing a complaint with, or responding to an inquiry made by, the board, a taxing authority or law enforcement authority of this state, or a licensing or similar authority of another state or the United States.</b></p>
KS	No	No	1-401	<p>(b) No certified public accountant shall be examined through judicial process or proceedings without the consent of the client as to any communication made by the client to the certified public accountant in person or through the media of books of account and financial records, or as to advice, reports or working papers given or made thereon in the course of professional employment, nor shall a secretary, stenographer, clerk or assistant of a certified public accountant be examined without the consent of the client concerned, concerning any fact the knowledge of which any such person has acquired in such capacity or relationship with the certified public accountant. Nothing in this section shall be construed as limiting the authority of this state or of the United States or any agency of this state or of the United States to subpoena books of account, financial records, reports or working papers or other documents and use such information in connection with any investigation, public hearing or court proceeding. This privilege shall not exist when any such communication is material to the defense of an action against a certified public accountant and as otherwise provided by this section. (c) Nothing in subsection (a) shall prohibit a certified public accountant, or any employee of a certified public accountant, from disclosing any data to any other certified public accountant, or anyone employed by a certified public accountant in connection with peer reviews of such certified public accountant's accounting and auditing practice. Nothing in subsection (a) shall prohibit the board of accountancy from securing working papers in connection with any investigation authorized under law. Nothing in subsection (b) shall prohibit a certified public accountant or anyone employed by a certified public accountant from disclosing any data to any other certified public accountant or anyone employed by a certified public accountant in connection with peer reviews of such certified public accountant's accounting and auditing practice nor shall such disclosure waive the privilege. Persons conducting such peer reviews shall be subject to the same duty of confidentiality in regard to such data as is applicable to certified public accountants under this section.</p>
KY	No	No	325.440	<p>(1) A licensee shall not, without the consent of his client, disclose any confidential information pertaining to his client obtained in the course of performing professional services. (2) This section does not: (a) Relieve a licensee of any obligations under the rules of professional conduct; (b) Affect in any way a licensee's obligation to comply with a validly issued subpoena or summons enforceable by order of a court; (c) Prohibit disclosures in the course of a quality review of a licensee's professional services; or (d) Preclude a licensee from responding to any inquiry made by the board or any investigative or disciplinary body established by law or formally recognized by the board. (3) Members of the board and professional practice reviewers shall not disclose any confidential client information which comes to their attention from licensees in disciplinary proceedings or otherwise in carrying out their responsibilities, except that they may furnish such information to an investigative or disciplinary body of the kind referred to above.</p>

LA	No	No	§37:86. & §1705	<p><b>§37:86.</b>  A. No licensee or person employed by a licensee shall be required to or shall voluntarily disclose or divulge the contents of any communication made to him by any person employing such licensee or person in connection with the rendition of tax services or to examine, audit, or report on any books, records, or accounts, or divulge any information derived from such books, records, or accounts in rendering professional services, except as provided by Code of Evidence Articles 515 through 517.  B. Notwithstanding the provisions of Subsection A of this Section, no licensee or person employed by a licensee shall be required by subpoena or otherwise to disclose or divulge any of the following internal documents maintained by such licensee: (1) Personnel files, except that an individual may subpoena his own personnel files. (2) Planning and procedure manuals. (3) Notes and comments made in the course of evaluating the efforts of any licensee or employee, partner, shareholder, or member of a licensee in the performance of an engagement.  C. No licensee furnishing information, data, reports, or records of a client to a person, firm, committee, or organization established for the purpose of a peer review shall, by reason of furnishing such information, be liable in damages to any person, partnership, corporation, or firm. The records and proceedings of any such person, firm, committee, or organization shall be confidential, shall be used only by such person, firm, committee, or organization solely in the exercise of the proper functions of a peer review, and shall not be disclosed to any third party except as provided in R.S. 37:77(H)(4)(b). However, peer review reports on participation by a licensee in the Public Corporation Practice Section Peer Review program may be disclosed.  D. The privilege against divulging information established by this Section shall not be invoked to withhold disclosure of information, data, reports, or records commanded by subpoena of the board in connection with proceedings pursuant to the provisions of this Part. Such proceedings of the board shall be confidential; information provided to the board pursuant to such provisions shall not be disclosed by it except to the extent necessary for the performance of its functions and shall not be subject to court subpoena. Any records, investigatory files, or other files maintained by the board in connection with any investigation or inquiry concerning the fitness of any person to receive or continue to hold a certificate or any firm to receive or continue to hold a permit shall be exempt from the provisions of R.S. 44:1 et seq. However, any final determination made by the board relative to the fitness of any person or firm to receive or continue to hold such a certificate or permit, including any legal grounds upon which such determination was made, shall be a public record.  ...  <b>§1705</b>  A. Confidential Client Information. A licensee shall not, without the consent of his client, disclose any confidential information pertaining to such client obtained in the course of performing professional services. 1. This rule does not: a. relieve a licensee of any obligations under §1705.B and C; or b. affect in any way a licensee's obligation to comply with a validly issued subpoena or summons enforceable by order of a court; or c. prohibit disclosures in the course of a peer review or for the purpose of assuring quality control of a licensee's professional services; or d. preclude a licensee from responding to any inquiry made by the board or any investigative or disciplinary body established by law or formally recognized by the board; or</p>
ME	No	No	§12279	<p>Except by permission of the client engaging a licensee under this chapter, or the heirs, successors or personal representatives of that client, a licensee or any partner, officer, shareholder or employee of a licensee may not voluntarily disclose information communicated to the licensee, or any partner, officer, shareholder or employee of the licensee, by the client relating to, and in connection with, services rendered to the client by the licensee in the practice of public accountancy. That information must be considered confidential as long as nothing may be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements or as prohibiting disclosures in court proceedings, investigations or proceedings under section 12273-A or Title 10, section 8003, subsection 5-A, in ethical investigations conducted by private professional organizations or in the course of quality reviews.</p>
MD	No	No	09.24.01.06H	<p>(1) Except by permission of the client or the heirs, successors, or personal representatives of the client, a licensee or any partner, officer, shareholder, or employee of a licensee may not voluntarily disclose information communicated by the client relating to and in connection with professional services rendered to the client by the licensee. This regulation does not:  (a) Relieve a licensee of any obligations under §G of this regulation; (b) Affect in any way a licensee's obligation to comply with a validly issued subpoena or summons in a criminal or bankruptcy case; (c) Prohibit disclosures in the course of a quality review of a licensee's professional services; or (d) Preclude a licensee from responding to any inquiry made by the Board or any investigative or disciplinary body established by law or formally recognized by the Board. (2) Members and agents of the Board and professional practice reviewers may not disclose any client information which comes to their attention from licensees in disciplinary proceedings or otherwise in carrying out their responsibilities, except that they may furnish this information to an investigative or disciplinary body of the kind referred to above.</p>

MA	No	No	Section 87E. & 3.03	<p><b>Section 87E.(2)</b>  ...Except by permission of the client engaging a licensee or the heirs, successors or personal representatives of such client, a licensee or any partner, member, officer, shareholder or employee of a licensee shall not voluntarily disclose information communicated to him by the client relating to and in connection with services rendered to the client by the licensee in the practice of public accountancy. Such information shall be deemed confidential; provided, however, that nothing herein shall be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements, or as prohibiting disclosures in court proceedings, in investigations or proceedings conducted pursuant to the provisions of this chapter, in ethical investigations conducted by private professional organizations, or in the course of quality reviews.</p> <p><b>3.03</b>  (1) Confidential Relationship. A certified public accountant shall not disclose any confidential information obtained in the course of a professional engagement, except with the consent of the client. 252 CMR 3.03 shall not be construed to relieve a person of his obligation to comply with a validly issued subpoena or summons enforceable by order of a court, or to respond to proper inquiries made by the Massachusetts Board of Public Accountancy or in the course of quality reviews of said certified public accountant or the licensee's firm.</p>
MI	Yes	Yes	Sec. 732	<p>(1) Except by written permission of the client or the heir, successor, or personal representative of the client to whom the information pertains, a licensee, or a person employed by a licensee, shall not disclose or divulge and shall not be required to disclose or divulge information relative to and in connection with an examination or audit of, or report on, books, records, or accounts that the licensee or a person employed by the licensee was employed to make. Except as otherwise provided in this section, the information derived from or as the result of professional service rendered by a certified public accountant is confidential and privileged.(2) <b>Subsection (1) does not prohibit any of the following:</b> (a) A certified public accountant, whose professional competence has been challenged in a court of law or before an administrative agency, from disclosing information otherwise confidential and privileged as part of a defense in the court action or administrative hearing. (b) The disclosure of information required to be disclosed in the course of practice monitoring programs and ethical investigations conducted by a licensed certified public accountant. In such cases, the information disclosed to another licensed certified public accountant in the course of practice monitoring programs and ethical investigations is confidential and privileged to the same degree and in the same manner as provided for in subsection (1). <b>(c) A licensee, or a person employed by a licensee, from disclosing information otherwise privileged and confidential to appropriate law enforcement or governmental agencies when the licensee, or person employed by the licensee, has knowledge that forms a reasonable basis to believe that a client has committed a violation of federal or state law or a local governmental ordinance.</b> (3) Documents or records in the possession of the department pertaining to a review, an investigation, or disciplinary actions under this article are exempt from disclosure under the freedom of information act, 1976 PA 442, MCL 15.231 to 15.246, unless the records or documents are used for either or both of the following purposes: (a) As evidence in a contested case held by the department. (b) As a basis for formal action by the department and until the action is resolved by a final order issued by the board.</p>
MN	No	No	326A.12	<p>(a) Except by permission of the client for whom a licensee performs services or the heirs, successors, or personal representatives of the client, a licensee shall not voluntarily disclose information communicated to the licensee by the client relating to and in connection with services rendered to the client by the licensee. Nothing in this section may be construed to prohibit: (1) the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements; or (2) disclosures in court proceedings, in investigations or proceedings under section 326A.08, in ethical investigations conducted by private professional organizations, in the course of peer reviews, to other persons active in the organization performing services for that client on a need-to-know basis, or to persons in the entity who need this information for the sole purpose of assuring quality control. (b) This section also applies to persons registered under section 326A.06, paragraph (b), and to persons granted a practice privilege under section 326A.14.</p>

MS	No	No	§ 73-33-16(2)	<p><b>§ 73-33-16(2)</b>  (2) Except by permission of the client engaging a certified public accountant under this chapter, or the heirs, successors or personal representatives of such client, a certified public accountant and any partner, officer, shareholder or employee of a certified public accountant shall not be required by any court of this state to disclose, and shall not voluntarily disclose, information communicated to him by the client relating to and in connection with services rendered to the client by the certified public accountant in his practice as a certified public accountant. Such information shall be deemed confidential and privileged; provided, however, that nothing herein shall be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements, or as prohibiting disclosures in court proceedings or in investigations or proceedings under Sections 73-33-5 and 73-33-11, when the services of the certified public accountant are at issue in such investigations or proceedings and the certified public accountant is a party thereto, or as prohibiting disclosure in the course of a practice review.</p> <p><b>Rule 6.12.1.</b> A CPA or firm permit holder shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client. <b>This rule shall not be construed:</b>  (a) to relieve a CPA or firm permit holder of his obligation under Rules 6.9., 6.10., and 6.11. of these Rules and Regulations;  (b) to affect in any way compliance with a valid subpoena or summons enforceable by the Board or by order of a court;  (c) to prohibit review of a practice unit's professional practices as a part of the Board's practice review or for peer review; or  (d) to preclude a CPA or firm permit holder from responding to any inquiry made by the Board under state statutes, or a duly constituted investigative or disciplinary body of a national or state professional accounting association.</p>
MO	No	No	326.322.	<p>1. Except by permission of the client for whom a licensee performs services or the heirs, successors or personal representatives of such client, a licensee pursuant to this chapter shall not voluntarily disclose information communicated to the licensee by the client relating to and in connection with services rendered to the client by the licensee. The information shall be privileged and confidential, provided, however, that nothing herein shall be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements or as prohibiting disclosures in investigations, in ethical investigations conducted by private professional organizations, or in the course of peer reviews, or to other persons active in the organization performing services for that client on a need-to-know basis or to persons in the entity who need this information for the sole purpose of assuring quality control. 2. A licensee shall not be examined by judicial process or proceedings without the consent of the licensee's client as to any communication made by the client to the licensee in person or through the media of books of account and financial records, or the licensee's advice, reports or working papers given or made thereon in the course of professional employment, nor shall a secretary, stenographer, clerk or assistant of a licensee, or a public accountant, be examined, without the consent of the client concerned, regarding any fact the knowledge of which he or she has acquired in his or her capacity as a licensee. This privilege shall exist in all cases except when material to the defense of an action against a licensee.</p>
MT	Yes	No	24.201.720	<p>(1) A permit holder or practice privilege holder has an obligation to maintain the confidentiality of information obtained in the performance of all professional activities. Maintaining such confidentiality is vital to the proper performance of the permit holder's or practice privilege holder's professional activities. A permit holder or practice privilege holder shall not use or disclose, or permit others within the permit holder's or practice privilege holder's control to use or disclose any confidential client or employer information without the consent of the client or employer. This obligation of confidentiality continues after the termination of the relationship between the permit holder or practice privilege holder and the client or employer and extends to information obtained by the permit holder or practice privilege holder in professional relationships with prospective clients and employers.  (a) This rule must not be construed to prohibit a permit holder or practice privilege holder from disclosing information as required to meet professional, regulatory, or other legal obligations.  (2) Members of the board and professional practice reviewers shall not disclose any confidential client information which comes to their attention from firms, permit holders, or practice privilege holders in disciplinary proceedings or otherwise in carrying out their responsibilities, except that they may furnish such information to an investigative or disciplinary body requiring compliance with state law.</p>
NE	No	No	5.01	<p>A licensee shall not disclose any confidential information obtained in the course of performing professional services except with the consent of the client. Provided, however, this rule shall not be construed:  005.01A to relieve the licensee of his obligations under 288 NAC 5-004.02 and 004.03 relating to auditing standards and accounting principles; 005.01B to affect in any way his compliance with the validly issued subpoena or summons enforceable by order of any Court or agency; 005.01C to prohibit review of the licensee's professional practices as a part of voluntary quality review under Board authorization; or 005.01D to preclude a licensee from responding to any inquiry made by the Board or by an authorized investigative or disciplinary body, which in the opinion of the Board is duly constituted.  The Board shall not disclose any confidential client information which comes to its attention from licensees involved in disciplinary proceedings or otherwise in carrying out its official responsibilities, providing, however, this prohibition shall not restrict the exchange of information with any authorized and duly constituted investigative or disciplinary body.</p>

NV	Yes	No	628.500	<p>1. The Board hereby adopts by reference the Code of Professional Conduct adopted by the American Institute of Certified Public Accountants, as that code existed on October 23, 2013, with the following exceptions: (a) References to "member" are amended to refer to "practitioner." (b) The definition of "financial statements" in ET Section 92 is amended to read as follows: (1) "Financial statements" means:(I) Any statements or footnotes related thereto that purport to demonstrate the financial condition of a person at a particular time or the change in a person's financial condition during a particular period; or (II) Any statements prepared using a cash or other comprehensive basis of accounting. (2) The term includes balance sheets, statements of income, statements of retained earnings, statements of cash flows and statements of changes in equity. (3) The term does not include incidental financial data that is included in reports concerning advisory services for management made to support recommendations to a client, tax returns or schedules in support of a tax return, or the statement, affidavit or signature of the person who prepares a tax return. (c) The definition of "public practice" in ET Section 92 is amended to have the meaning ascribed to the definition of "practice of public accounting" in NRS 628.023. (d) The disclosure required pursuant to Section B of Rule 503 must: (1) Include the amount of the commission expressed in dollars or the method, described in plain language, used to calculate the commission; (2) Include the name of the person or entity paying the commission; (3) Be written; (4) Be made on or before the date of referral or recommendation; and (5) Be signed and dated. (e) The statement, affidavit or signature of the preparer of a tax return does not constitute an opinion on a financial statement, and the preparer of the tax return is not required to make a disclaimer of such an opinion. (f) The Board does not adopt by reference pursuant to this section Appendix B of the ET Appendixes of the Code of Professional Conduct.</p>
NH	Yes	No	309-B:18 & 505.01	<p><b>309-B:18</b> Except by permission of the client for whom a licensee performs services, or the heirs, successors, or personal representatives of such client, a licensee or any partner, officer, member, manager, shareholder, or employee of a licensee shall not voluntarily disclose information communicated to such person by the client relating to and in connection with services rendered to the client by the licensee. Such information shall be deemed confidential, provided, however, that nothing in this chapter shall be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements or as prohibiting disclosures in court proceedings or administrative proceedings before governmental agencies in instances where a subpoena or summons has been issued, in investigations or proceedings under RSA 309-B:11 or RSA 309-B:12, in ethical investigations conducted by private professional organizations, or in the course of peer reviews, or to other persons active in the organization performing services for that client on a need to know basis or to persons in such professional organization, peer review entity, or organization performing services for that client who need this information for the sole purpose of assuring quality control.</p> <p><b>505.01</b> (a) A licensee in public practice shall not disclose any confidential client information without the specific consent of the client. (b) The requirement in (a) above shall not be construed: (1) To relieve a licensee of his or her professional obligations under Ac 504.01 and Ac 504.02; (2) To affect in any way the licensee's obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a licensee's compliance with applicable laws and government regulations;(3) To prohibit review of a licensee's professional practice under American Institute of Certified Public Accountants or state CPA society or board of accountancy authorization; or (4) To preclude a licensee from initiating a complaint with, or responding to any inquiry made by, the professional ethics division or trial board of the Institute or a duly constituted investigative or disciplinary body of a state CPA society or board of accountancy. (c) Licensees of any of the bodies identified in (b)(4) above and licensees involved with professional practice reviews identified in (b)(3) above shall not use to their own advantage or disclose any licensee's confidential client information that comes to their attention in carrying out those activities. This prohibition shall not restrict licensees' exchange of information in connection with the investigative or disciplinary proceedings described in (b)(4) above or the professional practice reviews described in (b)(3) above.</p>

NJ	Yes	No	45:2B-65 & § 13:29-3.7 &13:29-3.19	<p>45:2B-65 24. Except by permission of the client engaging a licensee or firm under this act, or the heirs, successors, or personal representatives of that client, no licensee or partner, officer, member, manager, shareholder, or employee of a licensee or firm shall disclose information communicated to the licensee or firm by the client relating to and in connection with services rendered to the client by the licensee or firm in the practice of public accountancy. Such information shall be deemed confidential; except that nothing herein shall be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements or as prohibiting disclosures in court proceedings, investigations or proceedings under this act, in ethical investigations conducted by private professional organizations, or in the course of quality reviews.</p> <p>§ 13:29-3.7 Confidential client information (a) A licensee or the licensee's firm shall not without the consent of the licensee's client disclose any confidential information pertaining to the licensee's client obtained in the course of performing professional services. (b) This rule shall not: 1. Relieve a licensee of any obligations under N.J.A.C. 13:29-3.5 and N.J.A.C. 13:29-3.6; or 2. Affect in any way a licensee's obligation to comply with a validly issued subpoena or summons enforceable by order of a court; or 3. Prohibit disclosures in the course of a quality review of a licensee's professional services; or 4. Preclude a licensee from responding to any inquiry made by the Board or any investigative or disciplinary body established by law or formally recognized by the Board. (c) Members of the Board and professional practice reviewers shall not disclose any confidential client information which comes to their attention from licensees or their firms in disciplinary proceedings or otherwise in carrying out their responsibilities, except that they may furnish such information to an investigative or disciplinary body of the kind referred to above.</p> <p>§ 13:29-3.19 Code of Professional Conduct All licensees shall comply with the Code of Professional Conduct of the American Institute of Certified Public Accountants (AICPA Code of Professional Conduct), incorporated herein by reference, effective December 15, 2014 (early implementation policy), as amended and supplemented. The AICPA Code of Professional Conduct may be found at the AICPA website, www.aicpa.org. The Board's rules of professional conduct shall prevail whenever any conflict exists between this chapter and the AICPA Code of Professional Conduct.</p>
NM	No	No	61-28B-24	<p>Except by permission of the client for whom a certificate or permit holder performs a service or the heir, successor or personal representative of the client, a certificate holder shall not voluntarily disclose information communicated to him by the client relating to and in connection with a service rendered to the client by him. Such information shall be deemed confidential; provided that nothing in this section shall prohibit the disclosure of information required to be disclosed by a standard of the public accounting profession in reporting on the examination of a financial statement or prohibit disclosure in a court proceeding, in an investigation or proceeding pursuant to the 1999 Public Accountancy Act [61-28B-1 NMSA 1978], in an ethical investigation conducted by a private professional organization or in the course of a peer review, or to another person active in the organization performing a service for that client on a need-to-know basis or to a person in the entity who needs this information for the sole purpose of assuring quality control.</p>
NY	Yes	No	§ 29.10(c)	<p>c.Unprofessional conduct shall also include revealing of personally identifiable facts, data or information obtained in a professional capacity without the prior consent of the client, except such information may be disclosed as necessary to other licensees of the profession conducting professional standards or ethics reviews, or as otherwise authorized or required by law.</p>
NC	Yes	Yes	21 NCAC 08N .0205	<p>a) Nondisclosure. A CPA shall not disclose any confidential information obtained in the course of employment or a professional engagement except with the consent of the employer or client. (b) Exceptions. <b>This Rule shall not be construed:</b> (1) to relieve a CPA of any report obligations pertaining to Section .0400 of this Subchapter; or (2) to affect in any way the CPA's compliance with a validly issued subpoena or summons enforceable by this Board or by order of a court; or (3) to preclude the CPA from responding to any inquiry made by the AICPA Ethics Division or Trial Board, by a duly constituted investigative or disciplinary body of a state CPA society, or under state statutes; or (4) to preclude the disclosure of confidential client information necessary for the peer review process or for any quality review program; or (5) to preclude the CPA from assisting the Board in enforcing the accountancy statutes and rules; or (6) <b>to affect a CPA's disclosure of confidential information to state or federal authorities when the CPA concludes in good faith based upon professional judgment that a crime is being or is likely to be committed; or (7) to affect a CPA's disclosure of confidential information when such disclosure is required by state or federal laws or regulations.</b></p>
ND	Yes	No	3-01-03-01.	<p>Licensees must observe the code of professional conduct of the American institute of certified public accountants, with references to "member" being understood to apply to licensees. Licensees must also observe the codes of conduct of the general accounting office, the securities and exchange administration, and any other bodies, whenever they are relevant and applicable based on services performed by the licensee.</p>

OH	No	No	11/2/4701	(A) An Ohio permit holder shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client. (B) This rule shall not be construed: (1) To relieve an Ohio permit holder of the obligation to comply with Chapter 4701-9 of the Administrative Code, (2) To affect in any way the compliance with a validly issued subpoena or summons enforceable by order of a court, (3) To prohibit review of the professional practice of an Ohio permit holder as part of a peer review, or (4) To preclude an Ohio permit holder from responding to any inquiry made by the professional ethics committee or trial board of a professional accounting organization of which the Ohio permit holder is a member, by a duly constituted investigative or disciplinary body of a state CPA society, or under state statutes. (C) Members of the accountancy board, a professional accounting organization ethics committee or trial board described in paragraph (B)(4) of this rule, as well as professional practice reviewers, shall not disclose any confidential client information which comes to their attention in disciplinary proceedings or otherwise in carrying out their official responsibilities. However, this prohibition shall not restrict the exchange of information with an aforementioned duly constituted investigative or disciplinary body.
OK	Yes	No	10:15-39-1.	(a) To the extent not contradicted by rule herein, a registrant shall conform in fact and in appearance to the AICPA Code of Professional Conduct.
OR	No	No	Division 30 Responsibilities to Clients	(1) Confidential client information. A member in public practice shall not disclose any confidential client information without the specific written consent of the client. (a) Except as provided in subsection (b) of this rule: (A) No licensee or any partner, officer, shareholder, member, manager, owner or employee of a licensee, shall voluntarily disclose information communicated to or obtained by the licensee from a client or on behalf of a client if such information relates to services that the licensee rendered for the client. (B) Members of the Board, members of Board committees and professional practice reviewers shall not disclose confidential client information which comes to their attention in the course of investigations, disciplinary proceedings or otherwise in carrying out their responsibilities, except that the Board may furnish such information when disclosure is required as described in subsection (b) of this rule. (b) Permitted disclosures. Nothing in subsection (a) of this rule shall prohibit the disclosure of confidential client information under the following circumstances: (A) When disclosure is required by the standards of the public accountancy profession in reporting on the examination of financial statements; (B) When disclosure is required by a court order; (C) In response to subpoenas issued in state or federal agency proceedings; (D) In investigations or proceedings under ORS 673.170 or 673.400; (E) In ethical investigations conducted by private professional organizations in the course of peer reviews; (F) To the insurance carrier of a licensee in connection with a claim or potential claim; or (G) When disclosure is required by the Oregon Board of Accountancy for regulatory purposes of the Board.
PA	No	No	11.1	Except by permission of the client engaging him or the heirs, successors or personal representatives of a client, a licensee or a person employed by a licensee shall not be required to, and shall not voluntarily, disclose or divulge information of which he may have become possessed unless the sharing of confidential information is within the peer review process. This provision on confidentiality shall prevent the board from receiving reports relative to and in connection with any professional services as a certified public accountant, public accountant or firm. The information derived from or as the result of such professional services shall be deemed confidential and privileged. Nothing in this section shall be taken or construed as prohibiting the disclosure of information required to be disclosed by the standards of the profession in reporting on the examination of financial statements, or in making disclosures in a court of law or in disciplinary investigations or proceedings when the professional services of the certified public accountant, public accountant or firm are at issue in an action, investigation or proceeding in which the certified public accountant, public accountant or firm is a party.
PR	Yes	No		Based on the AICPA Professional Ethics Team's translation of the Pureto Rico Board of Accountancy's regulations.
RI	No	No	§ 5-3.1-23	(a) No licensee or any employee of a licensee, including, but not limited to, clerks, paraprofessionals, and students under work-study programs on a paid or pro bono basis, shall disclose any confidential information obtained in the course of a professional engagement except with the written consent of the client or former client, or as disclosure of confidential information is permitted by subsection (c) or (d) of § 5-3.1-18 in connection with peer reviews or board investigations. (b) This section shall not be construed as limiting the authority of this state or of the United States or of an agency or court of this state or of the United States to subpoena and use the confidential information in connection with any investigation, public hearing, or other proceeding. Nor shall this section be construed as prohibiting a certified public accountant or public accountant whose professional competence has been challenged in a court of law or before an administrative agency from disclosing confidential information as part of a defense to the court action or administrative proceeding.
SC	No	No	SECTION 40-2-190.	(A) Except by permission of the client for whom a licensee performs services or the heirs, successors, or personal representatives of a client, a licensee under this chapter must not voluntarily disclose information communicated by the client relating to and in connection with services rendered. This information is confidential. However, nothing in this chapter may be construed to prohibit the disclosure of information requiring disclosure by the standards of the public accounting profession in reporting on the examination of financial statements or to prohibit disclosures in court proceedings, investigations or proceedings under this chapter, in ethical investigations conducted by private professional organizations, in the course of peer reviews, in performing services for that client on a need to know basis by other active persons of the organization, or in the business of persons in the entity needing this information for the sole purpose of assuring quality control.

SD	No	No	20:75:05:09.	A licensee may not without the consent of the client disclose any confidential information pertaining to the client obtained in the course of performing professional services. This rule does not do any of the following: (1) Relieve a licensee of any obligations under §§ 20:75:05:07 and 20:75:05:08; (2) Affect in any way a licensee's obligation to comply with a validly issued subpoena or summons enforceable by order of a court; (3) Prohibit disclosures in the course of a peer review of a licensee's professional services; or (4) Preclude a licensee from responding to an inquiry made by the board or an investigative or disciplinary body established by law or formally recognized by the board. An individual who conducts a peer review and the individual's firm may not disclose any confidential client information which comes to their attention from a licensee but they may furnish such information to an investigative or disciplinary body as described in subdivision (4) of this section. A board member, a member of a recognized investigative or disciplinary body, and a practice reviewer may not use to their own advantage or disclose any confidential client information that comes to their attention in carrying out their official responsibilities. This prohibition does not restrict the exchange of information with recognized investigative or disciplinary bodies or affect in any way compliance with a validly issued and enforceable subpoena or summons. A licensee reviewing a practice in connection with a prospective purchase or merger may not use to the licensee's advantage or disclose any confidential client information that comes to the licensee's attention.
TN	No	Yes	62-1-116. & 0020-03-.10	<b>62-1-116.</b> (a) Licensees shall not divulge, nor shall they in any manner be required to divulge, any information that is communicated to them or obtained by them by the reason of the confidential nature of their employment. The information shall be deemed confidential; provided, however, that nothing in this subsection (a) shall be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements or as prohibiting disclosures in investigations or proceedings under this chapter, in ethical investigations conducted by private professional organizations or in the course of peer reviews, or to other persons active in the organization performing services for that client on a need to know basis or to persons in the entity who need this information for the sole purpose of assuring quality control. Disclosure of confidential information pursuant to this subsection (a) shall not constitute a waiver of the confidential nature of the information for any other purpose. (b) Information derived as a result of such professional employment is deemed to be confidential, except that nothing in this chapter shall be construed as modifying, changing or affecting the criminal or bankruptcy laws of this state or of the United States. <b>0020-03-.10</b> (1) A licensee shall not disclose any confidential client information without the specific consent of the client. (2) This rule shall not be construed to: (a) Relieve a licensee of his or her professional obligations under Rules 0020-03-.08 and 0020-03-.09; (b) Affect in any way the licensee's obligation to comply with a validly issued and enforceable subpoena or summons; (c) Prohibit review of a licensee's professional practice by the AICPA, a state CPA society or state PA association, or the Board; (d) <b>Preclude a licensee from initiating a complaint with or responding to any inquiry made by a recognized investigative or disciplinary body;</b> (e) Prohibit a licensee from utilizing any such relevant information in the defense of a claim or reasonably anticipated claim against the licensee; or (f) Restrict the exchange of information with a recognized investigative or disciplinary body.
TX	Yes	No	§501.75	(a) Except by permission of the client or the authorized representatives of the client, a person or any partner, member, officer, shareholder, or employee of a person shall not voluntarily disclose information communicated to him by the client relating to, and in connection with, professional accounting services or professional accounting work rendered to the client by the person. Such information shall be deemed confidential. The following includes, but is not limited to, examples of authorized representatives: (1) the authorized representative of a successor entity becomes the authorized representative of the predecessor entity when the predecessor entity ceases to exist and no one exists to give permission on behalf of the predecessor entity; and (2) an executor/administrator of the estate of a deceased client possessing an order signed by a judge is an authorized representative of the estate. (b) <b>The provisions contained in subsection (a) of this section do not prohibit the disclosure of information required to be disclosed by:</b> (1) the professional standards for reporting on the examination of a financial statement and identified in Chapter 501, Subchapter B of this title (relating to Professional Standards); (2) <b>applicable federal laws, federal government regulations, including requirements of the PCAOB;</b> (3) a summons under the provisions of the Internal Revenue Code of 1986 and its subsequent amendments, a summons under the provisions of the Securities Act of 1933 (15 U.S.C. Section 77a et seq.) and its subsequent amendments, a summons under the provisions of the Securities Exchange Act of 1934 (15 U.S.C. Section 78a et seq.) and its subsequent amendments, or under a court order signed by a judge if the summons or the court order: (A) is addressed to the license holder; (B) mentions the client by name; and (C) requests specific information concerning the client. (4) the public accounting profession in reporting on the examination of financial statements; (5) a congressional or grand jury subpoena; (6) investigations or proceedings conducted by the Board; (7) ethical investigations conducted by a private professional organization of certified public accountants; or (8) in the course of peer reviews. (c) The provisions contained in subsection (a) of this section do not prohibit the disclosure of information already made public, including information disclosed to others not having a confidential communications relationship with the client or authorized representative of the client. (d) Interpretive comment. The definition of a successor entity does not include the purchaser of all assets of an entity.
UT	Yes	No	R156-26a-501.	"Unprofessional conduct" includes: *** (2) commission of an act or omission that fails to conform to the accepted and recognized standards and ethics of the profession including those stated in the "Code of Professional Conduct" of the American Institute of Certified Public Accountants (AICPA) as adopted June 1, 2008, which is hereby incorporated by reference.

VT	Yes	No	§ 82. & 10.8	<p>§ 82. (a) No firm or any of its employees or other public accountants engaged by the firm, shall disclose any confidential information obtained in the course of a professional engagement except with the consent of the client or former client or as disclosure may be required by law, legal process, or the standards of the profession. (b) This section does not limit the authority of this state or of the United States to subpoena and use information in connection with any investigation, or proceedings. This section does not prohibit a public accountant whose professional competence has been challenged in a court or before an administrative agency from disclosing confidential information as a part of a defense. (c) Nothing in this chapter prohibits a firm or any of its employees, from disclosing any data to other public accountants, peer review teams, or partnerships or corporations of public accountants engaged in conducting peer reviews under the auspices of a recognized professional association, or any of their employees, in connection with peer reviews of the accountant's accounting and auditing practice.</p> <p>(d) Nothing contained in this chapter prohibits a firm or any of its employees, from disclosing any data in confidence to any representative of a recognized professional association or to the board in connection with a professional ethics investigation or in the course of a peer review. (Added 1981, No. 161 (Adj. Sess.), § 2; amended 1991, No. 167 (Adj. Sess.), § 16; 2001, No. 129 (Adj. Sess.), § 19, eff. June 13, 2002; 2007, No. 29, § 15.)</p> <p>10.8 (a) A licensee shall treat any information obtained from a client confidentially. A licensee shall not disclose, without the consent of the client, any information pertaining to his or her client obtained in the course of performing professional services. If a licensee receives a subpoena or other judicial process seeking a client's information, the licensee has an obligation to immediately notify the client and cooperate with any lawful and good faith effort of the client to prevent disclosure of the client's information.</p>
VI	Yes	No	§250n	<p>Except by permission of the client for whom a permittee performs services or the heirs, successors, or personal representatives of such client, a permittee under this chapter, may not voluntarily disclose information communicated to the permittee by the client relating to and in connection with services rendered to the client by the permittee. Such information shall be deemed confidential, provided, however, that nothing herein shall be construed as prohibiting the disclosure of information required to be disclosed by the standards of the public accounting profession in reporting on the examination of financial statements or as prohibiting compliance with applicable laws, government regulations or PCAOB requirements, disclosures in court proceedings, in investigations or proceedings under Sections 250f or 250h of this chapter, in ethical investigations conducted by private professional organizations, or in the course of peer reviews, or to other persons active in the organization performing services for that client on a need to know basis or to persons in the entity who need this information for the sole purpose of assuring quality control.</p>
VA	Yes	No	§ 54.1-4413.3.	<p>Persons using the CPA title in Virginia and firms providing attest services or compilation services to persons or entities located in Virginia shall conform to the following standards of conduct and practice.</p> <p>...</p> <p>4. <b>Follow the Code of Professional Conduct, and the related interpretive guidance, issued by the American Institute of Certified Public Accountants, or any successor standard-setting authorities.</b></p>
WA	Yes	No	RCW 18.04.405	<p>(1) A licensee, certificate holder, or licensed firm, or any of their employees shall not disclose any confidential information obtained in the course of a professional transaction <b>except</b> with the consent of the client or former client or <b>as disclosure may be required by law</b>, legal process, the standards of the profession, or as disclosure of confidential information is permitted by *RCW 18.04.350 (3) and (4), 18.04.295(8), 18.04.390, and this section in connection with quality assurance, or peer reviews, investigations, and any proceeding under chapter 34.05 RCW. (2) This section shall not be construed as limiting the authority of this state or of the United States or an agency of this state, the board, or of the United States to subpoena and use such confidential information obtained by a licensee, or any of their employees in the course of a professional transaction in connection with any investigation, public hearing, or other proceeding, nor shall this section be construed as prohibiting a licensee or certified public accountant whose professional competence has been challenged in a court of law or before an administrative agency from disclosing confidential information as a part of a defense to the court action or administrative proceeding.</p>
WV	No	Yes	19.3.	<p>a. Except as provided in Section 15 of this Rule, a licensee or substantial equivalency practitioner shall not disclose any confidential client information without the specific consent of the client. <b>This Rule shall not be construed</b> (i) to relieve a licensee or substantial equivalency practitioner of its professional obligations under subdivisions 19.2.b. and c. of this Rule, (ii) to affect in any way the obligation to comply with a validly issued and enforceable subpoena or summons, (iii) to prohibit review of a licensee's or substantial equivalency practitioner's professional practice under Section 14 of this Rule, or <b>(iv) to preclude a licensee or substantial equivalency practitioner from initiating a complaint with or responding to any inquiry made by a recognized investigative or disciplinary body.</b> Members of a recognized investigative or disciplinary body and professional practice reviewers shall not use to their own advantage or disclose any licensee's or substantial equivalency practitioner's confidential client information that comes to their attention in carrying out their official responsibilities. However, this prohibition shall not restrict the exchange of information with a recognized investigative or disciplinary body or affect, in any way, compliance with a validly issued and enforceable subpoena or summons.</p>

WI	No	No	Accy. 1.101 & 1.301	<p>1.101 (1) The board adopts by reference the "Code of Professional Conduct" published by the American Institute of Certified Public Accountants, effective as of December 15, 2014, except that references to "member" are replaced by "a person licensed to practice as a certified public accountant."</p> <p>(2) All definitions included in the American Institute of Certified Public Accountants' Code of Professional Conduct shall apply only within that document.</p> <p>1.301(1) No person licensed to practice as a certified public accountant shall disclose any confidential information obtained in the course of a professional engagement except with the consent of the client or through the due process of law. (2) This rule shall not be construed: (a) To relieve such a person of the obligations under ss. Accy 1.202 and 1.203. (b) To affect in any way compliance with a validly issued subpoena or summons enforceable by order of a court, (c) To prohibit review of such a person's professional practices as a part of voluntary quality review under authorization of the American Institute of Certified Public Accountants or the Wisconsin Society of Certified Public Accountants, or (d) To preclude a certified public accountant from responding to an inquiry made by the Professional Ethics Division of the American Institute of Certified Public Accountants, by the duly constituted investigative or disciplinary body of a state society of certified public accountants, or under any state statutes. (3) Members of the ethics division and trial board of the American Institute of Certified Public Accountants and professional practice reviewers under American Institute of Certified Public Accountants authorization, or their state society counterparts, shall not disclose any confidential client information which comes to their attention from such persons in disciplinary proceedings or otherwise in carrying out their official responsibilities. However, this prohibition shall not restrict the exchange of information with an aforementioned duly constituted investigative or disciplinary body. (4) The prohibition in sub. (1) against disclosure of confidential information obtained in the course of a professional engagement does not apply to disclosure of such information when required to properly discharge the certified public accountant's responsibility according to the profession's standards. The prohibition would not apply, for example, to disclosure, as required by section 561 of Statement on Auditing Standards No. 1, of subsequent discovery of facts existing at the date of the auditor's report which would have affected the auditor's report had the auditor been aware of such facts.</p>
WY	No	No	Section 4.	<p>(a) Confidential Client Information Rule. A holder shall not, without the consent of the client, disclose any confidential information pertaining to the client obtained in the course of performing professional services. (i) This rule does not: (A) relieve a holder of any obligation under the Auditing Standards Rules, the Accounting Principles Rules, the Accounting and Review Services Rules, the Attestation Standards Rule, and Other Professional Standards Rules (formerly Rules 202, 203, 205, 206 and 207); (B) affect in any way a holder's obligation to comply with a validly issued subpoena or summons enforceable by order of a court; (C) prohibit disclosures in the course of a quality review of a holder's professional services; or (D) Preclude a holder from responding to any inquiry made by the Board or any investigative or disciplinary body established by law or formally recognized by the Board. (ii) Members of the Board and professional practice reviewers shall not disclose any confidential client information which comes to their attention from holders in disciplinary proceedings or otherwise in carrying out their responsibilities, except that they may furnish such information to an investigative or disciplinary body of the kind referred to above.</p>

Although Guam, Kansas, Minnesota, Missouri, New Mexico and Rhode Island have adopted the AICPA Code of Professional Conduct in their regulations, their statutes prohibit the sharing of confidential information even if it is required by law.

6/16/2016

**AICPA Confidentiality Standards**

1.700.001 Confidential Client Information Rule

.01 A member in public practice shall not disclose any confidential client information without the specific consent of the client.

.02 This rule shall not be construed (1) to relieve a member of his or her professional obligations of the “Compliance With Standards Rule” [1.310.001] or the “Accounting Principles Rule” [1.320.001], (2) to affect in any way the member’s obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a member’s compliance with applicable laws and government regulations, (3) to prohibit review of a member’s professional practice under AICPA or state CPA society or Board of Accountancy authorization, or (4) to preclude a member from initiating a complaint with, or responding to any inquiry made by, the professional ethics division or trial board of the Institute or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy. Members of any of the bodies identified in (4) above and members involved with professional practice reviews identified in (3) above shall not use to their own advantage or disclose any member’s confidential client information that comes to their attention in carrying out those activities. This prohibition shall not restrict members’ exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above. [Prior reference: paragraph .01 of ET section 301]

2.400.070 Confidential Information Obtained From Employment or Volunteer Activities

.01 A member should maintain the confidentiality of his or her employer’s confidential information and should not use or disclose any confidential employer information obtained as a result of an employment relationship, such as discussions with the employer’s vendors, customers, or lenders (for example, any confidential information pertaining to a current or previous employer, subsidiary, affiliate, or parent thereof, as well as any entities for which the member is working in a volunteer capacity).

.02 For purposes of this interpretation, confidential employer information is any proprietary information pertaining to the employer or any organization for whom the member may work in a volunteer capacity that is not known to be available to the public and is obtained as a result of such relationships.

.03 A member should be alert to the possibility of inadvertent disclosure, particularly to a close business associate or close relative or immediate family member. The member should also take reasonable steps to ensure that staff under his or her control or others within the employing organization and persons from whom advice and assistance are obtained are aware of the confidential nature of the information.

.04 When a member changes employment, a member should not use confidential employer information acquired as a result of a prior employment relationship to his or her personal advantage or the advantage of a third party, such as a current or prospective employer. The requirement to maintain the confidentiality of an employer’s confidential information continues even after the end of the relationship between a member and the employer. However, the member is entitled to use experience and expertise gained through prior employment relationships.

.05 A member would be considered in violation of the “Acts Discreditable Rule” [2.400.001] if the member discloses or uses any confidential employer information acquired as a result of employment or volunteer relationships without the proper authority or specific consent of the

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employer or organization for whom the member may work in a volunteer capacity, unless there is a legal or professional responsibility to use or disclose such information.

.06 The following are examples of situations in which members are permitted or may be required to disclose confidential employer information or when such disclosure may be appropriate:

- a. Disclosure is permitted by law and authorized by the employer.
- b. Disclosure is required by law, for example, to
  - i. comply with a validly issued and enforceable subpoena or summons or
  - ii. inform the appropriate public authorities of violations of law that have been discovered
- c. There is a professional responsibility or right to disclose information, when not prohibited by law, to
  - i. initiate a complaint with, or respond to any inquiry made by, the Professional Ethics Division or trial board of the AICPA or a duly constituted investigative or disciplinary body of a state CPA society, board of accountancy, or other regulatory body;
  - ii. protect the *member's* professional interests in legal proceedings;
  - iii. comply with professional standards and other ethics requirements; or
  - iv. report potential concerns regarding questionable accounting, auditing, or other matters to the employer's confidential complaint hotline or *those charged with governance*.
- d. Disclosure is permitted on behalf of the employer to
  - i. obtain financing with lenders;
  - ii. communicate with vendors, *clients*, and customers; or
  - iii. communicate with the employer's external accountant, attorneys, regulators, and other business professionals.

.07 In deciding whether to disclose confidential employer information, relevant factors to consider include the following:

- a. Whether all the relevant information is known and substantiated to the extent that it is practicable. When the situation involves unsubstantiated facts, incomplete information, or unsubstantiated conclusions, the member should use professional judgment in determining the type of disclosure to be made, if any.
- b. Whether the parties to whom the communication may be addressed are appropriate recipients.

.08 A *member* may wish to consult with his or her legal counsel prior to disclosing, or determining whether to disclose, confidential employer information.

[Cover Page To Be Added]

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## INTRODUCTION

The provision of nonattest services to attest clients gives rise to threats to independence. The interpretations of the “[Nonattest Services](#)” subtopic [AICPA, *Professional Standards*, ET sec.1.295] of the “Independence Rule” [AICPA, *Professional Standards*, ET sec.1.200.001] provide guidance on when these services would impair independence. This non-authoritative tool is designed to assist members in evaluating whether nonattest services will impair their independence.

This toolkit does not provide authoritative guidance and should be used in conjunction with the applicable interpretations of the “[Nonattest Services](#)” subtopic. Specifically, this toolkit includes the following:

- ▶ Overview of nonattest services.
- ▶ Flowcharts that illustrate the steps to evaluating independence when providing nonattest services.
- ▶ A checklist to aid members with evaluating whether independence would be impaired under the interpretations of the Nonattest Services subtopic of the Independence Topic.



The answers to frequently asked questions (FAQs) related to independence when providing nonattest services are available <http://www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/NonattestServicesFAQs.pdf>. The FAQs are not rules or interpretations of the Professional Ethics Executive Committee and, therefore, are not authoritative guidance.

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## Nonattest Services

If you perform nonattest services for an attest client, the independence rules impose limits on the nature and scope of the services you may provide. In other words, the extent to which you perform certain activities may be limited by the rules.

### Conceptual Framework for Independence

If the nonattest service is not specifically addressed in the Code, you should first evaluate the service using the [Conceptual Framework for Independence](#) [1.210.010] to determine if the service would impair independence even if the general requirements discussed below can be applied.

### Periods Requiring Independence

These rules apply during the period of the professional engagement and during the period covered by the financial statements (to which the attest services relate). However, if you provide the entity with nonattest services that impair independence prior to the entity becoming an attest client, independence will not be considered impaired if the nonattest services related to periods prior to the period covered by the financial statements you are engaged to audit and those prior period financial statements were audited by another firm (or in the case of a review engagement, reviewed or audited by another firm).

### General Requirements

The “[General Requirements for Performing Nonattest Services](#)” interpretation (AICPA, *Professional Standards*, ET sec. 1.295.040) explains the main [safeguards](#) that need to be applied whenever *members* provide nonattest services to their *attest clients*. The general requirements are broken down into three main components. One component outlines the responsibilities that the attest client has related to the nonattest services while another explains what your responsibilities are. The third component, and probably the most important one is a reminder that you may not assume management responsibilities or even appear to assume management responsibilities on behalf of your attest client. The general requirements also stipulate that before performing a nonattest service members are required to establish and document in writing their understanding with the attest client. Following is what needs to be documented:

- The objectives of the engagement
- The services to be performed
- The attest client’s acceptance of its responsibilities
- The member’s responsibilities
- Any limitation of the engagement

### Management Responsibilities

Members are prohibited from assuming [management responsibilities](#) in all circumstances. Management responsibilities involve leading and directing an entity, including making significant decisions regarding the acquisition, deployment, and control of human, financial, physical, and intangible resources.

Examples of activities that would be considered management responsibilities can be found in 1.295.030

### Nonattest Services That Impair Independence

The interpretations under the “[Nonattest Services](#)” subtopic include examples of nonattest services that impair independence even if the general requirements are met. For example, independence would be impaired if you provide expert witness services [1.295.140] or perform an appraisal, a valuation, or an actuarial service for an attest client when (a) the services involve a significant degree of subjectivity and (b) the results of the service, individually or when combined with other valuation, appraisal, or actuarial services, are material to the attest client’s financial statements [1.295.110]. As such, it is important you consult the [Nonattest Services](#)” subtopic to ensure you are fully informed of all the various nonattest services that if performed would impair your independence.

## Cumulative Effect

There may be times when the general requirements do not by themselves reduce threats to an acceptable level. This can occur especially when the attest clients asks you to perform multiple nonattest services. While individually the nonattest services may not impair independence, you should evaluate the threats in the aggregate to ensure that the safeguards provided for in the “General Requirements for Performing Nonattest Services” interpretation continue to adequately reduce threats to an acceptable level.

## Changes in Scope

Another issue that you may need to address are changes to the scope of your engagement (scope creep). It is important that you have controls in place to identify scope changes in this area because it is possible that the slightest change could result in your independence becoming impaired.

## Affiliate Considerations

Although you are required to apply the independence rule and interpretations to affiliates

of your financial statement attest clients, there is some relief when it comes to nonattest services. Specifically, you may provide nonattest services that impair independence to certain affiliates 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.

Refer to 1.224.010 for details related to the affiliate exceptions.

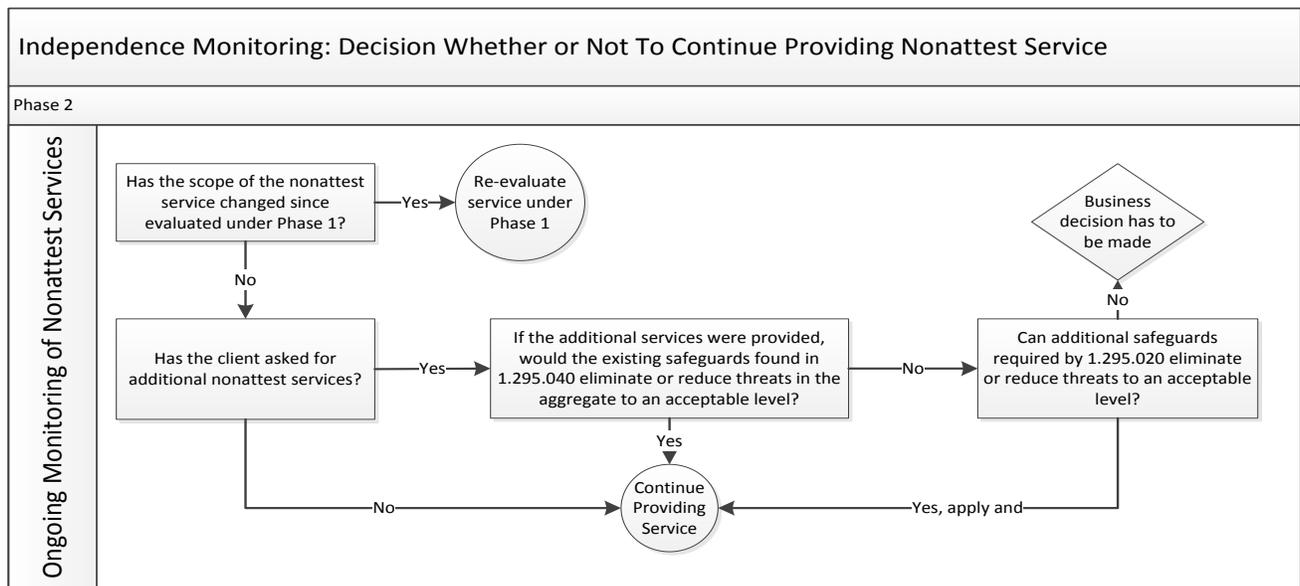
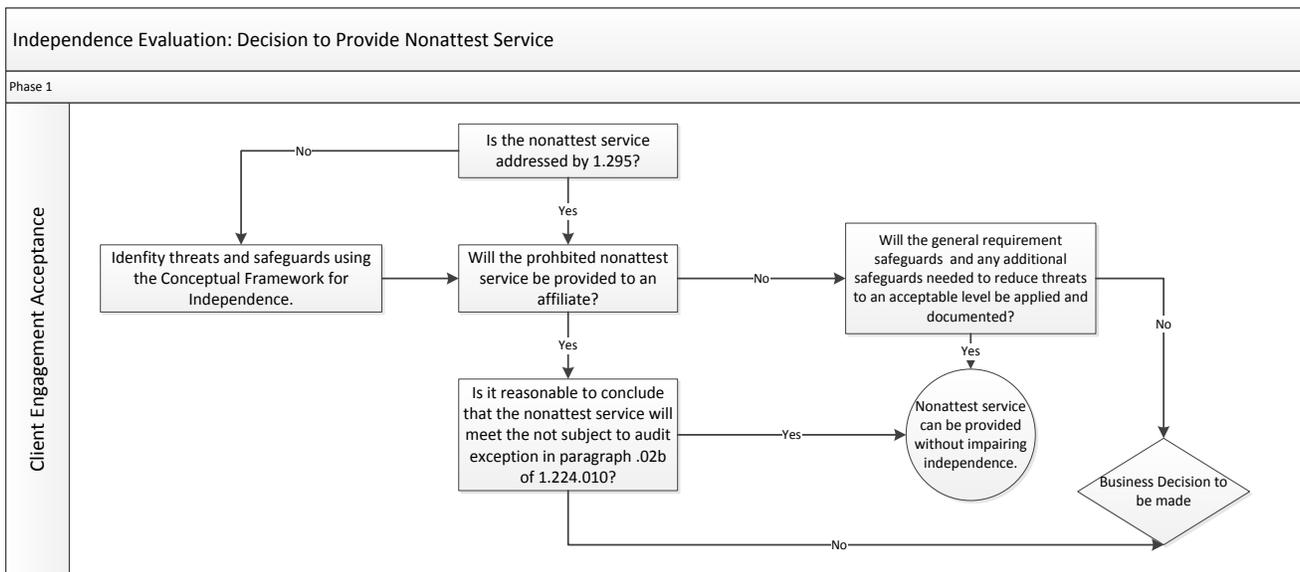
## Nonauthoritative Frequently Asked Questions

Professional Ethics Division staff developed answers to frequently asked questions and answers related to the performance of nonattest services. These nonauthoritative FAQs are available at [aicpa.org/nonattestfaqs](https://aicpa.org/nonattestfaqs).

# Independence Evaluation and Monitoring Flowcharts

The following flowcharts illustrate the steps in deciding whether a nonattest service that is addressed in the Code will impair your independence in the two main phases; client engagement and acceptance and ongoing monitoring of nonattest services.

If you are asked to provide a nonattest service that is not specifically addressed in the Code, you should first evaluate the service using the [Conceptual Framework for Independence](#) [1.210.010] and then follow the steps outlined below. The [Conceptual Framework Toolkit for Independence](#) is available to assist you with this analysis.



# Nonattest Services Checklist

1. What types of nonattest<sup>1</sup> services will be performed for this attest client or to an [affiliate](#) of the attest client? (Check all that apply):

- [Advisory Services](#) [1.295.105]
- [Appraisal, Valuation and Actuarial Services](#) [1.295.110]
- [Benefit Plan Administration](#) [1.295.115]
- [Bookkeeping, Payroll, and Other Disbursements](#) [1.295.120]
- [Business Risk Consulting](#) [1.295.125]
- [Corporate Finance Consulting](#) [1.295.130]
- [Executive or Employee Recruiting](#) [1.295.135]
- [Forensic Accounting](#) [1.295.140]
- [Information Systems Design, Implementation, or Integration](#) [1.295.145]
- [Internal Audit](#) [1.295.150]
- [Investment Advisory or Management](#) [1.295.155]
- [Tax Services](#) [1.295.160]
- Other \_\_\_\_\_

2. If the proposed nonattest services is not specifically addressed in the Code, was the Conceptual Framework for Independence [1.210.010] applied to evaluate whether service would impair independence?

- Yes  No  Work Paper Reference \_\_\_\_\_

3. Will any of the nonattest service(s) involve leading and directing the entity including making significant decisions regarding the acquisition, deployment, and control of human, financial, physical, and intangible resources as described in the [Management Responsibilities](#) interpretation [1.295.030] . Yes  No

Examples of such services include (Check all that apply):

- setting policy or strategic direction for the client
- directing or accepting responsibility for actions of the client's employees except to the extent permitted when using internal auditors to provide assistance for services performed under auditing or attestation standards
- authorizing, executing, or consummating transactions or otherwise exercising authority on behalf of a client or having the authority to do so
- preparing source documents, in electronic or other form, that evidence the occurrence of a transaction
- having custody of a client's assets
- deciding which recommendations of the member or other third parties to implement or prioritize
- reporting to those charged with governance on behalf of management
- serving as a client's stock transfer or escrow agent, registrar, general counsel or equivalent
- accepting responsibility for the management of a client's project
- accepting responsibility for the preparation and fair presentation of the client's financial statements in accordance with the applicable financial reporting framework
- accepting responsibility for designing, implementing, or maintaining internal control
- performing ongoing evaluations of the client's internal control as part of its monitoring activities
- other: \_\_\_\_\_

4. Will any of the nonattest service(s) impair independence under any of the above referenced interpretations?

<sup>1</sup> Effective for periods beginning after December 15, 2014 activities such as financial statement preparation, cash-to-accrual conversions, and reconciliations are considered outside the scope of the attest engagement and, therefore, constitute a nonattest service.

Yes  No

5. If you answered “Yes” to question 3, will any of the nonattest service(s) that impair independence meet the exceptions provided for in either paragraph .02b or .06 of the [Client Affiliates](#) interpretation [1.224.010]?  
 Yes  No  If you answered “Yes” proceed to question 5. If you answered “No” independence is impaired.

6. With regard to the nonattest service(s) identified in 1 above, has the client agreed to do the following *before* performing the nonattest service:

<u>Agreement</u>	<u>Established and Documented Before Performing</u>	<u>Working Paper Reference</u>
Assume all management responsibilities?	Yes <input type="checkbox"/> No <input type="checkbox"/>	_____
Oversee the service by designating an individual who possesses suitable skill, knowledge, and/or experience (“SKE”)?	Yes <input type="checkbox"/> No <input type="checkbox"/>	_____
Evaluate the adequacy and results of the services performed?	Yes <input type="checkbox"/> No <input type="checkbox"/>	_____
Accept responsibility for the results of the services?	Yes <input type="checkbox"/> No <input type="checkbox"/>	_____

7. For each nonattest service type identified in question 1 above, identify (attach additional sheets, if necessary):

<u>Specific Nonattest Service</u>	<u>Individual in Firm Responsible</u>	<u>Individual at Client Overseeing</u>	<u>Describe SKE of Client Personnel Identified</u>
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____
_____	_____	_____	_____

8. Do you have procedures in place that allow you to continually evaluate that that the scope of the nonattest services described in question 6 will not change during the engagement to performing the nonattest services?  
 Yes  No  Work Paper Reference \_\_\_\_\_

9. Were the following established and documented before performing each of the nonattest service(s):

<u>Understanding</u>	<u>Established and Documented Prior</u>	<u>Working paper reference</u>
Objectives of the engagement?	Yes <input type="checkbox"/> No <input type="checkbox"/>	_____
Services to be performed?	Yes <input type="checkbox"/> No <input type="checkbox"/>	_____
Client’s acceptance of their responsibilities?	Yes <input type="checkbox"/> No <input type="checkbox"/>	_____
Firm responsibilities?	Yes <input type="checkbox"/> No <input type="checkbox"/>	_____
Any limitations of the engagement?	Yes <input type="checkbox"/> No <input type="checkbox"/>	_____

**If multiple nonattest services were provided, answer questions 9 through 11.**

10. Describe the considerations evaluated with regard to whether the performance of additional nonattest services in the aggregate created a significant threat to independence that could not be reduced to an acceptable level by

the application of the safeguards in the “[General Requirements for Performing Nonattest Services](#)” interpretation [1.295.040]. \_\_\_\_\_

11. Did your evaluation in question 6 result in you concluding that the safeguards provided by the “[General Requirements for Performing Nonattest Services](#)” interpretation [1.295.040] did not reduce threats to an acceptable level? Yes  No

12. If you concluded that additional safeguards were necessary (answered “yes” to question 9), describe the additional safeguards applied to eliminate threats or reduce threats to an acceptable level. \_\_\_\_\_



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**AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS  
DIVISION OF PROFESSIONAL ETHICS  
PROFESSIONAL ETHICS EXECUTIVE COMMITTEE  
OPEN MEETING MINUTES  
May 5 – 6, 2016  
DURHAM, NC**

The Professional Ethics Executive Committee (Committee) held a duly called meeting on May 5, 2016. The meeting convened 9 a.m. and concluded at 4:30 p.m. The meeting reconvened on May 6<sup>th</sup> at 9 a.m. and concluded at 9:06 a.m.

<p><b><u>Attendance:</u></b> Samuel L. Burke, Chair Carlos Barrera Stanley Berman Michael Brand Tom Campbell Richard David Robert E. Denham Anna Dourdourekas Jana Dupree Brian S. Lynch William Darrol Mann</p>	<p>Andrew Mintzer* Lawrence I. Shapiro James Smolinski Shelly Van Dyne</p> <p><b><u>Not In Attendance:</u></b> Janice Gray Greg Guin Jarold Mittleider Steven Reed Laurie Tish</p>
<p><b><u>Staff:</u></b> Lisa Snyder, Director James Brackens, VP - Ethics &amp; Practice Quality Michael Buddendeck, General Counsel Mike Jones, Assistant General Counsel Amy Pawlicki, Director - Business Reporting Assurance &amp; Advisory Services**</p>	<p>Ellen Gorla, 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</p>
<p><b><u>Guests:</u></b> Jeff Lewis, Chair, Independence/Behavioral Standards Subcommittee Ian Benjamin, Chair, Technical Standards Subcommittee Nancy Miller, KPMG Dan Dustin, VP State Board Relations, NASBA Eric Holbrook, GAO Steven Booth, Independence/Behavioral Standards Subcommittee Jennifer Kary, Independence/Behavioral Standards Subcommittee Catherine Allen, Audit Conduct Blake Lewis, BDO Vincent DiBlanda, DT* Sonja Araujo, PwC* George Dietz, PwC* Edith Yaffe, E&amp;Y* Stacey Lockwood, Louisiana* Vassilios Karapanos, SEC* Karen Liu, SEC* Chris Halterman**</p> <p style="text-align: center;">*Via Phone</p> <p style="text-align: center;">** Via Phone for the ASEC Cyber Security Working Group Discussion Only</p>	

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## 1. **Definition of Client**

Mr. Mintzer explained to the Committee that after the last Committee meeting the Task Force realized there were possible independence consequences related to the entity that engages a member to perform an attest engagement (“engaging entity”) on another entity (“target entity”). Mr. Mintzer went on to explain that the Task Force had some specific questions for the Committee in order to assist the Task Force in deciding how to best move forward with the definition of client (currently contemplated as only including the engaging entity) and attest entity/attest client (currently contemplated as only including the target entity).

One Committee member asked if changes to the current definitions, aside from the government provision, were necessary. Another Committee member explained that under the current definitions a member would technically be required to show the target entity the member’s report for the attest engagement even if the member was engaged by a different entity to provide the attest engagement. This member noted that in previous discussions the Committee concluded this should no longer be permitted without the engaging entity’s consent.

Mr. Mintzer explained that although previously, the Task Force had recommended that the independence rules only apply to the target entity, after further thought, it might be more appropriate if at least some of the independence interpretations applied to the engaging entity that is not also the target entity.

One Committee member recommended that the independence rule and interpretations should apply to the engaging entity that is not also the target entity, similar to the Affiliates interpretation. Another Committee member suggested it might not be necessary to apply the independence interpretations specifically to the engaging entity because any independence interpretations would be captured under the Conflict of Interest interpretation of the Integrity and Objectivity Rule. Yet another Committee member, who is also a Task Force member, suggested the right answer might be requiring the member to apply the Conflict of Interest interpretation along with the financial interest interpretations of the Independence Rule to the engaging entity that is not also the target entity.

The question was then raised whether audit or review engagements should be addressed differently than other attest engagements. It was suggested that perhaps when performing an audit or review engagement, a member should apply the financial interest interpretations from the Independence Rule along with the Conflict of Interest interpretation to the engaging entity that is not also the target entity. But, with regards to all other attest engagements, members should only apply the Conflict on Interest interpretation to the engaging entity. Some members did not believe it was appropriate to only apply the Conflict of Interest interpretation in these situations.

A straw poll was taken which asked the Committee if they believed all the independence interpretations should apply to an engaging entity that is not also a target entity, if just some of the independence interpretations should be applied or if none of the independence interpretations should be applied. A majority of the Committee members voted that some of the independence interpretations should apply.

The Committee also discussed if the Task Force should take an “exception approach” or an “add-on approach.” The directive from the Committee was to have the Task Force recommend whether it made more sense for the guidance to conclude that members should

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apply all the independence interpretations to the engaging entity that is not also a target entity, except for specific situations or for the guidance to conclude that members should only apply certain specific independence interpretations to these entities.

Mr. Mintzer explained that the Task Force will have an all-day in-person meeting in June to discuss these recommendations and decide on how to best proceed with the definitions. He hoped that the Task Force would be in a position to bring proposals to the July PEEC meeting that are ready for exposure.

## **2. Information Technology and Cloud Services**

### ***Hosting Services***

Ms. VanDyne explained that based upon the feedback received from the Committee in February, the Task Force revised the proposal so that a member would be considered to be providing hosting services when a member has been engaged to either have custody or control over an attest client's data or records. This revision accommodates for situations where a member may not have both custody and control such as when the member has the ability to authorize disbursements of client funds from a bank. The Committee requested that the first occurrence be changed back to "custody and control" since this statement is explaining client management's responsibilities.

Ms. VanDyne also explained that an example was added to address the Committee's concern that a member not be considered to be providing hosting services when a portal is used to send a member's work product to a third party at the client's request. The Committee requested a minor revision to this example. The Committee also requested that the lead-in to the examples of situations that are not considered hosting services should stipulate that the examples included would not impair independence.

The Committee did not believe that a transition period was necessary. Rather, the Committee believed a delayed effective date would adequately address the Task Force's concern that the interpretation not be effective when issued but allow members time to discontinue providing hosting services before independence would be considered impaired.

A motion was made to expose the interpretation as revised by the Committee. The motion was seconded and unanimously passed.

### ***Cloud Based Services***

Ms. VanDyne explained that the Task Force believes the phrase "cloud based services" is appropriate and streamlined the text to address the Committee's concerns regarding readability. The Task Force was asked to determine if the guidance was really needed as many members of the Committee noted that they do not receive inquiries about this. The Committee agreed that if the Task Force continues to believe guidance is necessary, it should consider drafting guidance in the form of a FAQ instead of as an addition to the "Scope and Applicability of Nonattest Services" interpretation.

### ***Off-the-Shelf***

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Ms. VanDyne went on to explain that the Task Force believes it would be helpful to provide guidance on what “install or integrate” could involve and what would be an “off-the-shelf” accounting package and the amount of customization that could be done to an “off-the-shelf” accounting package without impairing independence. For example, she noted the Task Force has begun discussing whether something more complex, such as an Oracle implementation where there is a lot of customization or configuration, would be covered.

None of the members of the Committee indicated that their firms are applying the “insignificant coding exception” found in the FAQ but one member noted that if the software permits changes to the coding or how the data works inside the software, then the software probably shouldn’t be considered off-the-shelf software. It was noted this is different than when the program allows one to decide which modules to activate or deactivate.

The Committee agreed that the Task Force should consider whether it could develop a project management FAQ that focused on providing information technology services or if it believes a separate task force should be appointed to address project management as a whole.

### **3. ASEC Cyber Security Working Group**

Ms. Pawlicki and Mr. Halterman, the Chair of the ASEC Cyber Security Working Group joined the meeting.

Mr. Halterman explained that the Working Group is developing a guide on attestation standards for cybersecurity related work. He explained that these engagements can touch upon all aspects of IT including significant controls over financial reporting. He believes that almost all entities will require assistance with cybersecurity, which may be rendered either as attestation or consulting services. He explained that the Working Group would like to understand how the Code's independence rules address cybersecurity related work or if additional guidance is necessary. The Committee agreed that members should participate in a brainstorming session with AICPA subject matter experts to determine the types of nonattest services that would be performed and whether a task force should be appointed to consider possible amendments to the Code

### **4. Leases**

Mr. Wilson explained that the Leases Task Force was re-established to evaluate the need to update the independence guidance in the AICPA Code related to leasing arrangements since FASB recently issued its final Leases Standard (the “Update”). The Update made significant accounting changes to leases effective after years beginning after December 2018 (public companies) and 2019 (private companies).

*Impact of Accounting Treatment on Independence:* Mr. Wilson explained that the existing independence guidance in the AICPA Code is based in part upon the accounting treatment of a lease and requested feedback regarding whether this continues to be appropriate. The Committee generally agreed that a bright-line independence distinction based upon the accounting treatment of a lease does not address the interests or relationship(s) under a leasing arrangement and thus may not adequately address the threats to independence. Several members agreed that leases should be evaluated based upon the nature of the lease or leasing relationship, rather than upon the accounting treatment of a lease. One member believed that all leases should be treated the same regardless of accounting treatment, and

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an auditor should not be evaluating the auditor's payment of a future obligation to a financial statement attest client, given that those obligations are included in the client's financial statements, particularly if those items are material to the financial statements. Another member noted the extended effective date of the Update, and recommended that the Task Force approach leases as commercial transactions (rather than as loans or business relationships) and evaluate what impact newly entered leases will have on independence, rather than basing the evaluation upon the accounting treatment.

*Materiality:* Mr. Wilson asked the Committee for feedback on the position taken in the 2003 Exposure Draft, which contained a rejected proposal to revise the position on leases to be based on materiality. Committee members generally agreed that materiality of a lease has an impact on independence and should be a consideration included in any guidance proposed by the Task Force. The Committee agreed that materiality should not be defined rather, the Task Force should deliberate on the appropriate way to assess materiality of a lease for independence purposes. One member noted that the SEC independence rules allow certain immaterial real estate leases.

*New Leases and Grandfathering Existing Leases:* One member noted that leases already in existence should be grandfathered by applying the extant AICPA Code, and that the primary issue before the Committee is how to treat new leases. The member noted that the Task Force should provide guidance regarding newly entered leases, and apply the extant guidance to leases which are commenced prior to the effective date.

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

Ms. Miller provided the Committee with a recap of the overall structure of the SLG financial statements as well as some background regarding how the SLG environment differs from the typical FASB environment.

Ms. Miller then went on to explain that the Task Force believes that the SLG guidance should require members that are auditing the primary government to apply the independence rules to all funds and component units included or required to be included in the reporting entity under the applicable framework but then allow for some exceptions. She noted that this premise is similar to how the Client Affiliate interpretation treats entities covered by that interpretation.

Ms. Miller explained that the current guidance for SLGs does not require members monitor their independence with respect to any entities that the primary government is required to include but for some reason chooses to exclude. In such situations the Task Force is considering a change in position because it believes that members should remain independent of the excluded entity if the excluded entity is material to the primary government and the primary government has more than minimal influence over the accounting or financial reporting process of the excluded entity. However, the Task Force is considering including a provision that independence wouldn't be impaired if the member provided a prohibited nonattest service to the excluded entity if it is reasonable to conclude that the prohibited nonattest service will not be subject to audit procedures.

Ms. Miller further explained that the current day guidance for SLGs does not require members to monitor their independence with respect to any entities that are audited by another auditor where the member references the other auditor's report. In such situations the Task Force is also considering a change in position because it believes there are situations that could

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threaten a member's independence. One such situation is when the primary government has more than minimal influence over the accounting or financial reporting process of the entity. In this situation, the Task Force is considering requiring the member be independent of these entities but allow for an exception that would conclude that independence wouldn't be impaired if the member provided a prohibited nonattest service to the entity if it is reasonable to conclude that the prohibited nonattest service will not be subject to audit procedures.

Another situation where the Task Force is considering a change of position is when the member references another auditors report on an entity where the primary government doesn't have more than minimal influence but the entity is material to the primary government and will be subject to financial statement attest procedures of the member (such as when the primary government makes significant modifications to the entity's financial statements in order to be included in the primary government's basic financial statements). In this situation, the Task Force is considering allowing members to evaluate the threats created by relationships that impair independence to determine if they are at an acceptable level.

Ms. Miller reviewed Agenda Item 4B with the Committee which is a visual aid developed to help explain the Task Force's preliminary direction. While the Committee supported the idea of a visual aid, it did recommend that additional work be done on the visual aid so that it could better stand on its own without as much explanation.

#### **6. IESBA Update**

Ms. Snyder provided the Committee with an overview of the recent activities of the IESBA. Some of the specific items she noted were that the IESBA approved the NOCLAR guidance in April and the guidance is pending PIOB approval. She also noted that an exposure draft was reissued to address three specific issues involving "long association": (1) the cooling off period for the engagement quality control reviewer (EQCR) of a public interest entity (PIE); (2) the impact of jurisdictional safeguards; and (3) how to account for situations where an individual is only the engagement partner and EQCR for part of the 7 year period.

Ms. Snyder also explained that the IESBA agreed to undertake a fact-finding assessment to determine what, if any, relationship there may be between fees and threats to auditor independence and compliance with fundamental principles. She also noted that Phase II of the Part C review project had just begun.

#### **7. Compliance with Standards**

The Committee provided staff with some suggestions on its nonauthoritative FAQ that explains that members may apply alternative standards when there are no technical standards established by a body designated by AICPA Council provided the member applies the General Standards Rule as well.