



Professional Ethics Executive Committee

November 3-4, 2016 Open Meeting Agenda
Austin, TX

**AICPA Professional Ethics Executive Committee
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November 3 rd	<i>Open Meeting Begins</i>	
8:30 a.m. – 10:00 a.m.	Definition of Client Mr. Mintzer and Ms. Ziembra will seek the Committee's approval for exposure.	Agenda Item 1A Agenda Item 1B
10:00 a.m. – 10:15 a.m.	AM Break	
10:15 a.m. – 11:45 a.m.	Information Technology and Cloud Services Ms. VanDyne and Ms. Gorla will seek the Committee's approval to adopt the proposed Hosting Services interpretation and will update the Committee on its direction for IT services.	Agenda Item 2A Agenda Item 2B Agenda Item 2C Agenda Item 2D
11:45 a.m. - Noon	Cyber-Security Services Ms. Tish and Ms. Gorla will report on the Task Force's discussions to date.	Agenda Item 3
Noon – 1:00 p.m.	Lunch	
1:00 p.m. – 2:00 p.m.	Part C Task Force – IESBA Convergence Mr. Berman and Mr. Evans will discuss the activities of the Task Force and request the Committee's approval for possible exposure.	Agenda Item 4A Agenda Item 4B Agenda Item 4C
2:00 p.m. 3:30 p.m.	Leases Mr. Wilson and Mr. Mercer will report on the Task Force's activities and seek feedback on the Task Force's direction.	Agenda Item 5A Agenda Item 5B Agenda Item 5C Agenda Item 5D Agenda Item 5E
3:30 p.m. – 3:45 p.m.	PM Break	
3:45 p.m. – 5:15 p.m.	Entities Included In State and Local Government (SLG) Financial Statements 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.	Agenda Item 6A Agenda Item 6B Agenda Item 6C Agenda Item 6D Agenda Item 6E
November 4 th	<i>Open Meeting Reconvenes</i>	
8:00 a.m. – 9:15 a.m.	NOCLAR Task Force – IESBA Convergence Mr. Denham and Mr. Evans will discuss the activities of the Task Force and request the Committee's feedback.	Agenda Item 7A Agenda Item 7B Agenda Item 7C
9:15 a.m. – 9:35 a.m.	IESBA Update Ms. Snyder will update the Committee on the September meeting of the IESBA.	
9:35 a.m. – 9:40 a.m.	Minutes of the Professional Ethics Executive Committee Open Meeting The Committee is asked to approve the minutes from the July 2016 meeting.	Agenda Item 8
9:40 - 10:10 a.m.	Compilation of Pro-Forma Financial Statements and Specified Procedures Engagements Mr. Glynn will provide the Committee with background information and seek the Committee's feedback.	Agenda Item 9
10:10 a.m. – 10:20 a.m.	Transfer of Files and Return of Client Records in Sales, Transfer, Discontinuance or Acquisition of Practice Ms. Gorla will seek the Committee's input on a possible FAQ.	Agenda Item 10A Agenda Item 10B Agenda Item 10C
10:20 a.m. – 10:35 a.m.	AM Break - Open Meeting Concludes	

Informational Purposes Only	Committee Project Agenda ❖ <i>External Link</i> - Project Agenda	
	Future Meeting Dates <ul style="list-style-type: none">• February 9-10, 2017 – San Juan, PR	

Definition of Client

Task Force Members

Andy Mintzer (Chair), Rick David, Bob Denham, George Dietz, Gregory Guin, Debra Hahn, and Brian Lynch

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 July 2016 meeting, the Committee discussed the Task Force only making minor edits to the client and attest definition but adding interpretations to the Records Request and Client Confidentiality in order to clarify to whom the member owes work products and confidentiality. The Committee had some concern about the interpretations since it caused some contradictions when it came to performing work for executives of the company.

At this meeting, the Task Force is requesting approval for exposure to membership the proposed revised definition of client, attest client, and revisions and additions to the Code based on those revised definitions.

Summary of Issues

Definition of Client

The Task Force recommends two revisions to the definition of client. The first revision is to clarify that when the engaging entity is not also the target entity, that members will have two clients within one engagement. The Task Force believes this clarification will help address the concerns raised by the Committee related to Records Request and Confidential Client Information.

The second revision that the Task Force recommends is moving the government provision out of the client definition and into the Simultaneous Employment or Association with an Attest Client interpretation under the Independence Rule. The Committee did not express any concerns with this recommendation in previous discussions.

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 - Any person or entity, other than the member's employer, that engages a member or a member's firm to perform professional services (engaging entity) and also a person or entity with respect to which a member or member's firm performs professional services (target entity). When the engaging entity and the target entity are different, they are separate clients.

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.

Question for the Committee

1. Does the Committee approve the proposed revisions to the client definition for exposure to membership?

Definition of Attest Client

At the July meeting the Committee agreed that the level of independence should differ between the engaging entities and the target entities and that level should be evaluated using the specific facts and circumstance. The scenario the Task Force was asked to discuss was whether a member's independence with respect to a target entity should automatically be impaired if a firm provided prohibited nonattest services to the engaging entity.

In addition to discussing the above scenario, the Task Force also discussed the scenario where the firm has a direct financial interest in the engaging entity and the attest engagement to be performed on the target entity is being done so that engaging entity can obtain financing to purchase that target entity. In both situations the Task Force believes that the threat isn't necessarily to the member's independence, rather the threats are to the member's compliance with the Integrity and Objectivity Rule. More specifically, whether the member had a conflict of interest with the engaging entity that was so significant that safeguards could not be implemented to reduce those threats to an acceptable level. The Task Force notes that this approach is

consistent with how the Code treats engaging and target entities when members perform an engagement under the Statements on Standards for Attestation Engagements (SSAEs) and the engaging and target entities are different.

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 with respect to which an *attest engagement* is performed.

If the engaging entity is not also the *attest client*, the *member and the member's firm (member)* need not be independent of engaging entity. However, the member should consider the "[Conflicts of Interest](#)" interpretation [1.110.010] of the "Integrity and Objectivity Rule" [1.100.001], with regard to any relationships that may exist ~~with~~ between the member and the engaging entity.

See of the "Client Affiliate" interpretation [1.224.010] for acquisitions and business combinations that involve a *financial statement attest entity*.

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.

Question for the Committee

1. Does the Committee approve the proposed revisions to the "attest client" definition for exposure to membership?

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 concern relates to simultaneous employment therefore the Task Force determined the most logical place to place the government provision within the Independence section was in the Simultaneous Employment or Association With an Attest Entity [1.275.005].

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

1.275.005 Simultaneous Employment or Association With an Attest *Entity*

.01 In this interpretation, simultaneous employment or association with an *attest entity* 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 entity*, or in any capacity equivalent to that of a member of management of an *attest entity* 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 entity*, 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 entity* 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 Entity" 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 entity* 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

Question for the Committee

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| 1. Does the Committee approve exposing this to membership? |
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Records Request

One of the topics that has been discussed numerous times by the Task Force and Committee is to whom does the member need to provide records when the engaging and target entities are different. The Task Force believes that with regard to client-provided records the member needs to return them to whomever provided the records (i.e., if the engaging entity provided the member with these records, then the member should return them to the engaging entity. If the target entity provided the records return the records to the target entity).

As for member's work products, the Task Force recommends the member should provide the member's work product to the engaging entity absent any agreement to the contrary between the engaging and target entities. The Task Force recommends the following new paragraphs be added to the interpretation under an "Applicability" heading: (a marked version of the changes to the interpretation appear in Agenda Item 1B)

1.400.200 Records Requests (in part)

Terminology

.01 The following terms are defined here solely for use with this interpretation:

- a. A client includes current and former *clients*.
- b. A member means the *member* or the *member's firm*.
- c. Client-provided records are accounting or other records, including hardcopy and electronic reproductions of such records, belonging to the client that were provided to the member by, or on behalf of, the client.
- d. Member-prepared records are accounting or other records that the member was not specifically engaged to prepare and that are not in the client's books and records or are otherwise not available to the client, thus rendering the client's financial information incomplete. Examples include adjusting, closing, combining, or consolidating journal entries (including computations supporting such entries) and supporting schedules and documents that the member proposed or prepared as part of an engagement (for example, an audit).
- e. Member's work products are deliverables set forth in the terms of the engagement, such as tax returns.
- f. Working papers are all other items prepared solely for purposes of the engagement and include items prepared by the
 - i. member, such as audit programs, analytical review schedules, and statistical sampling results and analyses.
 - ii. client at the request of the member and reflecting testing or other work done by the member.

Applicability

.02 When a person or entity engages a member to perform *professional services* with respect to, or for the benefit of, another person or entity, a member would be in compliance with the requirements of this interpretation related to client-provided records, if the member returned these records to the person or entity that gave the member the records.

.03 When a person or entity engages a member (engaging entity) to perform *professional services* for the benefit of another person or entity (target entity), a member would be considered in compliance with the requirements of this interpretation related to member's work products, if the member provides these documents to the target entity. For example, if a company (engaging entity) engages a member to perform personal tax

services for the benefit of its executives (target entity), a member would be in compliance with the interpretation if the member provides the tax returns (work products) to the target entity. If, however, the member provides the tax returns (work products) to the engaging entity without the consent of the target entity, the member would be in violation of the Confidential Client Information Rule.

.04 When a person or entity engages a member to perform *professional services* with respect to a target entity, absent an agreement stating otherwise, the member would be in compliance with the requirements of this interpretation related to member's work products if the member provides these documents to the engaging entity. For example, if a company (engaging entity) engages a member to value the assets of another company (target entity) for a possible acquisition of target entity, absent an agreement stating otherwise, a member would be in compliance with this interpretation if the member provides the valuation report (work product) to only the engaging entity.

Client Confidentiality

When there are two clients involved because the engaging entity is different than the target entity, the Task Force believes it would be helpful to clarify which information can be discussed with which client without violating the Confidential Client Information Rule. The Task Force recommends clarifying this by making some revisions to the Disclosing Information to Clients interpretation [1.700.030]. Specifically, the Task Force believes the focus should be on which entity the professional services benefit. For example, in the situation where a member is engaged to prepare a joint tax return, the service is to benefit the couple and so the member should treat the couple as one client. Alternatively, when an employer pays a member to prepare personal tax returns for its executives, the preparation of the tax return is for the executive's benefit and as such the employer and each executive should be treated as separate clients. Finally, when an entity engages a member to perform a professional service with respect to another entity (not for the benefit of the other entity) while the Task Force believes the two entities involved are separate clients, the Task Force believes there is a presumption that the member may disclose the target entity's confidential client information to the engaging entity without the target entity's consent since the engagement is for the benefit of the engaging entity. Following are the revisions the Task Force proposes (a marked version of the changes to the interpretation appear in Agenda Item 1B):

1.700.030 Disclosing Information to Clients

.01 When a member is engaged by either spouse to prepare a married couple's joint tax return, the two spouses are considered to be one *client*, even if the member deals exclusively with one spouse. Accordingly the member would not need consent from either spouse in order to provide information related to the couple's joint tax return to the other spouse. For example, 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]

.02-When a person or entity engages a member to perform professional services (engaging entity) for the benefit of another person or entity (target entity), the engaging entity and the target entity are considered two separate clients. Accordingly, the member would need consent from either client before the member could disclose confidential client information to the other. For example, if a company (engaging entity) engages a member to perform personal tax services for the benefit of its executives (target entity), the member's disclosure of confidential client information to the company (engaging entity) without the consent of the applicable executives (target entity) would be a violation of the "[Confidential Client Information Rule](#)" [1.700.001]. [Prior reference: paragraphs .041–.042 of ET section391]

.03 When a person or entity engages a member to perform professional services (engaging entity) with respect to another person or entity (target entity), the engaging entity and the target entity are considered two separate clients. Since the professional services are being performed with respect to, and not for the benefit of, the target entity, there is a presumption that the member may disclose the target entity's confidential client information to the engaging entity without the target entity's consent. This presumption may be rebutted by a written agreement between the parties stating otherwise. However, this presumption would not exist with respect to disclosing any of the engaging entity's confidential client information to the target entity and such disclosure to the target entity without consent would be a violation of the Confidential Client Information Rule.

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

The Task Force reviewed all the references of client and attest client in the Code to determine if any revisions were needed based on the above edits to those definitions. The Task Force found two instances which cross referenced the government provision so the cross-reference needed to be changed due to the relocation of the government provision. These marked changes are in Agenda 1B.

The Task Force found some instances where making some minor changes to the wording, without changes the meaning, were warranted. These marked changes are in Agenda 1B with the rationale clarifying edit.

Effective Date

The Task Force did not discuss an appropriate effective date for the revised definitions, application of the AICPA Code, and the revised and new interpretations and therefore requests the Committee's input as to whether a transition period would be needed. Staff does not believe a transition period is necessary and recommends the changes become effective the last day of the month that they appear in the Journal of Accountancy.

Question For the Committee

1. Does the Committee agree that no transition period would be necessary for the revised definitions, application of the AICPA Code, and the revised and new interpretations?

Action Needed

The Committee is asked to approve the revised definitions, application of the AICPA Code, and the revised and new interpretations for exposure to membership and other interested parties.

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 client that engages a member to perform an attest engagement or~~ **A person or entity** with respect to which an *attest engagement* is performed.

If the engaging entity is not also the attest client, the member and the member’s firm (member) need not be independent of engaging entity. However, the member should consider the “Conflicts of Interest” interpretation [1.110.010] of the “Integrity and Objectivity Rule” [1.100.001], with regard to any relationships that may exist between the member and the engaging entity.

See 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.

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

0.400.07 Client. Any person or entity, other than the *member’s* employer, that engages a *member* or *member’s firm* to perform *professional services (engaging entity)* and ***also***, if ~~different, the~~ ***a person or entity with respect to which a member or member’s firm performs professional services (target entity) are performed.*** ***When the engaging entity and the target entity are different, they are separate clients.*** ~~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 Revised Definitions
(Additions appear in boldface italic and deletions are stricken)

0.400.26 Joint closely held investment. An investment in an entity or a property by the *member* and ***the attest client*** (or the ***attest client's*** officers or directors or any owner who has the ability to exercise *significant influence* over the ***attest client***) that enables them to *control* the entity or property. [Prior reference: paragraph .17 of ET section 92]

[Rationale for edit – clarifying edit](#)

0.400.27 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]

[Rationale for edit – clarifying edit](#)

0.400.39 Period of the professional engagement. The period begins when a *member* either signs an initial engagement letter or other agreement to perform attest services or begins to perform an *attest engagement* ~~for a client~~, whichever is earlier. The period lasts for the entire duration of the professional relationship, which could cover many periods, and ends with the formal or informal notification, either by the *member* or *client*, of the termination of the professional relationship or by the issuance of a report, whichever is later. Accordingly, the period does not end with the issuance of a report and recommence with the beginning of the following year's *attest engagement*. [Prior reference: paragraph .29 of ET section 92]

[Rationale for edit – clarifying edit](#)

0.400.41 Public interest entities. All of the following:

- a. All listed entities, including entities that are outside the United States whose shares, stock, or debt are quoted or listed on a recognized stock exchange or marketed under the regulations of a recognized stock exchange or other equivalent body.
- b. Any entity for which an audit is required by regulation or legislation to be conducted in compliance with the same *independence* requirements that apply to an audit of listed entities (for example, requirements of the SEC, the PCAOB, or other similar regulators or standard setters).

Members may wish to consider whether additional entities should also be treated as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered may include

- the nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders;
- size; and
- number of employees.

Members should refer to the *independence* regulations of applicable authoritative regulatory bodies when a *member* performs attest services and is required to be independent of the **attest client** under such regulations. [Prior reference: paragraph .20 of ET section 100-1]

Rationale for edit – clarifying edit

Text of Proposed Revised “Application of the AICPA Code”

(Additions appear in boldface italic and deletions are stricken)

0.200.020.05 The *independence* of a *member* in *public practice* or a *covered member* may be impaired with respect to ***an attest client*** as the result of the actions or relationships, as described in the “Independence Rule” [1.200.001] and its *interpretations*, of certain persons or entities whom the *member* or *covered member* does not have the authority or capacity to control. Even if the *member* is unable to control the actions or relationships of such persons or entities, the *member’s independence* may still be *impaired*. [Prior reference: ET section 91]

Rationale for edit – clarifying edit

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]

Rationale for edit – relocation of the government exception provision out of the client definition.

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]

Rationale for edit – change reference to direct the users to the new location of the government exception provision.

1.280.040.01 When a *covered member* is a member of a credit union that is an *attest client*, the self-interest *threat* would be at an *acceptable level*, and *independence* would not be *impaired*, if the *covered member* individually qualifies to join the credit union other than by virtue of the *professional services* provided to the ~~*client*~~ **credit union**. However, if during the *period of the professional engagement* the *member's* qualification to join the credit union is a result of the *professional services* provided to the ~~*client*~~ **credit union**, *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, *independence* would be *impaired*

Rationale for edit – Clarifying edit

1.290.010.07 If threatened or actual litigation is unrelated to the performance of an ~~*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 arise, for example, out of immaterial disputes regarding billings for services, results of tax or management services advice, or similar matters.

Rationale for edit – Clarifying edit

1.290.010.11 If only the underwriter or officers or directors of other **attest 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.”

Rationale for edit – Clarifying edit

1.295.040.02 The *safeguards* in paragraph .01 and the “Documentation Requirements When Providing Nonattest Services” interpretation [1.295.050] of the “Independence Rule” [1.200.001] do not apply to certain routine activities performed by the member, such as providing advice and responding to the *attest client's* questions as part of the **attest client**-member relationship. However, in providing such services, the member must not assume management responsibilities, as described in the “Management Responsibilities” interpretation [1.295.030] of the “Independence Rule.” [Prior reference: paragraph .05 of ET section 101]

Rationale for edit – Clarifying edit

1.295.120.02 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. record transactions to an *attest client's* general ledger when management has determined or approved the account classifications for the transaction.
- b. post ~~*client-coded*~~ transactions **coded by the attest client** to an **the attest client's** general ledger.
- c. prepare *financial statements* based on information in the *attest client's* trial balance.
- d. post **attest client**-approved journal or other entries to an *attest client's* trial balance.
- e. propose standard, adjusting, or correcting journal entries or other changes affecting the *financial statements* to the *attest client*. Prior to the member posting these journal entries or changes, the member should be satisfied that management has reviewed the entries and understands the nature of the proposed entries and the effect the entries will have on the *attest client's financial statements*.
- f. generate unsigned checks using *source documents* or other records provided and approved by the *attest client*.

- g. process an *attest client's* payroll using payroll time records that the *attest client* has provided and approved.
- h. transmit **attest client**-approved payroll or other disbursement information to a bank or similar entity subsequent to the *attest client's* review and authorization for the member to make the transmission. Prior to such transmission, the *attest client* is responsible for making the arrangements with the bank or similar entity to limit the corresponding individual payments regarding the amount and payee. In addition, once transmitted, the *attest client* must authorize the bank or similar entity to process the payroll information.
- i. prepare a reconciliation (for example, bank and accounts receivable) that identifies reconciling items for the **attest client's** evaluation.

Rationale for edit – Clarifying edit

- 1.295.135.02** 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. recommend a position description or candidate specifications.
 - b. solicit and screen candidates based on ~~client-approved~~ criteria **approved by the attest client**, such as required education, skills, or experience.
 - c. recommend qualified candidates to the *attest client* for their consideration based on ~~client-approved~~ criteria **approved by the attest client**.
 - d. participate in employee hiring or compensation discussions in an advisory capacity.

Rationale for edits – Clarifying edit

1.295.140.02 *Attest client*. For purposes of this interpretation, the term *attest client* refers to ~~an underlying party to the litigation for whom~~ **those attest clients for which** the member is providing **litigation** services, not the law firm that engages the member on behalf of the law firm's client. If the law firm that engages the member on behalf of the member's *attest client* is also an *attest client* of the member, the member should consider the applicability of the “Cooperative Arrangements With Attest Clients” interpretation [1.265.010] of the “Independence Rule” [1.200.001].

Rationale for edit – Clarifying edit

1.295.150.10 Members should use judgment in determining whether otherwise permitted internal audit services performed may result in a significant management participation *threat* to *independence*, considering factors such as the significance of the controls being tested, the scope or extent of the controls being tested in relation to the overall *financial statements* of the **attest client**, as well as the frequency of the internal audit services. If the *threat* to *independence* is considered significant, the member should apply *safeguards* to eliminate or reduce the *threat* to an *acceptable level*. If no *safeguards* could reduce the *threat* to an *acceptable level*, then *independence* would be *impaired*.

Rationale for edit – Clarifying edit

1.510.030.01 A *member's* spouse may provide services for a contingent fee to a ~~client for whom~~ **with respect to which** the *member* performs a service listed in paragraph .01a of the “Contingent Fees Rule” [1.510.001] without causing the *member* to be in violation of the “Contingent Fees Rule” if

- a. the activities of the *member's* spouse are separate from the *member's* practice and
- b. the *member* is not significantly involved in the spouse's activities.

Rationale for edits– Clarifying edit

1.510.040.01 A *member* or *member's firm* may provide investment advisory services for a contingent fee to

- a. owners, officers, or employees of a *client* ~~for whom~~ **with respect to which** the *member* performs a service listed in paragraph .01a of the "Contingent Fees Rule"
- b. a nonattest *client* employee benefit plan that is sponsored by an **attest client** ~~for whom~~ **with respect to which** the member performs a service listed in paragraph .01a of the "Contingent Fees Rule."

Rationale for edits – Clarifying edit

1.510.050.01 A *member* or *member's firm* may provide investment advisory services for a fee based on a percentage of the investment portfolio to a *client* ~~for whom~~ **with respect to which** the *member* performs a service listed in paragraph .01a of the "Contingent Fees Rule" [1.510.001] without violating that rule if all of the following *safeguards* are met:

- a. The fee is determined based on a specified percentage of the **attest client's** investment portfolio.
- b. The dollar amount of the portfolio on which the fee is based is determined at the beginning of each quarter (or longer period of time as may be agreed upon) and is adjusted only for the **attest client's** additions or withdrawals during the period.
- c. The fee arrangement is not renewed with the **attest client** more frequently than on a quarterly basis. [Prior reference: paragraphs .047-.048 of ET section 391]

Rationale for edits – Clarifying edit

1.520.030.01 A *member's* spouse may receive a commission for referring products or services to or from a *client* ~~for whom~~ **with respect to which** the *member* performs a service listed in paragraph .01 of the "Commissions and Referral Fees Rule" [1.520.001] without causing the *member* to be in violation of the "Commissions and Referral Fees Rule" if both

- a. the activities of the *member's* spouse are separate from the *member's* practice and
- b. the *member* is not significantly involved in the spouse's activities.

Rationale for edits – Clarifying edit

1.520.040.03 In addition, if a *member* receives a commission for referring a third party's product or service to a *client* ~~for whom~~ **with respect to which** the *member* does not perform a service listed in paragraph .01 of the "Commissions and Referral Fees Rule" [1.520.001] through a distributor or an agent and receives a commission from the third party, the *member* should disclose the commission ~~to the client~~, as discussed in paragraph .03 of the "Commissions and Referral Fees Rule." However, any subsequent performance of a service listed in paragraph .01 of that rule during a period in which the commission was received would be considered to violate the rule. [Prior reference: paragraphs .375-.376 of ET section 591]

Rationale for edits – Clarifying edit

1.520.050.01 A *member* or *member's firm* may receive a commission for referring a nonclient or nonattest *client's* products or services to the following:

- a. Owners, officers, or employees of a *client* ~~for whom~~ **with respect to which** the *member* performs a service listed in paragraph .01 of the "Commissions and Referral Fees Rule"
- b. A nonattest *client* employee benefit plan that is sponsored by a *client* ~~for whom~~ **with respect to which** the *member* performs a service listed in paragraph .01 of the "Commissions and Referral Fees Rule"

Rationale for edits – Clarifying edit

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 *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]

.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***

1.400.200 Records Requests (in part)

Applicability

.02 When a person or entity engages a member to perform professional services with respect to, or for the benefit of, another person or entity, a member would be in compliance with the requirements of this interpretation related to client-provided records, if the member returned these records to the person or entity that gave the member the records.

.03 When a person or entity engages a member (engaging entity) to perform professional services for the benefit of another person or entity (target entity), a member would be considered in compliance with the requirements of this interpretation related to member's work products, if the member provides these documents to the target entity. For example, if a company (engaging entity) engages a member to perform personal tax services for the benefit of its executives (target entity), a member would be in compliance with the interpretation if the member provides the tax returns (work products) to the target entity. If, however, the member provides the tax returns (work products) to the engaging entity without the consent of the target entity, the member would be in violation of the Confidential Client Information Rule.

.04 When a person or entity engages a member to perform professional services with respect to a target entity, absent an agreement stating otherwise, the member would be in compliance with the requirements of this interpretation related to member's work products if the member provides these documents to the engaging entity. For example, if a company (engaging entity) engages a member to value the assets of another company (target entity) for a possible acquisition of target entity, absent an agreement stating otherwise, a member would be in compliance with this interpretation if the member provides the valuation report (work product) to only the engaging entity.

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

.01 When a member is engaged by either spouse to prepare a married couple's joint tax return, the two both spouses are considered to be one the member's client, even if the member deals exclusively with was engaged by one spouse and deals exclusively with that spouse. .02 Accordingly the member would not need consent from either spouse in order to provide information related to the couple's joint tax return to the other spouse. For example, 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]

~~.02–03~~ ***When a person or entity engages a member to perform professional services (engaging entity) for the benefit of another person or entity (target entity), the engaging entity and the target entity are considered two separate clients. Accordingly, the member would need consent from either client before the member could disclose confidential client information to the other. For example, if a company (engaging entity) engages a member to perform personal tax services for the benefit of its*** ~~If a member provides professional services to a company's executives (target entity) at the request of the company, the member's disclosure of confidential client information to the company (engaging entity) without the consent of the applicable executives (target entity) 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]~~

.03 When a person or entity engages a member to perform professional services (engaging entity) with respect to another person or entity (target entity), the engaging entity and the target entity are considered two separate clients. Since the professional services are being performed with respect to, and not for the benefit of, the target entity, there is a presumption that the member may disclose the target entity's confidential client information to the engaging entity without the target entity's consent. This presumption may be rebutted by a written agreement between the parties stating otherwise. However, this presumption would not exist with respect to disclosing any of the engaging entity's confidential client information to the target entity and such disclosure to the target entity without consent would be a violation of the Confidential Client Information Rule.

IT and Cloud Services Task Force

Task Force Members: Shelly VanDyne (Chair), Cathy Allen, Wendy Davis, Mike Schmitz, Katie Jaeb, Anna Dourkourkas, 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 review the comments received on the proposed Hosting Services interpretation and adopt the proposal. Agenda Item 2C consolidates the comments received along with links to the individual comment letters. Each comment letter has been assigned a number that corresponds to the comment letter summary

The Task Force will also seek the Committee's feedback on its direction related to information systems services.

Summary of Issues – Hosting Services

In an effort to facilitate the discussion of the comments received on the Hosting Services interpretation, Staff grouped comments into the following discussion topics.

Custody or Control

One member of the Society of Louisiana CPAs Ethics Committee ([CL 2](#)) does not believe having custody of a client's records should impact independence at all. In speaking with this commenter, he explained that since so much of what he has is in electronic format, if the client lost their version and asked for a copy he could print it and basically make it become the "original". He is concerned that this is a slippery slope.

[CL 3](#) questions whether maintaining a client's depreciation records, and performing write-up services for which the accountant maintains the client's general ledger based on source documents provided and journal entries approved by the client would be considered having control. This commenter goes on to explain that as drafted it would appear to preclude write-up work for an attest client unless the data were stored on an unrelated third party's system and if this is not the intent, recommends clarification be made. This commenter does not believe access to client production systems alone impairs independence because the real issue arises when the licensee takes control of a client's systems. This commenter believes that when the client has no direct control over the disposition of their systems, threats arise to the client's continued financial operations should the ability of the licensee to provide those services be compromised, through third party actions or the licensee's own actions. These same issues exist if the licensee is providing the hosting service through a private cloud leased from a third party or if providing hosting services on their own system. [CL 6](#) has similar concerns and so **strongly disagrees** with the proposal¹.

CL 4 believes the concepts of custody and control over data or records should be replaced by a responsibility criteria because physical custody of data is an increasingly irrelevant concept as data moves to various third-party cloud servers. This commenter suggest the criteria be more along the lines of having "primary or sole responsibility for data".

CL 5 recommends the definition and meaning of "custody or control" as it relates to meaningful use of client data and systems be clarified and distinguish between physical and logical assets as it relates to custody and control.

¹ Refer to the comment letter for their detailed explanation.

Task Force Recommendation:

The Task Force was in agreement that it would be clearer if instead of referring to custody or control if the concepts were replaced by a responsibility criteria that better explained what the Task Force envisioned by those terms. After some discussion, it was agreed that what was envisioned was the situation where a member assumed sole or primary responsibility for the custody, storage, security or back-up of the data or records, such that that attest client's data or records would be incomplete unless they got the information from the member. The Task Force also agreed that instead of including the description in the interpretation, it would be better to include it in a definition for "hosting services" that could appear in the Preface and be hyperlinked each time the term appeared in the interpretation. The Task Force recommends the definition read as follows:

0.400.XX Hosting services. Services that involve a member accepting sole or primary responsibility for the custody, storage, security or back-up of an attest client's data or records whereby those data or records are otherwise only available to the attest client from the member, such that the attest client's data or records are incomplete.

The Task Force was also concerned that members might not realize that they are providing hosting services when they have the sole or primary responsibility for keeping an attest client's depreciation schedule or general ledger and so clarified this in item c of paragraph .02. The revised text for item c appears below in the discussion item entitled "*Original Lease Agreements or Other Legal Documents – Example c Paragraph .02*" since additional revisions were also made to this example for other reasons.

The majority of the Task Force members do not believe the clarifications result in a substantive change of position and so does not believe these changes would result in re-exposure.

Question For The Committee

1. Does the Committee agree with the Task Force's recommendations?
2. Does the Committee believe that the clarifications result in a substantive change of position?

Threats Not Necessarily Present

[CL 5](#) does not support the position taken by the PEEC that providing hosting services, including business continuity and disaster recovery, necessarily involves having custody or control of data or records that the client uses to conduct its operations which creates a "management participation threat" to independence, or that this creates a "self-review" threat to independence that cannot be reduced to an acceptable level through the application of safeguards. They believe that as defined both self-review and management participation threats, a properly provisioned and properly operated hosting environment is, by consequence of design, capable of satisfying independence requirements and does not involve the assumption of custody and control of the data and records. They believe that if self-review threats were created there are acceptable safeguards available and can be implemented in any applicable hosting environment in order to ensure that there is no opportunity for the appearance of an attest client impairment to independence to exist. They believe that only raw data is housed in the data center and is not usable without additional resources to convert it to interpretable information, so the member's role is to maintain a usable, secure, and reliable platform for the client's access. Consequently, CL 5 believes self-review threats are presented at levels that can be reduced with the application of safeguards.

CL 5 also points out that it believe business continuity plans entail many aspects and components that are not relative to the backup and recovery of information systems. The information technology component of a business continuity plan is an aspect of consideration that can only be addressed by management. In their experience they don't believe any management responsibilities are assumed by the member as it relates to the process of backing up and restoring data and is concerned with the unintended implications of a blanket policy as it relates to the ability of the member or member firm to assist an attest client with data recovery. This commenter also believes that creating an absolute rule will undermine the Conceptual Framework for Members in Public Practice and are concerned that the proposed interpretation will have inappropriate and unintended consequences and recommends the proposal be deferred until further analysis can be conducted.

CL 4 believes that the self-review threat may not always be present when providing hosting services, rather maybe associated with delivery of the service that caused the member to take responsibility for the data. This commenter recommends that an introductory paragraph is needed to clarify that the proposed interpretation covers only the threats related to hosting services and refer the member to other sections of the AICPA Code of Professional Conduct, including the conceptual framework for independence, to determine permissibility for related services provided along with potential hosting services.

Task Force Recommendation:

The Task Force recommends that the self-review threat be removed since the primary threat that is present when providing hosting services is the management participation threat. For the self-review and other threats, the Task Force believes the underlying nonattest service being provided will determine if there are any other threats that are present. To highlight this, the Task Force recommends that the lead in to the examples of nonattest services that are not hosting services (i.e., paragraph .03) remind members to apply the requirements outlined in the Nonattest Services subtopic that are applicable to the nonattest services being provided. The edits to accomplish this appear below under different discussion topics.

Question For The Committee

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

Additional Examples of Services that Members May Seek Guidance On

CL 3 recommends more examples of services that would impair, or not impair, independence be added to paragraphs .02 and .03. CL 3 notes that examples that clarify what constitutes control of client data, and what constitutes "data or records the attest client uses to conduct its operations" would help licensees, their clients and regulators better understand the boundaries of permitted services.

Due to the advancement of information technology services being performed by members, **CL 7** recommends more examples of services that would impair, or not impair, independence be added to paragraphs .02 and .03 or to the FAQ document. At a minimum, this commenter recommends an additional example be added to paragraph .03 that addresses assisting attest clients with migration of data to a third-party provider. The situation they provided as an example of what they mean is:

ABC Co., a private attest client, determines it will move its existing on premise operating data system platform to a third-party service provider. The services will not include design, configuration or data room to manage attest client data. ABC Co. has requested assistance to identify recommendations for them to consider related to like-to-like migration of their data and applications to a third-party service provider based

on the criteria established by client management, including assistance with the data migration.

CL 4 recommends additional examples of services that do not impair independence be added such as an example of survey tools and data and analytic services:

- *Survey tools*
An audit client engages the member to conduct a survey that is a permissible nonattest service. The survey data is stored on cloud servers licensed by the member. The client has the ability to obtain dashboard reporting through a visualization tool. The dashboard reporting is the only deliverable to the client and the detailed survey data is not provided to the client at the end of the engagement. We do not believe this constitutes hosting since the data is for internal use by the member in order to provide the summary reports to the client. This would be no different from the firm using paper surveys, summarizing them manually, and then providing a summary hard copy report to the client.
- *Data and analytics*
Data and analytics engagements involve analyzing very large amounts of structured and unstructured data using sophisticated analysis tools. A client engages a member to perform data and analytics on its customer records to identify purchasing patterns as part of a permissible service. The client provides copies of its customer records to the member who then performs the data and analytics analysis and provides the client with summary reports of the data. The analysis is performed once and the engagement is concluded. We do not believe this constitutes hosting of client data and/or records. The data obtained by the member is a copy of the client's data and is used by the member to perform the analysis. The data does not represent data that is necessary to the client's business process as it is a copy of historical data.

Task Force Recommendations:

The Task Force recommends adding an example to address the survey situation. Specifically, the Task Force believes that when a member conducts a survey, the data collected is the members and the work product is the report that summarizes the results of the survey. Following is the example the Task Force recommends be added to the interpretation:

- c. Retaining data collected related to a work product that the member prepared. For example, the member conducts an employee survey and provides the attest client with a report. The member retains the survey data collected to prepare the report.***

If the Committee believes this example is too specific (cannot be broadly applied to other situations) Staff drafted the following FAQ to replace the bullet for discussion purposes. It would be helpful if the Committee could discuss the merits of the belief that the data collected from the survey participants would be considered the member's data and not the attest client's data:

Question: Would a member be providing hosting services if the member's firm performed an employee satisfaction survey for an attest client because the member retained the data collected from the survey participants?

Answer: No the member would not be providing hosting services since the data collected from the survey participants would be considered the member's data.

The Task Force also believes that providing guidance on a data and analytics engagement would be helpful and recommends adding the following FAQ to the nonattest services FAQ document. The Task Force believes a FAQ is more appropriate since it addresses a unique situation and is not broad guidance like the other examples.

Question: A member's firm licenses software that resides on firm servers to an attest client. The attest client inputs data from its lease documents into the software, which generates reports that allows the attest client to view its lease data in various ways. Would the member be providing hosting services?

Answer: The member would not be considered to be providing hosting services if the client assumes primary responsibility for storing the data entered into the software and the output generated by the software is stored outside of the member's software. In this case, the software is solely being used for data manipulation purposes. Additionally, the member should ensure that the activities the software performs include only those activities that would not impair independence under the Nonattest Services subtopic [1.295] of the Independence Rule.

Questions For The Committee

1. Should the survey situation be addressed as an example in the interpretation or as a FAQ?
2. Why should the data collected when performing a survey for an attest client be the member's data and not the client's?
3. Does the Committee agree with the Task Force's recommendation to add a FAQ that addresses data analytics?

Production Environment – Example b Paragraph .02

CL 1 is recommends that the term "production environment" be clarified as it may not be widely understood by members. CL 3 also recommends "production environment" be clarified and indicated they assume that what is intended is any environment that contains real-time systems and/or data upon which the client depends for regular operations, financial or otherwise. CL 5 recommends a definition and meaning of "production environment" be included and the proposal discuss the implications of having "access to", versus "custody and control of", the data and records. CL 4 also recommends deleting the phrase "production environment" because it focuses inappropriately on the related service as opposed to the member taking responsibility for the client's data and/or records on behalf of the attest client. In addition, this commenter believes members may assume that hosting in a non-production environment may always be permissible hosting services which may not always be the case. The commenter suggests the following replace the example used in 1.295.143.02.b:

b. Housing the attest client's financial or non-financial system(s) on the member's firm's servers or servers licensed by the member firm. For example, the firm hosts the attest client's financial information system or website on firm servers.

Task Force Recommendations:

The Task Force recommends replacing example b in paragraph .02 with the example suggested by CL 4. Doing this would eliminate the need to use the phrase "production environment".

Question For The Committee

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

Original Lease Agreements or Other Legal Documents – Example c Paragraph .02

One member of the Society of Louisiana CPAs Ethics Committee ([CL 2](#)) does not believe physically storing documents would impair independence, assuming all the transactions related to the documents were executed by the attest client without the involvement of the member. However, since most records are stored electronically by members and many can be reproduced and accepted as an “original”, this member disagrees with including this type of example.

CL 4 believes this example seems dated and not reflective of data that is more often maintained electronically and suggests changing the example to the following:

c. Responsible for keeping the attest client’s data or records on behalf of the client. For example, the attest client’s lease agreements or other legal documents stored on servers licensed, maintained or provided by the member’s firm or hard copy storage maintained by the member’s firm.

Task Force Recommendations:

The Task Force agreed that the example should also include electronic data or records and as such revised the example using some of the thoughts suggested by CL 4. As discussed above under “Custody or Control”, the Task Force was concerned that members might not realize that they are providing hosting services when they have the sole or primary responsibility for keeping an attest client’s depreciation schedule or general ledger and so clarified this as well. The Task Force’s recommended revisions to item c of paragraph .02 are:

- c. **Responsible for keeping the attest client’s data or records on the attest client’s behalf** ~~in the member’s office for safekeeping~~. For example, the attest client’s **general ledger, supporting schedules (for example, depreciation or amortization schedules)**, original lease agreements or other legal documents are stored **on servers licensed, maintained or provided by the member’s firm or the member is responsible for storing hard copy versions of the data or records** ~~in the member’s office~~.

Question For The Committee

1. Does the Committee agree with the Task Force’s recommended revisions to item c?

Work Product – Example b Paragraph .03

CL 7 recommends the phrase “that the member was engaged to prepare” be removed from example b in paragraph .03 as it is redundant.

- b. Retaining a copy of a work product that the *member* was engaged to prepare, for example, a tax return ~~that the member was engaged to prepare~~.

Task Force Recommendation:

The Task Force agreed not only was the phrase redundant but given the definition of hosting services, it was no longer necessary to emphasize the importance of the member “being engaged”. As such, the Task Force recommends item b be revised as follows:

- b. Retaining a copy of a work product that the *member* ~~was engaged to prepared~~, (for example, a tax return) **for the member’s records** ~~that the member was engaged to prepare~~.

Question For The Committee

1. Does the Committee agree with the Task Force’s recommended revisions to item b?

Portal Example in Paragraph .03

CL 4 believes that use of portals could be a hosting service in certain circumstances. To safeguard against providing an unintended hosting service, the commenter suggests a firm may provide notification to a client that the portal is not intended to be the client’s repository for the work product delivered through the portal. The firm could then purge or return data after a reasonable time frame to ensure that the portal does not become a repository or means of hosting the client’s data or records. As such, this commenter suggests modifying the example in paragraph 1.295.143.03 as follows:

Electronically exchanging data or records with or on behalf of an *attest client* ~~provided the member has not been engaged to retain custody or control of the data or records on behalf of the attest client.~~ For example, a *member* and an attest client may use a portal to exchange data and records related to professional services the *member* has been engaged to provide or to deliver the *member’s* work product to third parties. **However, the member should consider threats that the client may use the portal as its primary or sole repository of data and therefore result in the member providing hosting services. In such cases, the member should apply the Conceptual Framework for Independence [1.210.010].**

CL 7 recommends guidance be provided on what a reasonable time period would be to keep information on a portal. For example, up to 1 year could be reasonable and not viewed as hosting/being the attest client’s repository.

CL 1 recommends that the phrase “exchanging data” in this example be clarified as it may not be widely understood by members.

Task Force Recommendation:

The Task Force recommends these concerns be addressed and revised the example accordingly:

Electronically exchanging data, **or records or the member’s work product** with an **attest client** or on behalf of an *attest client* **at the attest client’s request** ~~provided the member has not been engaged to retain custody or control of the data or records on behalf of the attest client.~~ For example a *member* and an *attest client* may use a portal to:

- a. exchange data and records related to professional services **provided by the member to the attest client** ~~has been engaged to provide,~~ or
- b. to deliver the *member’s* work product to third parties **at the attest client’s request.**

To avoid providing hosting services, members should terminate the attest client’s access to the data or records in the portal within a reasonable period of time after the engagement is terminated.

Question For The Committee

1. Does the Committee agree with the Task Force’s recommended revisions to this example?

Attest Client Inputs Data Example In Paragraph .03

CL 4 believes the example related to the attest client inputting data into software in paragraph .03 indicates that inputs by a client have an impact on determining whether a service is a hosting service. The commenter believes that if the member is responsible for client data as

a result of the client’s input, such would constitute hosting and be impermissible. The commenter believes that the determinant should be who has responsibility for the data and not who inputs the data and proposes the following modification to the example:

- d. Licensing to an *attest client* the use of software **where not providing hosting services** ~~into which the attest client inputs its data~~ and the software provides the *attest client* with an output that the *attest client* is responsible for maintaining. The software must perform an activity that if performed by the *member*, would not *impair independence*.

CL 7 suggests providing further clarification with respect to what is meant by the “use of software” in the interpretation or non-authoritative guidance. The example this commenter provided is when a member is evaluating independence in relation to licensing software, how should the member take into consideration the following: software developed by the member vs. a third-party, or a third-party with whom the member has a teaming relationship; software used to analyze data relevant to financial reporting; or software hosted in the client’s information technology infrastructure or a third-party infrastructure such as a cloud. This commenter also recommends providing further clarity around the last sentence of this example by adding a sentence with an example of one or more software activities that if performed by a member would not impair independence.

Task Force Recommendation:

The Task Force recommends that this example be deleted and instead a FAQ be issued that addresses whether a member would be providing hosting services in this situation. The FAQ that would replace this example was discussed above in the discussion item entitled “*Additional Examples of Services that Members May Seek Guidance On*”.

Question For The Committee

1. Does the Committee agree with the Task Force’s recommendation to delete this example and replace it with the FAQ that appears under the discussion item “*Additional Examples of Services that Members May Seek Guidance On*”?

Clarify Certain Terms or Phrases

CL 4 believes the concept of “engaged by” to determine independence seems to take a form over substance approach and if a member is substantively providing hosting services, the member has taken on a management responsibility regardless of whether the member was engaged to specifically provide hosting services. The commenter believes hosting services may be provided specifically as an explicit service or be inherent within the delivery of an otherwise permissible service.

CL 4 recommends that the term “asset” be removed from the first paragraph as it could be misunderstood. This commenter also recommends that data and records should be defined within the code or the proposed interpretation in order avoid having to include the phrase “client uses to conduct its operations”. This commenter believes that the data “client uses to conduct its operations” could be interpreted in several ways and may confuse members. To implement these changes, this commenter recommends paragraph .01 be edited as follows and that definitions of “hosting services” and “client data and/or records” be added to the code or to the interpretation:

- .01 An *attest client*’s management is responsible for maintaining ~~custody and control over its assets which includes~~ its data and records. When a *member* is engaged to ~~provide services that involve the member having custody or control of~~ **assumes responsibility for the client’s** data or records that the *attest client* uses to conduct its operations (hosting services) **on behalf of management**, the self-review and

management participation *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*, and *independence* would be *impaired*.

[0.400.xx] *Hosting services include services where the member has taken responsibility for the maintenance, custody, storage, security, repository, or back-up of client data and/or records on behalf of the client.*

[0.400.xx] *Client data and/or records are primary, source, or backup data used in the client's business processes. Client data and/or records includes information that the client would have to replicate if lost or otherwise becomes unavailable.*

CL 5 recommends the proposal:

1. Clarify the definition and meaning of "data or records the client uses to conduct its operations"
2. Expand upon the implications of having different platforms in the "hosting" arena.
3. Clarify the implications, if any, when a member establishes an affiliated entity to provide hosting services to the firm's attest clients.
4. Provide the meaning and definition of "member's servers" and clarify the difference with servers located at a third party data center.

Task Force Recommendation:

The Task Force agreed that the determining factor of whether hosting services were provided should not depend upon whether or not the member was engaged to provide the service. As such, the Task Force revised the interpretation to eliminate this concept wherever it was mentioned.

The Task Force recommends deleting the reference to the self-review threat for the reasons explained in discussion item entitled "*Threats Not Necessarily Present*" above.

Finally, the paragraph was streamlined since the Task Force agreed to add a definition for "hosting services", as explained above in discussion item entitled "*Hosting Services Definition*":

- .01 ~~An *attest client's* management is responsible for maintaining custody and control over its assets which includes its data and records. When a *member* is engaged to provide **hosting services** that involve the *member* having custody or control of data or records that the *attest client* uses to conduct its operations (hosting services) the self-review and management participation *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*, and *independence* would be *impaired*.~~

Question For The Committee

1. Does the Committee agree with the Task Force's revisions to paragraph .01?

Comments the Task Force Does Not Recommend Be Addressed

When summarizing the comments for the Task Force's discussion, Staff organized the comments into topics. The Task Force did not have any recommendations related to the following topics.

Need for a Holistic Approach to the Issues

[CL 3](#) believes it would be more helpful to address all the issues the Task Force is charged with working on in a single interpretation rather than piecemeal, to help avoid unintended consequences, inconsistency and confusion in applying guidance so that the final result is cohesive and provides clear guidance on these issues.

Management Responsibility Interpretation

[CL 4](#) recommends that hosting services be included as an example of a management responsibility in the Management Responsibility interpretation. PwC recommends that if the Committee believes having control over an attest client's assets is equally impermissible then it should be added to the example in the Management Responsibilities interpretation that discusses that having custody of a client's assets is a management responsibility.

Non-Financial Information

One member of the Society of Louisiana CPAs Ethics Committee ([CL 2](#)) does not believe having custody of non-financial information should impair independence. In communicating with this commenter, he explained that if for example management is responsible for maintenance of the information and all the auditor does is provide space for it he doesn't see how or why that should affect independence since it doesn't impact the financial statements. The Task Force believes the information is still the attest client's assets and hopes that eliminating the self-review threat will help convey this.

Business Continuity or Disaster Recovery Provider – Example a Paragraph .02

One member of the Society of Louisiana CPAs Ethics Committee ([CL 2](#)) does not believe being hired to be a provider for business continuity or disaster recovery plan would automatically impair independence since the vast majority of these plans are never implemented. Rather, this commenter notes that depending on the details in the plan, once the plan was implemented, then the member should evaluate the threats to determine if independence is impaired. CL 7 believes it is unclear whether the intent of this paragraph includes situations where the member is acting in an advisory capacity only to assist in developing the business continuity or disaster recovery plan or testing of a plan. If it is not the intent, this commenter recommends parenthetical clarification such as (not including business continuity or disaster recovery planning/advisory services) or clarify in non-authoritative guidance. PwC also believes this example is broadly written and should be clarified with a qualifying statement that better differentiates aspects of this service that are impermissible from those that permissible. What if the member is only advising the attest client on business continuity issues? As an example, while a member should not operate, for instance, as an attest client's "data center," the member would be permitted to provide advice on the attest client's business continuity or disaster recovery measures or plans without impairing his or her independence.

Title of Interpretation

[CL 1](#) is concerned that the proposed title might lead members to believe the guidance applies when a member is *only* providing a client with cloud services. Accordingly, CL 1 suggests that the PEEC consider amending the name of the proposed interpretation to something along the lines of, "Maintaining Custody and Control over Client Data and Records."

Question For the Committee

1. Does the Committee believe that any of these comments should be addressed in the Hosting Services interpretation?

Effective Date

CL 1 recommends that the proposed interpretation be effective 6 months from the last day of the month that it is published as opposed to from 6 months from the date it is published in the Journal of Accountancy. Staff believes this was just a drafting error and if the Task Force continues to believe 6 months is the appropriate amount of time, then the phrase “from the date it is published” should be changed to “from the last day of the month that it is published”.

CL 4 propose an effective date of one year from issuance for existing engagements since they believe that many of these engagements could require significant effort by members and their clients to move data onto other platforms. For new engagements, this commenter recommends members apply the proposed interpretation upon issuance.

Although CL 7 believes the effective date proposed seems reasonable, they are concerned that some firms may not be viewing hosting services as impairing independence and as such, it might be better if the effective date was based upon the engagement period. For example, the effective date could be for engagement periods beginning or after June 30, 2017.

The Task Force is concerned that some members may be providing hosting services and not realize they are doing so (e.g., depreciation schedules). As such, the Task Force believes members will need time to learn about the guidance and then time to get out of existing arrangements and implement policies. If the Committee adopts the interpretation at this meeting it will likely not appear in the Journal of Accountancy until March, the heart of busy season. The Task Force can envision some members not learning about the change until they attend a CPE class this summer and then need to get out of arrangements. Since hosting services would impair independence during the period covered by the financial statements, the Task Force recommends the interpretation be effective for engagement periods beginning on or after December 15, 2017. This would allow members about 9 months to learn about the requirement and terminate any problematic services while not tainting them for periods that are in 2017.

Staff was asked to research whether a transition provision was necessary. Staff believes that a transition provision is usually adopted when a standard is effective on one date but members are allowed additional time to wrap up existing engagements. Given the recommended extended effective date, Staff doesn't believe a transition provision is necessary. If the Committee believes a transition provision is necessary, it should discuss if the effective date should be sooner than December 15, 2017 and would read something like:

Independence would not be impaired as a result of the more restrictive requirements of the Hosting Services interpretation provided such services are pursuant to engagements commenced prior to December 15, 2017, and completed prior to March 1, 2018, and the member complied with all applicable independence interpretations and rulings in effect on December 15, 2017.

Question For the Committee

1. Does the Committee agree with the Task Force's recommended effective date?
2. Does the Committee believe a transition provision is necessary?
3. Does the Committee believe that the changes agreed to result in a substantive change of position such that the guidance should be re-exposed?

Summary of Issues - Information Systems Services

As explained at the July meeting, the Task Force planned to develop definitions for many of the activities discussed by the *Information Systems Design, Implementation and Integration Services* interpretation and then developed guidance to assist members in understanding the

independence implications associated with providing these activities. While initially the Task Force thought this guidance would be in the form of non-authoritative FAQs, after its initial discussions, it thinks the guidance would be helpful to include in the Code.

The Task Force would appreciate the Committee's input on its draft strawman which outlines the activities discussed so far.

Communication Plan – Hosting Services

The Committee is asked if it believes it would be helpful to issue communications around this new interpretation aside from the traditional steps of publication in the Journal of Accountancy and Ethically Speaking. If so, any specific suggestions would be helpful.

Materials Presented

Agenda Item 2B	Hosting Services interpretation
Agenda Item 2C	Comment Letter Summary
Agenda Item 2D	Information Systems Services Strawman

Additions to the Proposals Appear in Boldface Italic and Deletions are Stricken.

Text In Red Font Means the Term Will be Linked to the New Definition of Hosting Services

Text of New Definition of Hosting Services

0.400.XX Hosting services. Services that involve a member accepting sole or primary responsibility for the custody, storage, security or back-up of an attest client's data or records whereby those data or records are otherwise only available to the attest client from the member, such that the attest client's data or records are incomplete.

Text of Proposed Hosting Services Interpretation

1.295.143 - Hosting Services

- .01 An ~~attest client's~~ management is responsible for maintaining custody and control over its assets which includes its data and records. When a *member* is engaged to provide **hosting services** that involve the ~~member~~ having custody or control of data or records that the ~~attest client~~ uses to conduct its operations (hosting services) the self-review and management participation *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*, and *independence* would be *impaired*.
- .02 **The following are** Examples of ~~hosting~~ **nonattest** services that would *impair independence* include these **because they are considered to be hosting services**:
- a. Acting as the *attest client's* business continuity or disaster recovery provider.
 - b. Housing the ~~production environment of the attest client's system (financial or non-financial)~~ **system(s)** on the *member's firm's* servers **or servers licensed by the member firm**. For example, the *firm* hosts the *attest client's* financial system or website on *firm* servers.
 - a. **Responsible for** ~~keeping the attest client's data or records on the attest client's behalf in the member's office for safekeeping.~~ For example, the *attest client's* **general ledger, supporting schedules (for example, depreciation or amortization schedules)**, original lease agreements or other legal documents are stored **on servers licensed, maintained or provided by the member's firm or the member is responsible for storing hard copy versions of the data or records** ~~in the member's office.~~
- .03 ~~The following are examples of activities situations in which a member that~~ would not be considered to be **hosting services**. **Members are reminded to apply the requirements outlined in the interpretations of the Nonattest Services subtopic when providing nonattest services.** ~~data or records that the attest client uses to conduct its operations and would not impair independence:~~
- a. Retaining a copy of an *attest client's* data or records as documentation to support a service provided. ~~For example, the member retains a copy of:~~
 - i. the payroll data that supports a payroll tax return the *member* prepared.
 - or
 - ii. ~~a copy of~~ a bank reconciliation that supports attest procedures performed on the cash account.
 - iii. **the client's vendor data used to prepare an analysis of vendor activity.**

-
- b. Retaining a copy of a work product that the *member* was engaged to prepare, (for example, a tax return) **for the member's records** that the *member* was engaged to prepare.
 - c. **Retaining data collected related to a work product that the member prepared. For example, the member conducts an employee survey and provides the attest client with a report. The member retains the survey data collected to prepare the report.**
 - d. Electronically exchanging data, **or records or the member's work product with an attest client** or on behalf of an *attest client* **at the attest client's request** provided the *member* has not been engaged to retain custody or control of the data or records on behalf of the *attest client*. For example a *member* and an *attest client* may use a portal to:
 - a. exchange data and records related to professional services **provided by the member to the attest client** has been engaged to provide, or
 - b. to deliver the *member's* work product to third parties **at the attest client's request.**
- To avoid providing hosting services, members should terminate the attest client's access to the data or records in the portal within a reasonable period of time after the engagement is terminated.**
- e. Licensing to an *attest client* the use of software into which the *attest client* inputs its data and the software provides the *attest client* with an output that the *attest client* is responsible for maintaining. The software must perform an activity that, if performed by the *member*, would not *impair independence*.

Effective Date

- .04 This interpretation is effective **for engagement periods beginning on or after December 31, 2017** [~~6 months from the date it is published in the *Journal of Accountancy*.~~].

COMMENT SUMMARY
PROPOSED NEW HOSTING SERVICES INTERPRETATION

Comment Letter	Feedback Highlights
<p><u>CL 1</u> NYSSCPA Ethics Committee</p> <p><i>Support with Recommendations</i></p>	<p>The NYSSCPA agrees with the position taken by the PEEC that the provision of hosting services, as defined in the Proposed Interpretation, to an attest client represents an independence threat that cannot be reduced to an acceptable level through the application of safeguards. We are, however, concerned that members might confuse “hosting services” with solely providing a client with cloud services. Accordingly, we suggest that the PEEC consider amending the name of the Proposed Interpretation to something along the lines of, “Maintaining Custody and Control over Client Data and Records.”</p> <p>We are concerned that the terms “production environment” in paragraph 02.b. and “exchanging data” in paragraph 03.c. will not be widely understood by members. Perhaps the PEEC might consider clarifying the meaning of these phrases as they relate to the Proposed Interpretation. In addition, we suggest changing the effective date of the Proposed Interpretation to six months from the last day of the month in which it is published in the <i>Journal of Accountancy</i>.</p> <p>We believe this Proposed Interpretation will affect a variety of firms, especially small and medium-sized firms, and suggest that the PEEC consider issuing a related question-and-answer white paper upon issuance of the final interpretation. We suggest that the white paper address various “real-world” examples in order to help members navigate this important issue. The NYSSCPA provided some situations that the PEEC might want to consider addressing.</p>
<p><u>CL 2</u> Society of Louisiana of CPAs</p> <p><i>Support with Recommendations</i></p>	<p>I have no problem with the prohibition on hosting financial information, however I think it is inappropriate to limit the provision of hosting of non-financial data, such as the client's web site.</p>

Comment Letter	Feedback Highlights
	<p>I am basically in agreement with the ED relating to the Proposed Interpretation as it relates to the hosting (Control) of financial records or data. This would appear to impair independence. I do not feel that storing (Custody) of records should impact independence at all. I also believe that the ED has several good examples of when a member’s independence would not be impaired. However, I disagree with the following:</p> <p style="padding-left: 40px;">Section 1.295.143-.02a states that independence would be impaired if a member was acting as the attest client’s business continuity or disaster recovery provider.</p> <p><i>I believe that a member that is acting as a provider for business continuity or disaster recovery plan would not impair independence. Depending on the details in the plan, once the plan was implemented, then independence <u>may</u> be impaired. However, just being a provider should not impact independence since the vast majority of these plans are never implemented.</i></p> <p>Section 1.295.143-.02c states that independence would be impaired if a member was keeping the attest client’s original lease agreements or other legal documents stored in the member’s office.</p> <p><i>I am not sure why physically storing documents would impair independence, assuming all the transactions related to the documents were executed by the attest client without the involvement of the member. However, since most records are stored electronically by members and many can be reproduced and accepted as an “original”, I disagree with including this type of example in the standard.</i></p>
<p>CL 3 NSABA</p> <p>Recommendations</p>	<p>Impaired Independence as a Result of Hosting Client Systems or Data</p> <p>The core issues to address are who controls the client’s data and what constitutes control. It is not clear whether services commonly provided under the existing code (See AICPA, “Frequently Asked Questions: Non Attest Services Questions as of November 12, 2015”) would, under the proposal,</p>

Comment Letter	Feedback Highlights
	<p>impair independence. Would the conclusion be different if they were to be maintained on the licensee’s software or in a hosted environment? Common examples include maintaining a client’s depreciation records, and performing write-up services for which the accountant maintains the client’s general ledger based on source documents provided and journal entries approved by the client.</p> <p>It appears reasonable to conclude that, when a licensee takes custody or control of data or records that the attest client uses to conduct its operations, the licensee’s independence would be impaired. However, as the proposal is worded it would appear to preclude write-up work for an attest client unless the data were stored on an unrelated third party’s system. If that is not PEEC’s intent, we recommend the PEEC clarify the circumstances in which write-up work would still be permitted under the new rule.</p> <p>Examples of Services that Would Impair Independence We believe more examples of services that would impair, or not impair, independence are needed in paragraphs 02 and 03. Specifically, examples that clarify what constitutes control of client data, and what constitutes “data or records the attest client uses to conduct its operations” would help licensees, their clients and regulators better understand the boundaries of permitted services.</p> <p>Define Production Environment The concept of the “production environment” should be more completely defined. We assume what is intended is any environment that contains real-time systems and/or data upon which the client depends for regular operations, financial or otherwise.</p> <p>Need for a Holistic Approach to the Issues We understand that the task force addressing the hosting issue is also reviewing a number of issues related to hosting, cloud services (a type of</p>

Comment Letter	Feedback Highlights
	<p>hosting service) and licensee access to client production data. While we acknowledge that these are complex issues, we suggest it may be more helpful to address the issues in a single interpretation rather than piecemeal, to help avoid unintended consequences, inconsistency and confusion in applying guidance. We hope PEEC will work to ensure the final result is cohesive and provides clear guidance on these issues.</p> <p>Control and Access Issues arise when the licensee takes control of a client’s systems, as is the case when the licensee hosts the client’s production systems on servers owned or controlled by the licensee. When the client has no direct control over the disposition of their systems, threats arise to the client’s continued financial operations should the ability of the licensee to provide those services be compromised, through third party actions or the licensee’s own actions. These same issues exist if the licensee is providing the hosting service through a private cloud leased from a third party. We do not believe access to client production systems alone impairs independence.</p>
<p>CL 4 KPMG</p>	<p>Management Responsibility Example Taking responsibility for the maintenance, custody, storage, security, repository or back-up of client data and/or records (i.e., “client data”) on behalf of an attest client (i.e., “hosting of client data” or “hosting services”) is an intrinsic management responsibility that should not be assumed by a member for an attest client. Whether such responsibility is over electronic or hard copy data does not change the underlying premise that such responsibility is a management responsibility. Therefore, hosting of client data by a member for an attest client where the member has taken responsibility for the client’s data or records should be prohibited for an attest client. As a result, we recommend that the PEEC include hosting services in ET 1.295.030.02 as an example of a management responsibility that would impair independence.</p>

Comment Letter	Feedback Highlights
	<p>Engaged to Provide Hosting Services The concept of “engaged by” to determine independence as noted in the proposed interpretation at ET 1.295.143.01 and ET 1.295.143.03.c seems to take a form over substance approach to the independence consideration when providing hosting services. We believe that if a member is substantively providing hosting services, the member has taken on a management responsibility regardless of whether the member was engaged to specifically provide hosting services. Hosting services may be provided specifically as an explicit service or be inherent within the delivery of an otherwise permissible service.</p> <p>Custody and Control While the act of taking responsibility includes the concept of control of such data, a member may not actually control data but still have responsibility by virtue of being a repository of the client’s data. Physical custody of data is an increasingly irrelevant concept as data moves to various third-party cloud servers. Therefore we suggest the criteria change from custody or control to responsibility. Control and custody over data would both be incorporated into criteria of “primary or sole responsibility for data”.</p> <p>Hosting services do not change the determination of permissibility of services offered in connection with the hosting service. As written, the proposed interpretation may confuse members in regard to the threats inherent in taking responsibility for the data with the threats associated with delivery of the service that caused the member to take responsibility for the data. We believe that an introductory paragraph is needed to clarify that the proposed interpretation covers only the threats related to hosting services. That paragraph should refer the member to other sections of the AICPA Code of Professional Conduct, including the conceptual framework for independence, to determine permissibility for related services provided along with potential hosting services.</p>

Comment Letter	Feedback Highlights
	<p>We believe the emphasis of the proposed interpretation should be on the impermissible management responsibilities inherent in hosting client data. Hosting services contain inherent management participation threats as a result of taking responsibility for client data. We believe self-review threats do not always exist by virtue of hosting client data but rather, a self-review threat results from other services associated with the hosting activity. We suggest that the proposed interpretation avoid implying that self-review threats always exist when providing hosting services.</p> <p><u>Prohibition on hosting services (ET 1.295.143.01)</u></p> <ul style="list-style-type: none"> • We recommend avoiding the use of the term “asset” in the first paragraph of the proposed interpretation. We do not believe that it provides clarification regarding the definition of data and could be misunderstood. • Data and records should be defined within the code or the proposed interpretation in order avoid having to include the phrase “client uses to conduct its operations”. We believe that data “client uses to conduct its operations” could be interpreted in several ways and may confuse members. • We suggest the following revisions to reflect the preceding comments: <ul style="list-style-type: none"> <i>[0.400.xx] Client data and/or records are primary, source, or backup data used in the client’s business processes. Client data and/or records includes information that the client would have to replicate if lost or otherwise becomes unavailable.</i> <i>[0.400.xx] Hosting services include services where the member has taken responsibility for the maintenance, custody, storage, security, repository, or back-up of client data and/or records on behalf of the client.</i> <i>1.295.143.01 An attest client’s management is responsible for maintaining its data and records. When a member assumes responsibility for the client’s</i>

Comment Letter	Feedback Highlights
	<p><i>data and/or records (hosting services) on behalf of management, the management participation threats to the member's compliance....</i></p> <p><u>Hosting service examples (ET 1.295.143.02)</u></p> <ul style="list-style-type: none"> • We recommend deleting the phrase “production environment” as used in ET 1.295.143.b of the proposed interpretation. We believe the phrase “production environment” focuses inappropriately on the related service as opposed to the member taking responsibility for the client’s data and/or records on behalf of the attest client. In addition, members may assume that hosting in a non-production environment may always be permissible hosting services which may not always be the case. We propose the following replace the example used in 1.295.143.02.b: <ul style="list-style-type: none"> <i>b. Housing the attest client’s financial or non-financial system(s) on the member’s firm’s servers or servers licensed by the member firm. For example, the firm hosts the attest client’s financial information system or website on firm servers.</i> • Paragraph 1.295.143.02.c of the proposed interpretation seems dated and not reflective of data that is more often maintained electronically. We suggest changing the example to the following: <ul style="list-style-type: none"> <i>c. Responsible for keeping the attest client’s data or records on behalf of the client. For example, the attest client’s lease agreements or other legal documents stored on servers licensed, maintained or provided by the member’s firm or hard copy storage maintained by the member’s firm.</i> <p><u>Examples where a hosting service is not occurring (ET 1.295.143.03)</u></p> <p>We agree with the PEEC that exchanges of data (i.e., through the use of an electronic portal or other means) for otherwise permissible services can occur without the member taking on responsibility for client data or records. However, we believe that use of portals could be a hosting service in certain</p>

Comment Letter	Feedback Highlights
	<p>circumstances. To safeguard against providing an unintended hosting service, a firm may provide notification to a client that the portal is not intended to be the client's repository for the work product delivered through the portal. The firm may then purge or return data after a reasonable time frame to ensure that the portal does not become a repository or means of hosting the client's data or records. We therefore suggest modifying paragraph 1.295.143.03.c as follows:</p> <p><i>c. Electronically exchanging data or records with or on behalf of an attest client. For example, a member... to third parties. However, the member should consider threats that the client may use the portal as its primary or sole repository of data and therefore result in the member providing hosting services. In such cases, the member should apply the Conceptual Framework for Independence [1.210.010].</i></p> <p>Paragraph 1.295.143.03.d indicates that inputs by a client have an impact on determining whether a service is a hosting service. If the member is responsible for client data as a result of the client's input, we believe that would constitute hosting and be impermissible. We believe that the determinant should be who has responsibility for the data and not who inputs the data. We propose the following modification to the example:</p> <p><i>d. Licensing to an attest client the use of software where not providing hosting services and the software provides the attest client with an output that the attest client is responsible for maintaining. The software must perform an activity that if performed by the member, would not impair independence.</i></p> <p><u>Other examples</u></p> <p>We offer the following examples of circumstances where a member may not be responsible for hosting client data and/or records.</p> <p>Survey tools</p> <p>An audit client engages the member to conduct a survey that is a permissible</p>

Comment Letter	Feedback Highlights
	<p>nonattest service. The survey data is stored on cloud servers licensed by the member. The client has the ability to obtain dashboard reporting through a visualization tool. The dashboard reporting is the only deliverable to the client and the detailed survey data is not provided to the client at the end of the engagement. We do not believe this constitutes hosting since the data is for internal use by the member in order to provide the summary reports to the client. This would be no different from the firm using paper surveys, summarizing them manually, and then providing a summary hard copy report to the client.</p> <p>Data and analytics Data and analytics engagements involve analyzing very large amounts of structured and unstructured data using sophisticated analysis tools. A client engages a member to perform data and analytics on its customer records to identify purchasing patterns as part of a permissible service. The client provides copies of its customer records to the member who then performs the data and analytics analysis and provides the client with summary reports of the data. The analysis is performed once and the engagement is concluded. We do not believe this constitutes hosting of client data and/or records. The data obtained by the member is a copy of the client's data and is used by the member to perform the analysis. The data does not represent data that is necessary to the client's business process as it is a copy of historical data.</p> <p><u>Effective date</u> We propose an effective date of one year from issuance for existing engagements. Many of these engagements could require significant effort by members and their clients to move data onto other platforms. For new engagements, members should apply the proposed interpretation upon issuance.</p>

Comment Letter	Feedback Highlights
<p>CL 5 Warren Averett</p>	<p>We do not support the position taken by the PEEC that the providing of hosting services, including business continuity and disaster recovery, necessarily involves having custody or control of data or records that the client uses to conduct its operations which creates a “management participation threat” to independence, or that this creates a “self- review” threat to independence that cannot be reduced to an acceptable level through the application of safeguards.</p> <p>When a member is engaged to provide a hosted platform, we believe that, as the AICPA has defined both self-review and management participation threats, a properly provisioned and properly operated hosting environment is, by consequence of design, capable of satisfying independence requirements and does not involve the assumption of custody and control of the data and records. We are certain that if self-review threats were created there are acceptable safeguards available. These safeguards can be implemented in any applicable hosting environment in order to ensure that there is no opportunity for the appearance of an attest client impairment to independence to exist.</p> <p>A hosting provider of any size or type must have acquired a facility from which to operate, and a platform from which to provide a service. Platforms consist of physical hardware to include network devices for communication, computing devices for processing of information, and storage devices for the housing of information. The combined facility and platform is referred to as a datacenter. There are no physical attest client assets in a datacenter used for hosting. Only raw data is hosted. The data itself is not usable without additional resources to convert it from its raw form into meaningful and interpretable information. In a hosting engagement, the role of the member firm is to provide the datacenter platform for the client to use in accessing, viewing, interpreting, creating, and editing data. The client maintains custody of its assets, to include applications, operating systems, and licenses, and uses the hosted platform for access and presentation of information. The member or member firm’s role is to maintain a</p>

Comment Letter	Feedback Highlights
	<p>usable, secure, and reliable platform for the client’s access. Consequently, self-review threats are presented at levels that can be reduced with the application of safeguards.</p> <p>Business continuity plans entail many aspects and components that are not relative to the backup and recovery of information systems. The information technology component of a business continuity plan is an aspect of consideration that can only be addressed by management. It is our experience that no management responsibilities are assumed by the member as it relates to the process of backing up and restoring data. We are concerned with the unintended implications of a blanket policy as it relates to the ability of the member or member firm to assist an attest client with data recovery.</p> <p>The “General Requirements for Performing Non Attest Services” (AICPA, Professional Standards, ET sec 1.295.040) explains the main safeguards that need to be applied whenever members provide non attest services to their attest clients.</p> <p>Safeguards are defined as controls that partially or completely eliminate threats or diminish the potential influence of a threat. We believe safeguards, if needed, can be implemented and applied to reduce a perceived threat to an acceptable level for those hosting services as described in the proposed interpretation.</p> <p>If a threat were to exist it is considered to be "at an acceptable level" when the significance of the threat combined with the safeguards applied reduce the risk of the threat to a level where a reasonable and informed person would likely conclude that the service could be performed with integrity and objectivity.</p> <p>Examples of safeguards implemented by an attest client that would operate in combination with other safeguards:</p>

Comment Letter	Feedback Highlights
	<ul style="list-style-type: none"> a. The attest client has personnel with suitable skill, knowledge, and/or experience who make all managerial decisions with respect to the delivery of non-attest services by the member to the attest client b. A tone at the top that emphasizes the attest client's commitment to fair financial reporting c. Policies and procedures that are designed to achieve fair financial reporting d. A governance structure, such as an active audit committee, that is designed to ensure appropriate decision making, oversight, and communications regarding a firm's services e. Policies that dictate the types of services that the entity can hire the audit firm to provide without causing the firm's independence to be considered impaired <p>Examples of specific safeguards implemented by the member relative to hosting services:</p> <ul style="list-style-type: none"> a. Firm leadership that stresses the importance of independence and the expectation that members of attest engagement teams will act in the public interest b. The use of different partners, partner equivalents, and engagement teams that have separate reporting lines in the delivery of permitted non-attest services to an attest client, particularly when the separation between reporting lines is significant c. Policies that limit physical access to the hosting premises (datacenter) to non-attest partners, partner equivalents, and engagement teams d. Use of a datacenter facility owned and operated by a 3rd party e. Use of a datacenter facility located on physical premises separate from facilities housing attest partners, partner equivalents, and engagement teams f. Physical controls of datacenter meeting standards of access and operation of SOC II or comparable levels

Comment Letter	Feedback Highlights
	<p>g. Policies that require the use of technologies ensuring comprehensive logging, alerting, and regular review of access to the hosting environment and the attest client systems</p> <p>h. Policies ensuring the attest client physical access to the datacenter at any time</p> <p>Additional Comments related to areas the PEEC needs to address</p> <ol style="list-style-type: none"> 1. Clarify the definition and meaning of “custody or control” as it relates to the meaningful use of client data and systems. 2. Clarify the definition and meaning of “data or records the client uses to conduct its operations” 3. Distinguish between physical and logical assets as it relates to custody and control. 4. Expand upon the implications of having different platforms in the “hosting” arena. 5. The implications, if any, when a member establishes an affiliated entity to provide hosting services to the firm’s attest clients. 6. The meaning and definition of “member’s servers” and clarify the difference with servers located at a third party data center. 7. The definition and meaning of “production environment” and discuss the implications of having “access to”, versus “custody and control of”, the data and records. <p>By creating an absolute rule we believe the PEEC would be undermining the principles that recently became effective as outlined in the Conceptual Framework for Members in Public Practice and are concerned that the proposed interpretation will have inappropriate and unintended consequences.</p> <p>We ask that the PEEC give further consideration to whether hosting services expressly imply the assumption of custody and control of assets as we do not believe this occurs under circumstances wherein practical safeguards are implemented and IT systems are provisioned according to industry standards.</p>

Comment Letter	Feedback Highlights
	<p>We also respectfully request further review and analysis as to the opinion of independence relative to business continuity and disaster recovery services.</p> <p>We appreciate the PEEC's efforts to provide enhanced guidance related to situations where independence with respect to an attest client may become impaired. We urge the PEEC defer this proposal until further discussion and analysis can be completed.</p>
<p>CL 6 Massachusetts Society of CPAs</p>	<p>The Accounting Principles and Auditing Procedures Committee (Committee) strongly disagrees with the proposal and believes it would be very troublesome to small and medium entities. They believe that procedures can be put in place to safeguard that the bookkeeping information needed to prepare and present financial statements would reflect that of the client and not be judged as a management responsibility. To help demonstrate their point they provided the following example which they believe illustrates that the accountant would not control of the client data or records:</p> <ul style="list-style-type: none"> • Client is a small or medium size entity that records all disbursements in its checkbook and identifies the type of expense on the checkbook stub. During the course of providing bookkeeping, the accountant assigns general ledger account numbers based on the type of expense and records these payments in the client's accounting system. Under FAQ #4 this is not deemed to impair independence. The client's accounting system software used is located on the accountant's server. The Committee believes the location of the software on the accountant's server would not impair independence provided proper safeguards are put in place. These safeguards could include properly documenting the client taking responsibility for all the input and output of the bookkeeping. The use of engagement letters could be used to document these safeguards and should be mandatory.

Comment Letter	Feedback Highlights
	<p>The Committee also believes that under this proposal the same services could be provided to the client through cloud computing and be in compliance with the proposed hosting standards.</p> <p>The Committee is also concerned that independence would be impaired under the proposal:</p> <ul style="list-style-type: none"> • When the accountant maintains schedules such as depreciation schedules maintained in tax software programs. • If the member were to perform write-up work for any client unless it is on a 3rd party system (resulting in greater cost to the client). <p>The Committee believes the proposal would prevent small firm members from properly servicing their clients' needs because it could result in situations that would prevent them from issuing audits and reviews.</p>
<p>CL 7 Grant Thornton</p>	<p>Grant Thornton supports PEEC's position that a new independence interpretation and guidance is needed to address "hosting services," as we agree it is management's responsibility to have custody and control over its assets. We also agree it is important to provide examples for our members of what is and is not considered hosting services due to the advancement of information technology services being performed by our members. Additional examples not covered in the new interpretation could be addressed in other non-authoritative guidance (such as a frequently asked questions document).</p> <p>Paragraph 02.a. of the proposed interpretation addresses "Acting as the attest client's business continuity or disaster recovery provider." However, it is unclear whether the intent of this paragraph includes situations where the member is acting in an advisory capacity only to assist in developing the business continuity or disaster recovery plan or testing of a plan. If it is not the intent, we recommend parenthetical clarification such as (not including business continuity or disaster recovery planning/advisory services) or clarify in non-authoritative guidance.</p>

Comment Letter	Feedback Highlights
	<p>The third paragraph (.03) of the proposed interpretation addresses examples of services not considered hosting. We have the following comments:</p> <ul style="list-style-type: none"> • PEEC should considering including an additional example of what is not considered hosting that involves assisting attest clients with migration of data to a third-party provider. For example, ABC Co., a private attest client, determines it will move its existing on premise operating data system platform to a third-party service provider. The services will not include design, configuration or data room to manage attest client data. ABC Co. has requested assistance to identify recommendations for them to consider related to like-to-like migration of their data and applications to a third-party service provider based on the criteria established by client management, including assistance with the data migration. • Paragraph 03.b. We suggest removing the last phrase “that the <i>member</i> was engaged to prepare” as it is redundant. • Paragraph 03.c. We believe PEEC should consider providing guidance to members on what a reasonable time period would be to keep information on a portal. For example, up to 1 year could be reasonable and not viewed as hosting/being the attest client’s repository. • Paragraph 03.d. <ul style="list-style-type: none"> ○ We suggest providing further clarification with respect to what is meant by the “use of software” in the interpretation or non-authoritative guidance. For example, when a member is evaluating independence in relation to licensing software, how should the member take into consideration the following: software developed by the member vs. a third-party, or a third-party with whom the member has a teaming relationship; software used to analyze data relevant to financial reporting; or software hosted in the client’s information technology infrastructure or a third-party infrastructure such as a cloud.

Comment Letter	Feedback Highlights
	<ul style="list-style-type: none"> ○ PEEC to consider providing further clarity around the last sentence of paragraph 03.d. by adding a sentence with an example of one or more software activities that if performed by a member would not impair independence. <p>Effective Date Grant Thornton agrees with PEEC that a delayed effective date of six-months from the date it is published in the <i>Journal of Accountancy</i> would be reasonable for members to complete any existing contracts they may have in place to provide hosting services and if PEEC provides additional guidance and clarity, as this will allow firms to avail themselves of the new interpretation. However, smaller firms may not currently be viewing certain hosting services as prohibited, therefore, did PEEC consider the independence implications if a member has provided hosting services during the professional engagement period of an attest engagement that is currently in process. Therefore, it may be more appropriate for PEEC to align the effective date to an engagement period. For example, the effective date could be for engagement periods beginning or after June 30, 2017.</p>

Information Systems Services Strawman

- .01 When a member provides services related to an attest client's information systems, self-review and management participation threats to the covered member's compliance with the "[Independence Rule](#)" [1.200.001] may exist.
- .02 When performing information systems services for an attest client that are permitted under this interpretation, all requirements of the "[General Requirements for Performing Nonattest Services](#)" interpretation [1.295.040] of the "Independence Rule" [1.200.001] should be met, including that all significant assumptions and matters of judgment are determined or approved by the attest client, and the attest client is in a position to have an informed judgment on, and accepts responsibility for, the results of the service.

Terminology

- .03 The following terms are defined solely for the purpose of applying this interpretation:
 - a. Commercial Off-the-Shelf: ("COTS") means a software package developed, distributed, maintained and supported by a third party vendor (vendor), sometimes simply referred to as an "off the shelf" package or solution. COTS solutions have generally referred to traditional on-premises software that runs on a customer's own computers or on a vendor's "cloud" infrastructure. COTS solutions range from software packages requiring only installation on a computer and ready to run or to large scale, complex enterprise applications.
 - b. Placing into Production: means that the system is now available for use on a regular basis for its intended purpose.
 - c. Interface: means connecting two or more systems by designing and developing software code that passes data from one system to another. Interfaces may flow in one direction or be bidirectional and may involve the performance of an end-to-end transaction or pass data from one system to another for reporting purposes.

Design or Development of an Information System

- .04 Designing an information system means determining how a system or transaction will function, process data and produce results (for example, reports, journal vouchers and documents such as sales and purchase orders) to provide a blueprint or schematic for the development of software code (programs) and data structures. Once designed, the information system is developed, which entails creating software code, for individual or multiple modules, and testing such code to confirm it is functioning as designed.
- .05 If a member designs or develops an attest client's financial information system 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.
- .06 If however, the member designs or develops an information system that is unrelated to the attest client's financial statements or accounting records, threats may be reduced to an acceptable level provided the safeguards outlined in paragraph .02 of this interpretation are applied.

Implementation Services

- .07 Implementation services can involve any activity after the design and development of an information system that a member is engaged to provide related to an attest client's information systems. For example, implementation can include activities such as

configuring, testing and placing into production a system, and also includes supporting activities such as end-user training, change management and organizational communications. It can also involve installing, integrating, customizing and performing data conversions necessary for implementing a COTS software solution. Threats created by certain implementation services can be reduced to an acceptable level by the application of safeguards, while in other situations threats to compliance with the “[Independence Rule](#)” [1.200.001] would be significant and could not be reduced to an acceptable level by the application of safeguards.

Installing a Software Solution

- .08 Installing a software solution means the initial loading of software on a computer. In the case of a COTS implementation, installation would normally refer to loading the software on a customer’s server(s). Software configuration, development, integration and conversion activities may follow installation.
- .09 When a member installs a COTS software solution, even if a financial information system, threats may be reduced to an acceptable level provided the safeguards outlined in paragraph .02 of this interpretation are applied.

Configuring a Commercial-Off-The Shelf Software Solution

- .10 Configuring a COTS software solution means selecting the software features, functionality options, and settings of the COTS software solution, that when selected determine how the software will perform certain transactions and process data. Configuration options may also include selecting the predefined format of certain data attributes and the inclusion or exclusion of such attributes. For purposes of this interpretation, configuring a COTS software solution does not generally involve developing new software code or features to modify or alter the functionality of the COTS software solution in ways not pre-defined by the vendor.
- .11 When a member configures a COTS software solution, even if a financial information system, threats may be reduced to an acceptable level provided the safeguards outlined in paragraph .02 of this interpretation are applied.

Customization of a Commercial-Off-The Shelf Software Solution

- .12 Customizing a COTs software solution means altering or adding to the features and functions of the software as provided for by the vendor, which go beyond all options available when configuring the COTS software solution. Customizing can either involve:
 - a. Modification which for purposes of this interpretation involves altering the COTS software solution code to change or add to the functionality provided by the vendor, or
 - b. Enhancements which for purposes of this interpretation involves developing new code, external to the COTS software solution, and works in concert with the COTS software solution to provide altered or additional functionality.
- .13 If a member customizes an attest client’s financial information system 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.
- .14 If however, the member customizes an information system that is unrelated to the attest client’s financial statements or accounting records, threats may be reduced to an acceptable level provided the safeguards outlined in paragraph .02 of this interpretation are applied.

Integrating an Commercial-Off-The Shelf Software Solution

.15 TBD

Data Conversion Services

.16 TBD

Other Information Systems Services

.17 TBD

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.

Cybersecurity Services

Task Force Members

Laurie Tish (Chair), James Smolinski, Nancy Miller, Daimon Geopfert and Julie Winger.

Staff: Lisa Snyder and Ellen Gorla

Task Force Charge

Determine if independence guidance should be developed related to the provision of nonattest cybersecurity services.

Reason for Agenda Item

The Committee is asked to determine if there are any other steps it would like the Task Force to take with regard to cybersecurity services or if the Task Force should be disbanded.

Summary of Issues

The Committee asked the Task Force to determine if independence guidance should be developed related to the provision of nonattest cybersecurity services. Staff obtained examples of nonattest cybersecurity services from two firms and the Task Force met to discuss.

Overall the Task Force believes that the existing independence guidance seemed to be drafted broadly enough for the members of the Task Force and their firms to determine when a cybersecurity service would or would not impair independence. For example, it was noted that services typically coined as readiness assessments or gap analysis tended to fall into the category of permitted advisory services as long as the advice did not result in the member providing management responsibilities such as designing or developing the cybersecurity controls. Alternatively, assessments that involve the member to lead and perform ongoing “attack and penetration testing” would typically result in the member being part of the company’s internal controls and as such impair the member’s independence. Although outside of the scope of this Task Force, several members of the Task Force thought it would be useful if the Committee was open to providing additional general guidance on what it considers to be “ongoing monitoring vs. separate evaluations.”

In an effort to confirm the Task Force’s belief, Staff reached out to the hotline staff and to Mr. Carl Peterson, VP Small Firms, to get a sense for whether other firms might feel differently. A search of the hotline database resulted in only 1 inquiry on this topic in the past 22 months. Mr. Peterson put Staff in contact with two members of a medium size firm that performs cybersecurity services. These members could not think of any challenges they have with determining which cybersecurity services did or did not impair independence but agreed to reach out to Staff if any came to light. Accordingly, the Task Force does not recommend any specific guidance be developed at this time. However, if the Committee believes it would be helpful to heighten an awareness of cybersecurity services, the Task Force would recommend adding a reference to cybersecurity services to the fifth Information Technology Services FAQ as identified below:

5. Would supervising client personnel in the daily operation of the attest client’s financial information system **or cybersecurity program** 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]

Action Needed

The Committee is asked if there is anything else it would like the Task Force to consider or if the Task Force should be disbanded.

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 the Task Force's proposals to converge to the IESBA Part C standards and consider possible exposure to membership.

Summary of Issues

Background

The IESBA approved revised Section 320 and new Section 370 at its December 2015 meeting. At the PEEC's July 2016 meeting, the Committee considered both Sections 320 and 370 of the IESBA Code and provided its feedback to the Task Force with regards to possible convergence. The Committee was generally supportive of converging with the IESBA standards.

The Task Force has drafted proposed interpretations for purposes of converging with Sections 320 and 370 (see Agenda Items 4B and 4C). The guidance from Section 320 has been incorporated into the *Knowing Misrepresentations in the Preparation of Financial Statements or Records* Interpretation and the title has been broadened to state, *Knowing Misrepresentations in the Preparation and Presentation of Information*. Failure to comply with the requirements would therefore result in a violation of the Integrity and Objectivity Rule. The Task Force considered whether the guidance should also be incorporated into the *Negligence in the Preparation of Financial Statements or Records* interpretation under the Acts Discreditable Rule [2.400.040] and concluded it was unnecessary since the IESBA guidance is focused on the professional accountant acting with the intent to mislead (i.e., knowingly) rather than being negligent.

The guidance in Section 370 has been incorporated into a new interpretation under the Integrity and Objectivity Rule. The Committee should note that the IESBA standard addresses pressures that could result in a member taking actions that breach or cause others to breach the fundamental principles and does not focus specifically on the principles of Integrity or Objectivity. However, for purposes of the AICPA Code, an interpretation must be associated with a specific rule(s) and the Task Force believes the Integrity and Objectivity Rule is the most logical rule for purposes of the guidance.

Section 320/ Knowing Misrepresentations in the Preparation and Presentation of Information

As noted above, the guidance under the *Knowing Misrepresentations in the Preparation of Financial Statements or Records Interpretation* [2.130.010], now appears under par. .03 of the proposed Interpretation.

At the July 2016 meeting, one committee member suggested that the AICPA standard should only refer to “misleading” and not include the phrase, “influence contractual or regulatory outcomes inappropriately” as it was somewhat confusing. The Task Force considered this comment and believes that the second bullet in paragraph .02 should still include a requirement not to “influence contractual or regulatory outcomes inappropriately” but that additional references to this phrase within the standard, including the example of what would be considered to be “influencing contractual or regulatory outcomes inappropriately” should be deleted as it was unnecessary.

The Task Force also considered the guidance addressing the use of discretion to achieve inappropriate outcomes (par. .04). The Task Force had some concerns with the example addressing the timing of transactions. Specifically, the Task Force noted that even though the purpose of this example was to prohibit using discretion to determine the timing of transactions with the intent to mislead, it believed that members may interpret the example to prohibit the acceptable practice of using judgment to determine when a particular transaction should take place that would be in accordance with GAAP. Accordingly, the Task Force has recommended to delete this example but requests the Committee’s input on whether it should be included.

The Task Force has also incorporated language from the Subordination of Judgment Interpretation [2.130.020] into par. .10 of the proposed Interpretation and made reference to this Interpretation in par. .12. Other conforming and editorial revisions to the proposed Interpretation are also reflected in the marked version in Agenda Item 4B.

Action Needed:

1. The PEEC is asked whether they agree with the inclusion and placement of the *Knowing Misrepresentations in the Preparation of Financial Statements or Records Interpretation* within the proposed Interpretation.
2. The PEEC is asked for feedback on all other revisions made to the proposed Interpretation, including the deletion of the example addressing the timing of transactions.

Section 370/ Pressure to Breach the Integrity and Objectivity Rule

As noted above, the Task Force recommends that the guidance in Section 370 should be incorporated into a new interpretation under the Integrity and Objectivity Rule. Accordingly, the overarching requirement is that a member should not allow pressure from others to result in a breach of the Integrity and Objectivity Rule. The Task Force also believes that a member should not place pressure on other individuals that would cause such individuals to breach *any* of the Rules. If the member were to do so, the member would be considered to be in violation of the Integrity and Objectivity Rule.

The Task Force has made other conforming and editorial revisions to the proposed Interpretation that are reflected in the marked version in Agenda Item 4B.

Action Needed:

1. The PEEC is asked whether they agree that the guidance should focus on pressure to breach the Integrity and Objectivity Rule and therefore included as an Interpretation of such Rule.
2. The PEEC is asked whether they agree that with regard to a member who places pressure on another individual, the the member should not cause another individual to breach *any* of the Rules and if the member were to do so, the member would be considered to be in violation of the Integrity and Objectivity Rule.
3. The PEEC is asked for feedback on all other revisions made to the proposed Interpretation,

Materials Presented

Agenda 4A – This Agenda Item

Agenda 4B – Proposed Interpretations (Mark-up from IESBA Standards)

Agenda 4B – Proposed Interpretations (Clean Version)

IFAC Convergence – Part C – Sections 320 and 370
Mark up of IESBA Standard to Conform to AICPA Proposed Standard

2.130.010 Knowing Misrepresentations in the Preparation and Presentation of Information Financial Statements or Records

Preparation and Presentation of Information

320.01 ~~Professional accountants~~Members 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 employing 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.

320.02 ~~Professional accountants~~Members in business who are responsible for recording, maintaining, preparing, approving or presenting information ~~should~~shall do so in accordance with the Integrity and Objectivity Rule~~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~~not to mislead, including ~~not~~ to influence contractual or regulatory outcomes inappropriately.

- ~~Preparing or presenting information without omissions that would 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 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

- 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.

Preparation and Presentation of Financial Statements and Records

.03. 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

- a. makes, or permits or directs another to make, materially false and misleading entries in an entity's financial statements or records;
- 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
- c. signs, or permits or directs another to sign, a document containing materially false and misleading information

320.043 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~~ compliance with the Integrity and Objectivity Rule requires the ~~professional accountant~~ member 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 the level of reserves and 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.

Preparation and Presentation of Information Not Subject to Reporting Framework

320.405 When performing professional activities, especially those that do not require compliance with a relevant reporting framework, the ~~professional accountant shall~~ member should 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~~ member may also consider clarifying the intended audience, context and purpose of the information presented.

Reliance on the Work of Others

320.5.06 A ~~professional accountant~~ member 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 requirements~~ set out in paragraphs ~~.02 and .03~~ 320.2 are fulfilled. Factors to consider in determining whether reliance on others is reasonable include: reputation, 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.

Association with Misleading Information

320.6.07 If the ~~professional accountant~~ member knows or has reason to believe that the information with which ~~the professional accountant~~ he or she is associated is misleading, the ~~professional accountant shall~~ should apply take appropriate ~~safeguards~~ actions to seek to resolve the matter. Such ~~actions~~ safeguards 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~~ member's supervisor and/or the appropriate level(s) of management within the ~~professional accountant~~ member's employing 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 \(Open reference for NOCLAR\)](#) provides guidance relating to non-compliance with laws and regulations.

~~320.7.08~~ If the ~~professional accountant~~member determines that appropriate action has not been taken and continues to have reason to believe that the information is misleading, threats to compliance with the Integrity and Objectivity Rule would not be at an acceptable level. In such circumstances, the professional accountant, while being alert to the fundamental principle of confidentiality requirements of the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [2.400.070], ~~shall~~ should consider one or more of the following safeguards:

- 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, the organization's external accountant, or regulatory authorities.
- Consulting legal counsel regarding his or her responsibilities.

~~320.8.09~~ If after exhausting all feasible options, the ~~professional accountant~~member determines that appropriate action has not been taken and there is reason to believe that the information is still misleading, the ~~professional accountant~~member ~~shall~~ should refuse to be or to remain associated with the information. The ~~professional accountant~~member also ~~may~~ should consider his or her continuing relationship with resigning from the employing organization.

.10 Nothing in this interpretation precludes a member from resigning from the organization at any time. However, resignation may not relieve the member of responsibilities in the situation, including any responsibility to disclose concerns to third parties, such as regulatory authorities or the employer's (former employer's) external accountant.

.11 The professional accountant ~~member~~ 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~~member 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~~ .12 Where threats to compliance with the Integrity and Objectivity rule are due to differences of opinion between a member and his or her supervisor (or any other person within the member's organization) relating to the application of accounting principles; auditing standards; or other relevant professional standards, the member should also refer to the Subordination of Judgment Interpretation [2.130.020]. ~~compliance with the fundamental principles relating to the preparation and presentation of information arise from pressure, the guidance in Section 370 is relevant.~~

2.140.010 Pressure to Breach the Rules Fundamental Principles

370.01 This section addresses pressures that could result in a professional accountant member taking actions that breach or cause others to breach the rules particularly, the Integrity and Objectivity Rule fundamental principles.

370.02 A professional accountant member in business may face pressure that could create threats, for example, intimidation threats, to compliance with the fundamental principles Integrity and Objectivity Rule 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~~ A member should not allow pressure from others to result in a breach of the Integrity and Objectivity Rule fundamental principles. ~~The A professional accountant member~~ also ~~shall~~ should not place pressure on others that the professional accountant member knows, or has reason to believe, would result in the other individuals breaching the rules of the AICPA Code of Professional Conduct fundamental principles.

370.03 Examples of pressure that could result in a breach of the fundamental principles Integrity and Objectivity Rule include:

- Pressure related to conflicts of interest:
 - Pressure from a family member bidding to act as a vendor to the professional accountant member's employing organization to select them over another prospective vendor.

~~The guidance in~~ Refer to the Conflicts of Interest for Members in Business Interpretation [2.110.010] for additional guidance ~~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 government 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.~~ Refer to the Knowing Misrepresentations in the Preparation and Presentation of Information Interpretation [2.130.010]

- Pressure to act without sufficient [competence](#)~~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.

[Refer to the General Standards Rule \[2.300.001\] for additional](#) ~~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 [gifts or entertainment](#)~~inducements~~:
 - Pressure from others, either internal or external to the employing organization, to offer [inducements](#)~~gifts or entertainment~~ 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](#) in appropriate gifts or entertainment from potential vendors in a bidding process.

[Refer to the Offering or Accepting Gifts or Entertainment interpretation \[2.120.010\] for additional](#) ~~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.~~

[370.04](#) In determining whether the pressure could result in a breach of the [Integrity and Objectivity Rule](#)~~fundamental principles~~, the [professional accountant](#)~~member~~ 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 [requirements of the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation \[2.400.070\]](#), ~~fundamental principle of confidentiality~~, the ~~professional accountant in business~~ [member](#) may consult with:

- [A colleague, superior, human resources personnel, internal compliance personnel or another professional accountant;](#)
- Relevant professional or regulatory bodies or industry associations; or
- Legal counsel.

[370.05](#) If the ~~professional accountant~~ [member](#) determines that the pressure would result in a breach of the [Integrity and Objectivity Rule](#) ~~fundamental principles~~, the professional accountant may consider ~~actions~~ [safeguards](#), including:

- Discussing the matter with the individual who is exerting the pressure to seek to resolve it.
- Discussing the matter with the ~~professional accountant~~ [member](#)'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~~ [member](#) is no longer involved with the individual or entity exerting the pressure, where doing so would eliminate the pressure to breach the ~~fundamental principles~~ [Integrity and Objectivity Rule](#). For example, if a ~~professional accountant~~ [member](#) is pressured in relation to a conflict of interest, the pressure to breach the ~~fundamental principles~~ [Rule](#) may be eliminated if the ~~professional accountant~~ [member](#) 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.

[370.06](#) In situations where the ~~professional accountant~~ [member](#) determines that the pressure to breach the [Integrity and Objectivity Rule](#) ~~fundamental principles~~ has not been eliminated, the ~~professional accountant~~ [member should](#) ~~shall~~:

- Decline to undertake or discontinue the professional activity that would result in a breach of the ~~Rule~~ [fundamental principles](#); and
- Consider ~~resigning from his or her continuing relationship with~~ the employing organization.

| .07 The ~~professional accountant~~member 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 – Sections 320 and 370
Clean Version of IESBA Standard to Conform to AICPA Proposed Standard**

2.130.010 Knowing Misrepresentations in the Preparation and Presentation of Information

.01 Members 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 employing 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.

.02 Members in business who are responsible for recording, maintaining, preparing, approving or presenting information should do so in accordance with the Integrity and Objectivity Rule. This includes:

- Presenting the information in accordance with a relevant reporting framework, where applicable.
- Preparing or presenting information in a manner that is intended not to mislead, including not to influence contractual or regulatory outcomes inappropriately.
- Preparing or presenting information without omissions that would render the information misleading.

This responsibility involves using professional judgment to

- 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.

Preparation and Presentation of Financial Statements and Records

.03. 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*

- a. makes, or permits or directs another to make, materially false and misleading entries in an entity's *financial statements* or records;
- 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
- c. signs, or permits or directs another to sign, a document containing materially false and misleading information

.04. Preparing or presenting information may require the exercise of discretion in making professional judgments. Preparing or presenting such information in compliance with the Integrity and Objectivity Rule requires the member not to exercise such discretion with the intention of misleading. This includes not using discretion to achieve inappropriate outcomes in one or more of the following ways:

- Determining estimates. For example, determining the level of reserves and 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 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.

Preparation and Presentation of Information Not Subject to Reporting Framework

.05. When performing professional activities, especially those that do not require compliance with a relevant reporting framework, the member should 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 member may

also consider clarifying the intended audience, context and purpose of the information presented.

Reliance on the Work of Others

- .06 A member 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 requirements set out in paragraphs .02 and .03 are fulfilled. Factors to consider in determining whether reliance on others is reasonable include: reputation, 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.

Association with Misleading Information

- .07 If the member knows or has reason to believe that the information with which he or she is associated is misleading, the member should apply appropriate safeguards to seek to resolve the matter. Such safeguards 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 member's supervisor and/or the appropriate level(s) of management within the member's employing 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, (Open reference for NOCLAR) provides guidance relating to non-compliance with laws and regulations.

- .08 If the member determines that appropriate action has not been taken and continues to have reason to believe that the information is misleading, threats to compliance with the Integrity and Objectivity Rule would not be at an acceptable level. In such circumstances, the member, while being alert to the requirements of the [Confidential Information Obtained From Employment or Volunteer Activities](#) Interpretation [2.400.070], should consider one or more of the following safeguards:

- 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, the organization's external accountant, or regulatory authorities.

- Consulting legal counsel regarding his or her responsibilities.
- .09 If after exhausting all feasible options, the member determines that appropriate action has not been taken and there is reason to believe that the information is still misleading, the member should refuse to be or to remain associated with the information. The member also should consider his or her continuing relationship with the employing organization.
- .10 Nothing in this interpretation precludes a *member* from resigning from the organization at any time. However, resignation may not relieve the *member* of responsibilities in the situation, including any responsibility to disclose concerns to third parties, such as regulatory authorities or the employer's (former employer's) external accountant.
- .11 The member 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 member attempted to address the matter(s).
- .12 Where threats to compliance with the Integrity and Objectivity rule are due to differences of opinion between a member and his or her supervisor (or any other person within the *member's* organization) relating to the application of accounting principles; auditing standards; or other relevant professional standards, the member should also refer to the Subordination of Judgment Interpretation [2.130.020].

2.140.010 Pressure to Breach the Rules

- .01 This section addresses pressures that could result in a member taking actions that breach or cause others to breach the rules particularly, the Integrity and Objectivity Rule..
- .02 A member in business may face pressure that could create threats, for example, intimidation threats, to compliance with the Integrity and Objectivity Rule 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.
- A member should not allow pressure from others to result in a breach of the Integrity and Objectivity Rule. A member also should not place pressure on others that the member knows, or has reason to believe, would result in the other individuals breaching the rules of the AICPA Code of Professional Conduct.
- .03 Examples of pressure that could result in a breach of the Integrity and Objectivity Rule include:
- Pressure related to conflicts of interest:
 - Pressure from a family member bidding to act as a vendor to the member's employing organization to select them over another prospective vendor.
- Refer to the Conflicts of Interest for Members in Business Interpretation [2.110.010] for additional guidance.

- Pressure to influence presentation of information:
 - Pressure to report misleading financial results to meet investor, analyst or lender expectations.
 - Pressure from elected officials on government 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.

Refer to the Knowing Misrepresentations in the Preparation and Presentation of Information Interpretation [2.130.010]

- Pressure to act without sufficient competence 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.

Refer to the General Standards Rule [2.300.001] for additional guidance.

- 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.

- Pressure related to gifts or entertainment:
 - Pressure from others, either internal or external to the employing organization, to offer gifts or entertainment to inappropriately influence the judgment or decision-making process of an individual or organization.
 - Pressure from colleagues to accept inappropriate gifts or entertainment from potential vendors in a bidding process.

Refer to the Offering or Accepting Gifts or Entertainment interpretation [2.120.010] for additional guidance.

.04 In determining whether the pressure could result in a breach of the Integrity and Objectivity Rule, the member 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 requirements of the [Confidential Information Obtained From Employment or Volunteer Activities Interpretation \[2.400.070\]](#), the member may consult with:

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

.05 If the member determines that the pressure would result in a breach of the Integrity and Objectivity Rule, the professional accountant may consider safeguards, including:

- Discussing the matter with the individual who is exerting the pressure to seek to resolve it.
- Discussing the matter with the member'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 member is no longer involved with the individual or entity exerting the pressure, where doing so would eliminate the pressure to breach the Integrity and Objectivity Rule. For example, if a member is pressured in relation to a conflict of interest, the pressure to breach the Rule may be eliminated if the member 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.

.06 In situations where the member determines that the pressure to breach the Integrity and Objectivity Rule has not been eliminated, the member should:

- Decline to undertake or discontinue the professional activity that would result in a breach of the Rule; and

- Consider his or her continuing relationship with the employing organization.

.07 The member 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.

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 July 2016 PEEC meeting, the Leases Task Force (the “Task Force”) presented issues discussed by the Task Force and presented sample revisions to the PEEC for its feedback. The Task Force held a conference call in October 2016 to further discuss the feedback received from PEEC. The purpose of this agenda item is to update PEEC on the Task Force’s discussions and present additional revision options for the committee’s consideration.

Background

The extant AICPA Code addresses leasing arrangements and independence at the Leases Interpretation (1.260.040), which is presented below. 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.

1.260.040 Leases

.01 If a *covered member* enters into a leasing 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 (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]

Summary of Issues

At its July 2016 meeting, PEEC provided feedback to the Task Force on its progress and a sample revision (Option 2 at **Agenda Item 5B**). PEEC requested that the Task Force further consider the concept of “normal course of business” as it relates to lease terms/conditions, and to consider a more conceptual or principles-based approach as an additional option for revised guidance (Option 3, discussed below). The Task Force considered these and other issues via conference call in October 2016, as noted below.

Revision Option 2

At the July 2016 PEEC meeting, the Task Force presented a sample revision (Option 2) for consideration, which is presented at **Agenda Item 5B**. In general, the revision retains the extant Code position that finance leases (formerly capital leases) are loans and impair independence. However, Option 2 also indicates that operating leases and short term leases would not impair independence if the lease terms are established in the normal course of business and comparable to other leases of a similar nature, all amounts are paid in accordance with the lease terms, and the lease is immaterial to the lessee, lessor, and the financial statements being reported upon. The PEEC did not indicate any objection to the criteria noted in Option 2, but did express some concerns regarding the interpretation of “normal course of business” and regarding materiality. The Task Force discussed these issues and addresses them below.

Normal Course of Business

The Task Force’s Option 2 revision included the additional requirement that non-finance leases be entered into in the normal course of business, which was intended to mean that the lease should not be entered in for illegitimate reasons (such as solely to impact the financial statements) or under any undue influence or self-interest threats to independence, and should be at arm’s length. PEEC members expressed concern that usage of “normal course of business” may lead to confusion about whether the lessor is required to be in the line of business of leasing real or personal property. PEEC indicated that if the term is used, it should be clear that the term only applies to the terms and conditions of the lease, and not the lessor’s line of business. For example, a manufacturing attest client leases office property from an LLC, and wants to sublease its own space to the audit firm. Neither party is in the line of business of leasing property, however, the transaction would not be considered to be outside the normal course of business solely because the lessor is in the manufacturing business. If the terms and conditions of the lease were agreed upon to materially impact the financial statements being reported upon, the transaction would be considered outside the normal course.

The Task Force discussed the PEEC feedback, and noted that the extant AICPA Code does not use the term “normal course of business” in the authoritative guidance, but uses the term “normal business operations” to describe loans that are issued by a lending institution. Furthermore, the SEC independence guidance uses the term “normal course of business” and “ordinary course of business” interchangeably referring to leasing transactions that are outside the customary professional relationship. This is not consistent with the Task Force’s original intent of including the concept in its revision. After discussion, the Task Force determined that “normal course of business” is likely to cause more confusion than clarification. In addition, the Task Force generally agreed that the existing terminology (“terms and conditions are comparable with other leases of a similar nature”) adequately addresses the concerns of arm’s length transactions and “sweetheart deals.” Thus, the Task Force recommends excluding “normal course of business” from the Option 2 revision and future revisions that also include the extant language (See **Agenda Item 5B**).

Does PEEC agree that the existing terminology adequately addresses the concerns of “sweetheart deals” and arm’s length transactions? Does PEEC further agree that use of the term “normal course of business” may cause more confusion in the application of the rule, and should not be included in any revision?

If PEEC does not agree, the Task Force requests PEEC discuss the most appropriate manner of clarifying how the Code defines the normal course of business specifically for purposes of this interpretation, and the potential divergences in the application of the term between the AICPA and other bodies.

Materiality

In the course of discussing Option 2 at its July 2016 meeting, PEEC members expressed concern regarding the notion of assigning criteria or factors to materiality. To the extent criteria are assigned to materiality, it becomes prescriptive and eliminates professional judgment. Several members noted that the extant interpretation on leases is prescriptive, and expressed preference for something more principles-based. The Task Force discussed the PEEC concerns and agrees that the current interpretation is prescriptive. The Task Force’s view is that materiality of the lease is the primary factor that impacts the objectivity of a covered member who is a party to a lease with an attest client. Materiality is more relevant to independence than the criteria of finance or operating lease, therefore materiality should be the primary in the guidance as well. This view is consistent with current SEC requirements and is consistent with a more conceptual approach.

In the course of its discussion, the Task Force concluded that, at their core, leases are business relationships in that materiality drives objectivity much more so than whether the lease meets GAAP criteria for a capital lease. The Task Force further concluded that it is not appropriate to retain in the guidance the concept that GAAP lease criteria are the primary drivers of the threats to independence, and thus eliminate capital/finance and operating leases altogether. Doing so would be consistent with IESBA, SEC, and GAO, none of which base independence upon lease categorization. The Task Force also noted that GASB is issuing its final leases standard in 2016, and their standard does not include the concept of finance or operating leases; thus the applicability of guidance based upon GAAP treatment may not be applicable or practical for GASB engagements when there is otherwise no evaluation of whether a lease is operating or capital/finance. The Task Force also expressed concerns that GAAP may change again in the future, and that PEEC may inevitably have to revisit the issue of GAAP-based independence if it remains in the extant Code.

In light of the Task Force discussions, the Task Force has prepared Option 3 at **Agenda Item 5B** for PEEC consideration and feedback.

Does PEEC agree with the Task Force’s conclusion that materiality impacts objectivity the most, and that the accounting classification of a lease much less of impact, if any, on the threat to a covered member’s independence?

Does PEEC agree that removal of the concept of GAAP treatment driving independence is appropriate as presented in Option 3?

Consistency Concerns

The Task Force discussed concerns regarding consistency with other bodies' independence rules as well as consistency with other areas of the extant AICPA Code (i.e. Loans Interpretation). A summary and requests to PEEC are discussed below.

External – IESBA, SEC, GAO

As noted above, the Task Force discussed consistency with other bodies and the application of the Code by members who perform engagements under multiple rule sets. The AICPA State and Local Government Expert Group ("SLG") reached out to Staff with concerns that the divergence between the GAAP and GASB accounting standards may lead to unintended consequences for those performing GASB engagements, as the concept of finance or operating lease will not be in the GASB standard. The Task Force concluded that Option 3 adequately addressed the concerns expressed by the SLG.

The Task Force also noted that Option 3 would make the conclusion for most leases under AICPA Code more consistent with conclusions of members also subject to the independence requirements of IESBA, SEC, and GAO in that independence evaluation is fully independent of the accounting categorization of the lease. To facilitate discussion of consistency, the Task Force has prepared a table comparing the apparent conclusions of various bodies' independence rules with the AICPA Code at **Agenda Item 5C**. The table also indicates the conclusion under Options 2 and 3. Note that under Options 2 and 3, the conclusions for immaterial finance leases (not impaired) and material operating leases (impaired) are similar to the conclusions of other bodies' requirements. In contrast, the extant AICPA Code diverges toward a conclusion that independence is impaired for immaterial finance leases and not impaired for material operating leases. This extant Code conclusion is inherently based upon the accounting categorization and is currently not consistent with the other bodies that members practice under.

Internal – Immaterial Finance Leases versus Immaterial Loans and Automobile Leases

A background on this issue, the Task Force notes that the 2003 Exposure Draft (**Agenda Item 5D**) held a similar position to the Task Force, in that materiality and not the accounting treatment is the primary factor of independence regarding leases. In the 2003 Exposure Draft, PEEC's position was that regardless of whether a lease is classified as an operating lease or capital lease, independence should be impaired unless the lease is immaterial; the lease is under the lessor's normal terms, procedures, and requirements; and payments are kept current at all times. According to minutes, the exposed revisions to the Code were not adopted by PEEC because the revisions would be inconsistent with the 2003 AICPA Code prohibition of immaterial unsecured loans; i.e. an immaterial finance lease would be allowed, but an immaterial unsecured loan would not be allowed. There were also concerns regarding how to measure materiality and unspecified inconsistencies with the existing SEC rules. The current AICPA Loans Interpretation [1.260.010] prohibits the existence of a loan between a covered member and an attest client during the period of professional engagement, with certain exceptions for loans with lending institution clients as noted in the Loans and Leases with Lending Institutions Interpretation [1.260.020]. The loan exceptions relevant to this topic include immaterial unsecured loans with lending institutions and automobile loans and leases with lending institutions collateralized by the automobile.

Under the current AICPA Code, an immaterial unsecured loan is prohibited if between a covered member and a non-lending institution client. The extant AICPA Code also states that capital leases are considered loans, but also specifically excludes leases from the definition of a loan. The Task Force's view is that specifically excluding leases from the definition of a loan is appropriate, but that classifying all capital finance leases as loans is not consistent with the

defined view that leases are not loans. In conjunction with the exclusion of leases from loans, the concept that a capital lease is a loan can only be based upon the accounting treatment and GAAP criteria, and is not based on materiality in any way. Thus, independence based on GAAP criteria ties independence directly to ratios of asset value and economic life, rather than utilizing professional judgment and a threats/safeguards approach with materiality consideration.

Automobile leases are specifically allowed as an exception to the Loans Interpretation, but only if with a lending institution and collateralized by the automobile, without regard to materiality. The leases must also remain current and be under the lending institution's normal terms, procedures, and requirements. Related to that, the Leases Interpretation and the sample revisions specifically exclude these leases from its requirements, meaning that an automobile lease with a non-lending institution client is and would be prohibited, regardless of materiality. Thus, any revision of the Leases Interpretation that includes materiality will still not allow immaterial automobile leases with non-lending institution attest clients, while allowing all other immaterial leases of other types of property. The Task Force's view is that the conclusion for leases for automobiles and leases of other property should be the same from an independence perspective. Some believe that this issue may necessitate deletion of automobile leases from the Loans topic and inclusion in the Leases interpretation is appropriate to address this inconsistency.

Does PEEC agree that an approach centered on materiality regardless of the categorization of a lease as finance or operating is appropriate and would lead to more consistency with other bodies, and is in the public interest? See Option 3 discussion below.

Does PEEC believe that the perceived inconsistency between allowing an immaterial finance lease and prohibiting immaterial unsecured loans with non-lending institution attest clients is so significant that it prohibits the use of materiality in the Leases Interpretation? If PEEC thinks it is significant, the Task Force suggests consideration of charging a separate task force or subgroup of PEEC to address immaterial unsecured loans from non-lending institution attest clients and whether those should continue to be prohibited.

If PEEC includes materiality in the Leases Interpretation, does PEEC agree that automobile leases should not be subject to more restrictive requirements than all other property (i.e. immaterial auto leases not allowed)? If so, does PEEC believe that it is appropriate to consider deleting automobile leases from the Loans topic and include them in the revised Leases Interpretation?

Option 3 – Conceptual Approach

The Task Force unanimously supports Option 3 as the most appropriate approach to the Leases Interpretation, for the reasons noted in this agenda. The Task Force's conclusion that GAAP criteria are not applicable to independence and a covered member's objectivity leads the group to unanimously recommend pursuing Option 3 as the revised Leases Interpretation. This is consistent with PEEC's request for a more conceptual and principles based approach to leases that addresses the factor(s) that truly impact independence.

Does PEEC agree that Option 3 as the most appropriate approach to revising the Leases Interpretation?

Grandfathering

The Task Force continues to agree with PEEC's position that all permitted operating leases in existence at the effective date of the revision would not impair independence. Grandfathering provisions have been included in Options 2 and 3 at **Agenda Item 5B**.

Effective Date

The FASB Update is effective for fiscal years beginning after December 15, 2018 for public companies and December 18, 2019 for private companies. The Task Force sees no reason to deviate from a similar timeline, with early adoption permitted. This will be addressed by the Task Force when or if an exposure draft is considered.

Action Needed

The Task Force requests that PEEC discuss the issues noted above and provide feedback on the Task Force's direction as noted.

Communications Plan

The Task Force will take PEEC's input on the issues noted above and will report its progress to PEEC at its next meeting in early 2017.

Materials Presented

Agenda Item 5B: Revisions to the Leases Interpretation

Agenda Item 5C: Independence Conclusion Comparison (AICPA / IESBA / SEC / GAO)

Agenda Item 5D: 2003 Exposure Draft

Agenda Item 5E: SEC Codification with select examples

Sample Revisions to the AICPA Code

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

Option 1: Conforming Revisions Only

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]

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.

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).

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]

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.

Option 3: Principles Based / Conceptual Approach

1.260.040 Leases

.01 If a *covered member* enters into ~~has~~ a leasing agreement (as described in GAAP) with an *attest client* during the *period of the professional engagement*, ~~the self-interest, familiarity, and undue influence threats 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, during the period of the professional engagement, the lease is material to the covered member or the attest client. Accordingly, independence would not be impaired. For other leases, threats 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. **b.** 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].

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.

~~.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]~~

Comparison of AICPA to Other Regulators – Impact of Lease Types on Independence

Type of Lease (GAAP / IFRS)	AICPA – Operating leases and finance leases Extant AICPA Code	IESBA – Conceptual Framework approach	SEC: Direct / material indirect business relationships outside ordinary course of business (“OCB”)	GAO – Conceptual Framework approach
Leases in General	Operating leases do not impair independence if terms comparable to similar leases and payments kept current. All finance leases impair independence.	Leases not specifically addressed, use conceptual framework approach.	Direct or material indirect business relationships outside OCB prohibited. SEC Codif indicates exception for immaterial landlord / tenant agreements.	Leases not specifically addressed, use conceptual framework approach.
Finance lease – material	Impaired	Threats/Safeguards	Impaired (material)	Threats/Safeguards
Finance lease – immaterial	Impaired	Threats/Safeguards	Possibly impaired (direct); but may meet immaterial landlord / tenant exception.	Threats/Safeguards
Operating lease – material	Not impaired (impaired under Option 2/3 - material)	Threats/Safeguards	Impaired (material)	Threats/Safeguards
Operating lease – immaterial	Not impaired	Threats/Safeguards	Possibly impaired (direct); but may meet immaterial landlord / tenant exception.	Threats/Safeguards
Short term lease – material	Not impaired (impaired under Option 2/3 - material)	Threats/Safeguards	Impaired (material)	Threats/Safeguards
Short term lease – immaterial	Not impaired	Threats/Safeguards	Possibly impaired (direct); but may meet immaterial landlord / tenant exception.	Threats/Safeguards
Small asset leases (IFRS) – material	Not impaired (impaired under Option 2/3 - material)	Threats/Safeguards	Impaired (material)	Threats/Safeguards
Small asset leases (IFRS) – immaterial	Not impaired	Threats/Safeguards	Possibly impaired (direct) and not likely to meet immaterial landlord / tenant exception	Threats/Safeguards

2003 PEEC Exposure Draft Revisions

2003 Exposure Draft – Immaterial capital leases would no longer impair independence.

In 2003, PEEC issued an Exposure Draft proposing revisions to Ethics Ruling No. 91. According to the Exposure Draft, PEEC's position was that "regardless of whether a lease is classified as an operating lease or a capital lease, independence should be considered impaired if a covered member leased personal or business property to or from a client, unless the lease was immaterial to the lessee and lessor, and certain other criteria are met. Accordingly...immaterial capital leases would no longer be deemed to impair independence." The exposed revision to Ethics Ruling No. 91 appears below, with additions in bold italic and deletions in strikethrough:

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.

SEC Rules and Examples

SEC Independence Rules: 210.2-01 (c)(3)

(3) Business relationships. An accountant is not independent if, at any point during the audit and professional engagement period, **the accounting firm or any covered person in the firm has any direct or material indirect business relationship** with an audit client, or with persons associated with the audit client in a decision-making capacity, such as an audit client's officers, directors, or substantial stockholders. The relationships described in this paragraph **do not include a relationship in which the accounting firm or covered person in the firm provides professional services to an audit client or is a consumer in the ordinary course of business.**

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:

[AICPA Staff Note: Examples 1-8 and 13-22 not presented]

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.

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, 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 the Agenda

The Task Force seeks the Committee's feedback on the Task Force's draft revised interpretation. Since the revisions to the interpretation are so significant they are not shown in track changes.

Summary of Issues

Since the July meeting the focus of the Task Force's discussions have been with regard to upstream affiliates and brother/sister entities. Following is a summary of the Task Force's recommendations on these areas.

Upstream Affiliates

When a fund or component unit is a financial statement attest client and the primary government is not, the extant guidance does not require the member apply the independence rules to the primary government. After further discussion, the Task Force is proposing a change of position when the fund or component unit is *material* to the primary government. Specifically, the Task Force recommends that members be required to be independent of the primary government when the financial statement attest client is material to the primary government unless the member can rebut the presumption that the primary government has more than minimal influence over the fund or component unit's accounting or financial reporting process. However, even if the member is not able to rebut this presumption, the Task Force believes that the exceptions provided for in the [Client Affiliates](#) interpretation should be available to members in the SLG environment.

The Task Force's recommendations can be found in paragraphs .09 and .10 of **Agenda Item 6B** and **Agenda Item 6C** is a visual aid of an example of how the guidance would apply upstream.

Questions For the Committee

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

Primary Government Definition

When discussing upstream affiliates Staff used the term "upstream reporting entity" to describe the entity(ies) that would be captured by the guidance. However, some members of the Task Force were concerned that users would not understand what this

meant and so instead the Task Force developed the following definition for the term “Primary Government” that it recommends be added to the 0.400 section of the Code so that it can be linked to the definition throughout the interpretation. Item (1) would pull in the entities that are “downstream” from the financial statement attest client while item (2) would pull in the “upstream” entity.

Primary Government. The primary government includes (1) the [financial statement attest client](#) and all entities that are included or required to be included in the [financial statement attest client’s](#) reporting entity under the applicable financial reporting framework or (2) the reporting entity in which the [attest client’s financial statements](#) are included or are required to be included under the applicable financial reporting framework. For purposes of this definition the applicable financial reporting framework is as defined in the auditing standards (for example, governmental GAAP, regulatory basis, cash basis, modified cash basis).

Question For The Committee

1. Are there any revisions the Committee believes should be made to this definition and do you agree that it should be added to the 0.400 section of the Code and not defined for use only in the interpretation?

Brother/Sister Entities

When a fund or component unit is a financial statement attest client and the primary government is not, the extant guidance does not require the member apply the independence rules to other funds and component units (brother/sister entities) in the reporting entity. Although the Task Force agrees that members should not have to automatically apply the independence rules to brother/sister entities, it believes there could be situations that could create threats to member’s independence. As such, the Task Force recommends when a members knows or has reason to believe a relationship or circumstance with one of the brother/sister entities would create threats to the member’s independence with respect to the financial statement attest client, the member should use the Conceptual Framework for Independence to evaluate those threats.

The Task Force’s recommendations can be found in paragraphs .11 of **Agenda Item 6B**.

Visual Aids and Frequently Asked Questions and Answers

The Task Force believes that it would be helpful to issue FAQs and visual aids to provide further insight and guidance on certain issues.

Action Needed

The Committee is asked to provide feedback on the draft revised interpretation.

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 and plans to update them again after this meeting.

Materials Presented

Agenda Item 6B Draft Interpretation
Agenda Item 6C Visual Aid – Upstream

Agenda Item 6B

0.400.XX **Primary Government.** The primary government includes (1) the [*financial statement attest client*](#) and all entities that are included or required to be included in the [*financial statement attest client's*](#) reporting entity under the applicable financial reporting framework or (2) the reporting entity in which the [*attest client's financial statements*](#) are included or are required to be included under the applicable financial reporting framework. For purposes of this definition the applicable financial reporting framework is as defined in the auditing standards (for example, governmental GAAP, regulatory basis, cash basis, modified cash basis).

1.224.020 Entities Included in State and Local Government Financial Statements

Introduction

- .01 This [interpretation](#) provides guidance on which entities should be subject to the [Independence Rule](#) [1.200.001] and related [interpretations](#) of the AICPA Code of Professional Conduct because the entities have some relationship to a [financial statement attest client](#) that is a state and local government entity.
- .02 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 financial reporting framework, to be included in the reporting entity of a **primary government**. For purposes of this interpretation the applicable financial reporting framework is as defined in the auditing standards (for example, governmental GAAP, regulatory basis, cash basis, modified cash basis).
- .03 For purposes of this [interpretation](#), state and local governmental entities include:
- a. General purpose governments such as states, counties, cities, towns, villages and special purpose governments that perform limited activity.
 - i. Examples of special purpose governments include, but are not limited to, cemetery districts, school districts, universities and colleges, utilities, hospitals or other health care organizations, and public employee retirement systems (PERSs).
 - b. Funds and component units. 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.

Investments Held By a State and Local Government Entity

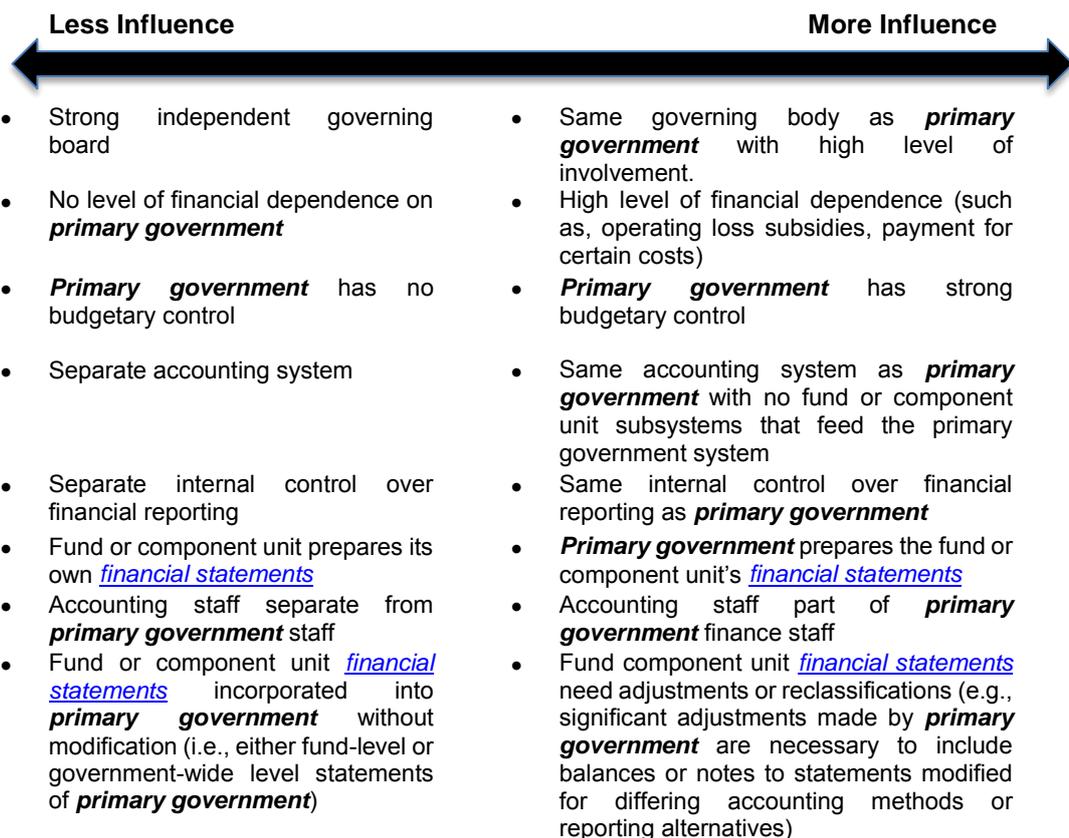
- .04 [Members](#) should apply the [Client Affiliate](#) interpretation [1.224.010] and related [affiliate](#) definition [0.400.02] to investments. An investment is a security or other asset that (a) the entity holds primarily for the purpose of income or profit and (b) has a present service capacity 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 GASB Codification 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](#).

Primary Government Is a Financial Statement Attest Client

- .05 When performing a [financial statement attest engagement](#) for a **primary government**, [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 financial reporting framework except in the following specific situations.
- a. When the [covered 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** provided it is reasonable to conclude that the material fund or component unit will not be subject to financial statement attest procedures by 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 should use the Conceptual Framework for Independence [1.210.010] 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 nonattest services that impair independence 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 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
 - 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 as the **primary government**.
 - 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 .06 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's 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's or component unit's financial statements made by the **primary government** to revise the fund's or component unit's financial information for accounting methods or reporting alternatives?

Fund or Component Unit Is a Financial Statement Attest Client

- .09 When a fund or component unit is a financial statement attest client but the **primary government** is not a financial statement attest client, covered members do not need to apply the "Independence Rule" [1.200.001] and related interpretations applicable to the financial statement attest client to the **primary government** when the financial statement attest client is immaterial to the **primary government**. However, when the financial statement attest client is material to the **primary government**, covered members need to apply the "Independence Rule" [1.200.001] and related interpretations applicable to the financial statement attest client to the **primary government** unless the covered member can rebut the presumption that the **primary government** has more than minimal influence over the accounting or financial reporting process of the financial statement attest client. See paragraphs .06 and .07 for factors that may demonstrate that the **primary government** has only minimal influence.
- .10 When independence is required for the **primary government**, the following exceptions may be applied:
- 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 the **primary government** 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 **primary government**. 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 **primary government**, 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].
 - A member or the member's firm may provide prohibited nonattest services to the **primary government** 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.
 - 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 is employed by the **primary government** and 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 the **primary government** 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 **primary government** is not a key position.

- d. A covered member's immediate family members and close relatives may be employed in a key position at the **primary government** 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.

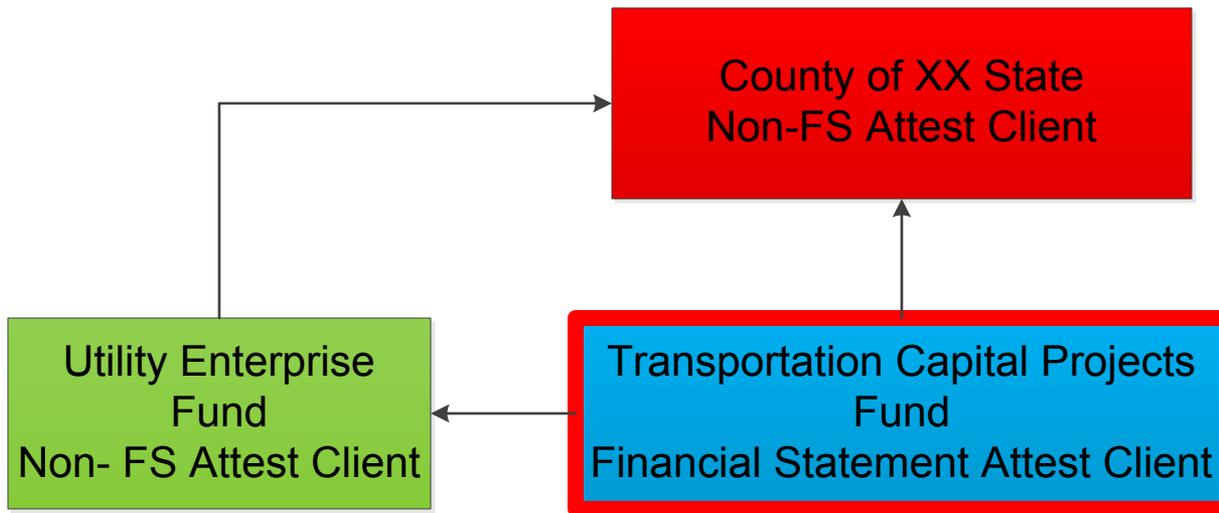
Primary Government and Other Funds or Component Units Included in the Primary Government and Are Not Financial Statement Attest Clients

- .11 When a covered member provides financial statement attest services to a fund or component unit that is included in the reporting entity of the **primary government**, the covered member does not need to apply the “Independence Rule” [1.200.001] and related interpretations applicable to a financial statement attest client, to other funds and component units in that reporting entity provided the covered member does not provide financial statement attest services to either the **primary government** or to the other funds or component units. However, if the covered member knows or has reason to believe a relationship or circumstance with one of the other funds or component units exists that creates threats with respect to the financial statement attest client, the covered member should evaluate the effect that the relationship or circumstance would have on the covered member's independence by applying the Conceptual Framework for Independence [1.210.010].

Upstream Visual Aid

Agenda Item 6C

Financial Statement Attest Client is a Fund

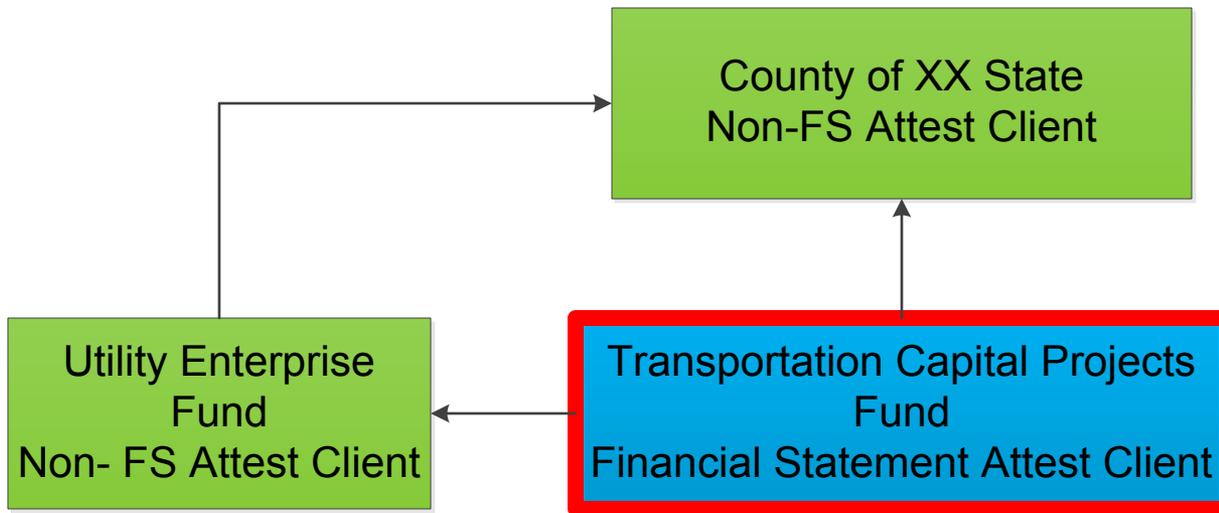


- Firm A audits Transportation Capital Projects Fund.
- Firm A does not provide any financial statement attest services to County of XX State or to Utility Enterprise Fund.
- The County of XX State (primary government) is audited by a Firm B and makes reference to Firm A's audit report for the Transportation Capital Projects Fund which is material to the County of XX State. The County of XX State also has more than minimal influence over the accounting or financial reporting process of Transportation Capital Projects Fund,
- County of XX State is an affiliate to the Transportation Capital Projects Fund and the independence rules are applicable. Firm A must consider independence with respect to County of XX State. (ET 1.224.020.09-.10)
- The Utility Enterprise Fund is not an affiliate of the Transportation Capital Projects Fund (ET 1.224.020.11)

- Financial Statement Attest Client
- Independence required
- Independence may be required
- Independence not required

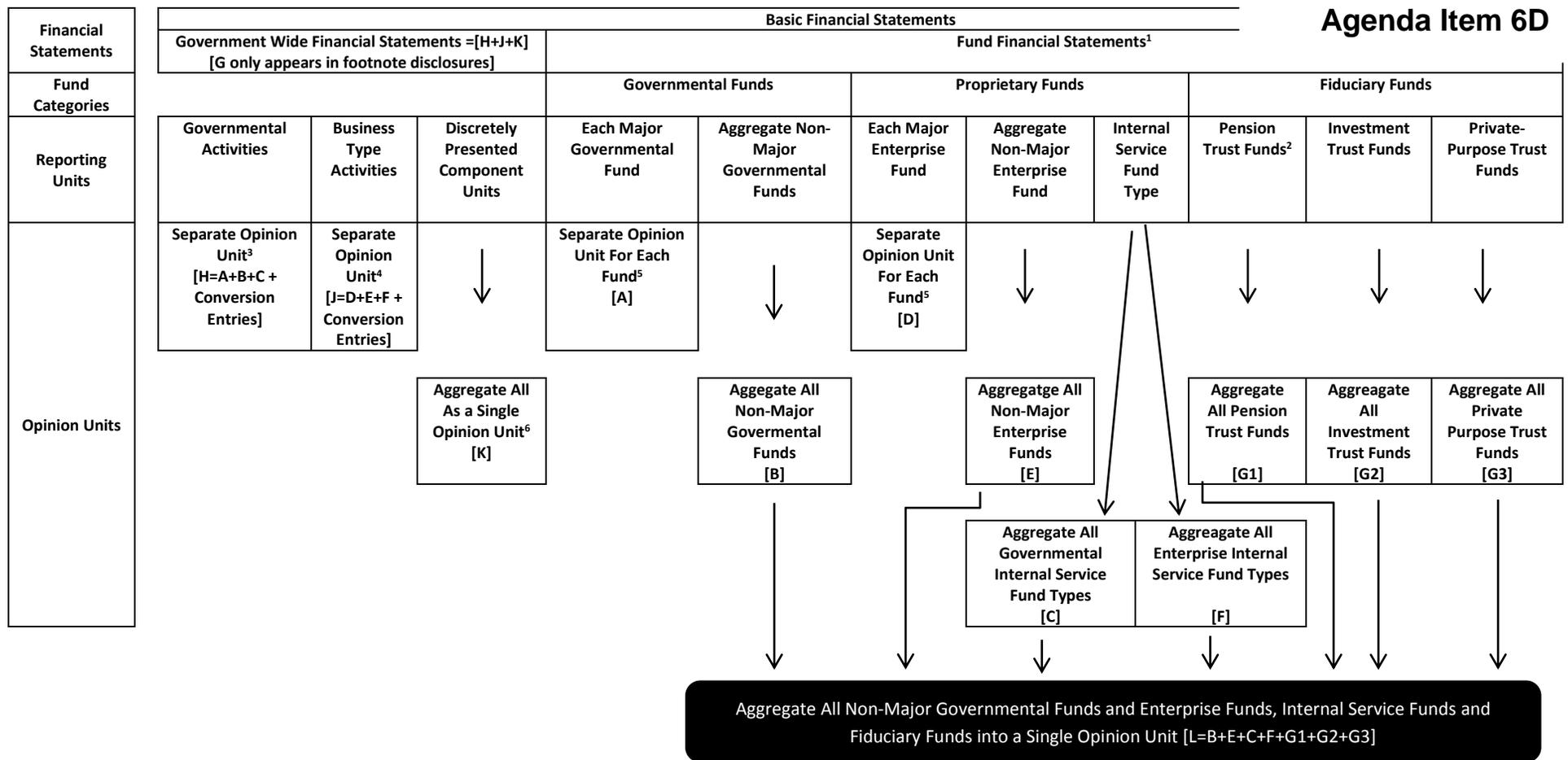
Upstream Visual Aid

Financial Statement Attest Client is a Fund



- Firm A audits Transportation Capital Projects Fund.
- Firm A does not provide any financial statement attest services to County of XX State or to Utility Enterprise Fund.
- The County of XX State (primary government) is audited by a Firm B and makes reference to Firm A's audit report for the Transportation Capital Projects Fund which is **NOT** material to the County of XX State. The County of XX State has more than minimal influence over the accounting or financial reporting process of Transportation Capital Projects Fund,
- County of XX State is **NOT** an affiliate to the Transportation Capital Projects Fund and the independence rules are **NOT** applicable. Firm A does not have to consider independence with respect to County of XX State. (ET 1.224.020.09-.10)
- The Utility Enterprise Fund is not an affiliate of the Transportation Capital Projects Fund (ET 1.224.020.11)

- Financial Statement Attest Client
- Independence required
- Independence may be required
- Independence not required



¹ 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.

² In addition to pension trust funds, this fund includes other employee benefit trust funds.

³ 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

⁴ 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.

⁵ 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.

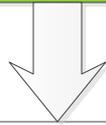
⁶ Aggregate discretely presented component units opinion unit is comprised of separate legal entities where the primary government has financial [control] sufficient to require the inclusion of that entity into the Government Wide Financial Statements because the relationship is not so close that is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

Downstream Exceptions

Entities Audited By Another Auditor

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

Current Interpretation



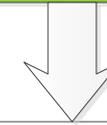
Proposed Interpretation

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 Will Not Be Subject to Financial Statement Attest Procedures of the Member	Entity Will 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

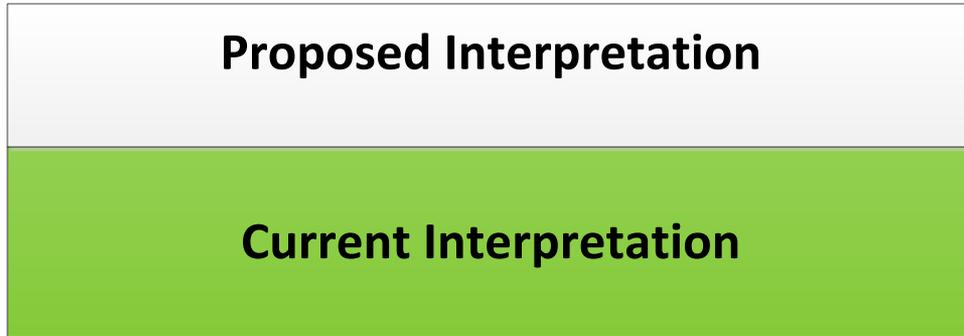
Excluded Entity is Immaterial to Primary Government	Excluded Entity is Material to Primary Government (Will the Exclusion Result in GAAP Departure?)	
	Primary Government Has Only Minimal Influence Over the Accounting or Financial Reporting Process of Excluded Entity	Primary Government Has More Than Minimal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

How Entities Audited By Another Auditor Handled



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

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

- Independence Not Required
- Must 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

How Excluded Entities Handled

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

Current Interpretation

Proposed Interpretation

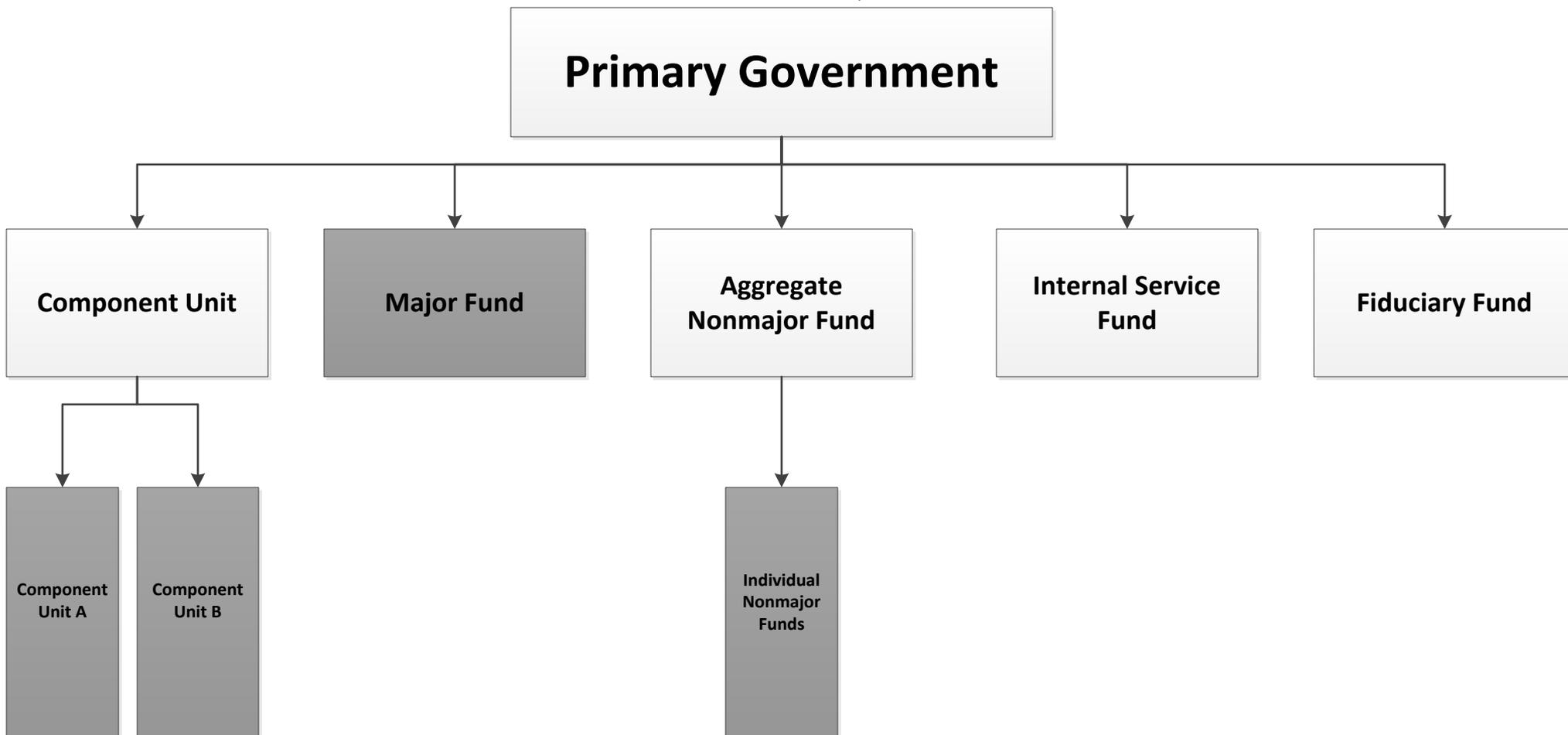
Excluded Entity That is Immaterial to Primary Government	Excluded Entity is Material to Primary Government	
	Primary Government Has Only Minimal Influence Over the Accounting or Financial Reporting Process of Excluded Entity	Primary Government Has More Than Minimal Influence Over the Accounting or Financial Reporting Process of Excluded Entity

 Independence Not Required

 Independence Required With An Exception Available for Nonattest Services When Reasonable to Conclude Services Will Not Be Subject To Attest Procedures

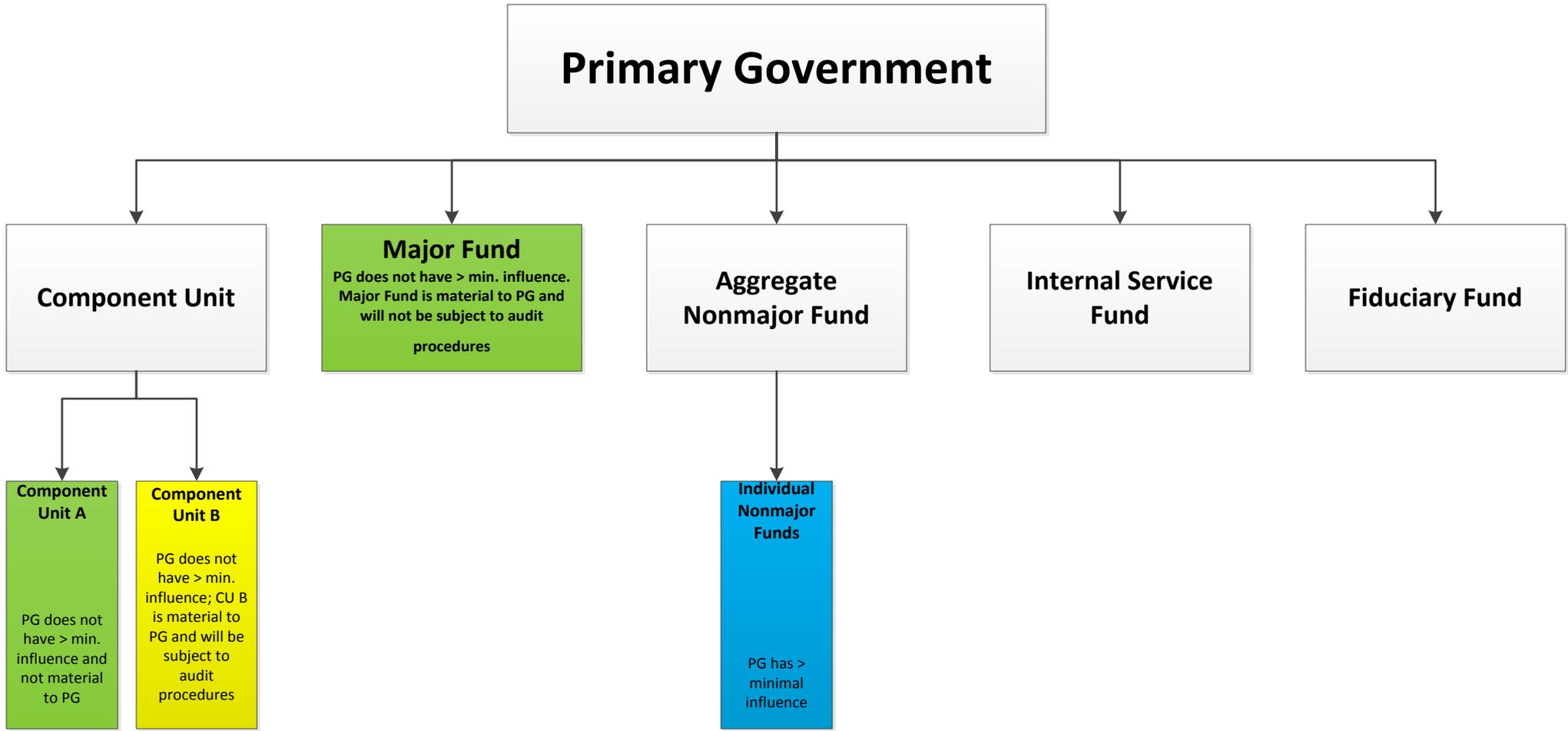
Entities Audited By Another Auditor

(Funds and Component Units that Auditor of Primary Government Makes Reference to Other Auditors Reports Are Shaded)



Entities Audited By Another Auditor

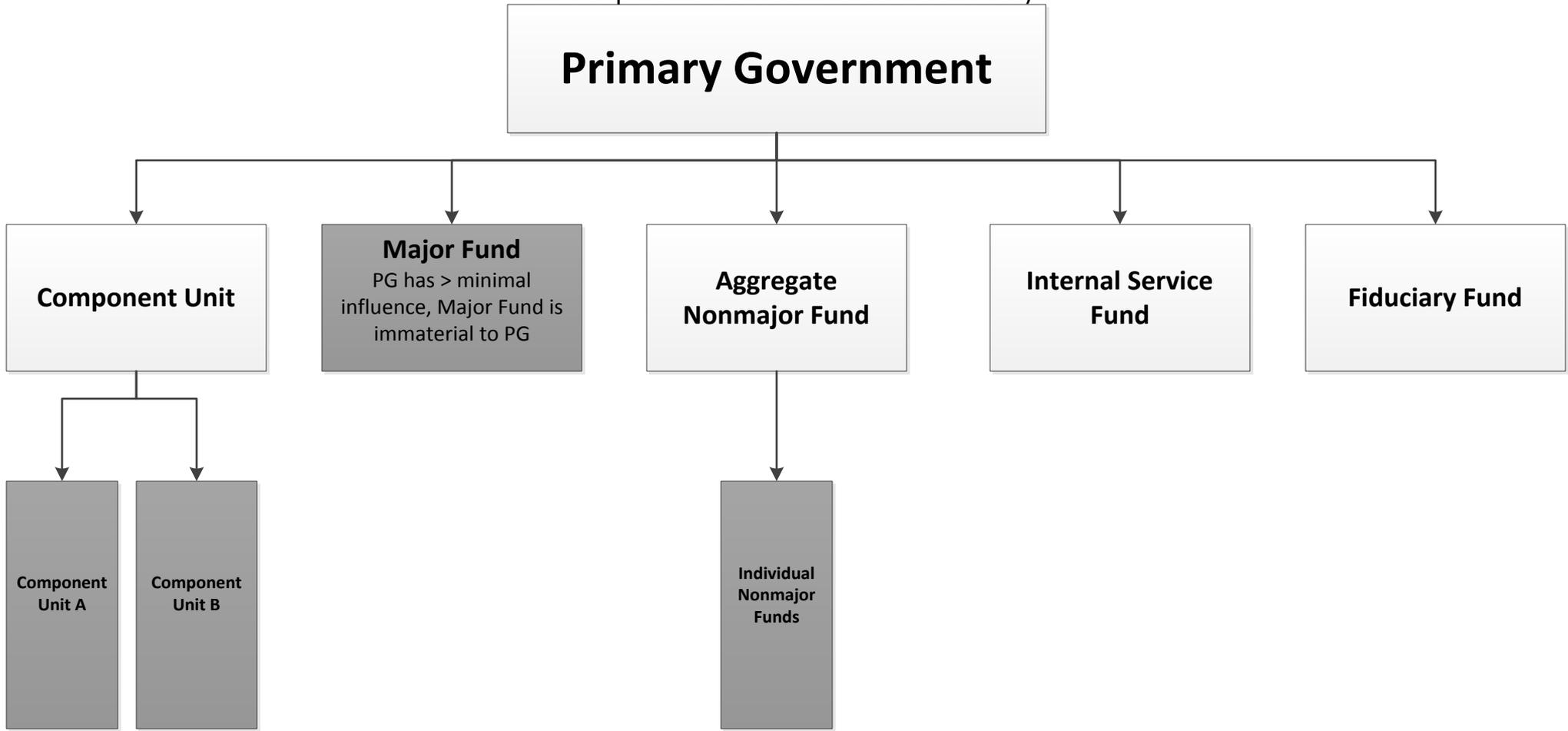
(Funds and Component Units that Auditor of Primary Government Makes Reference to Other Auditors Reports Are Shaded)



	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
	Independence Required

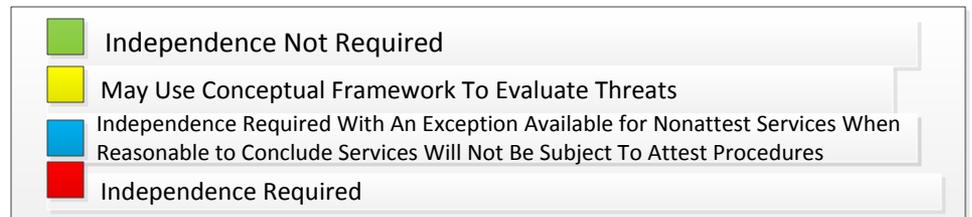
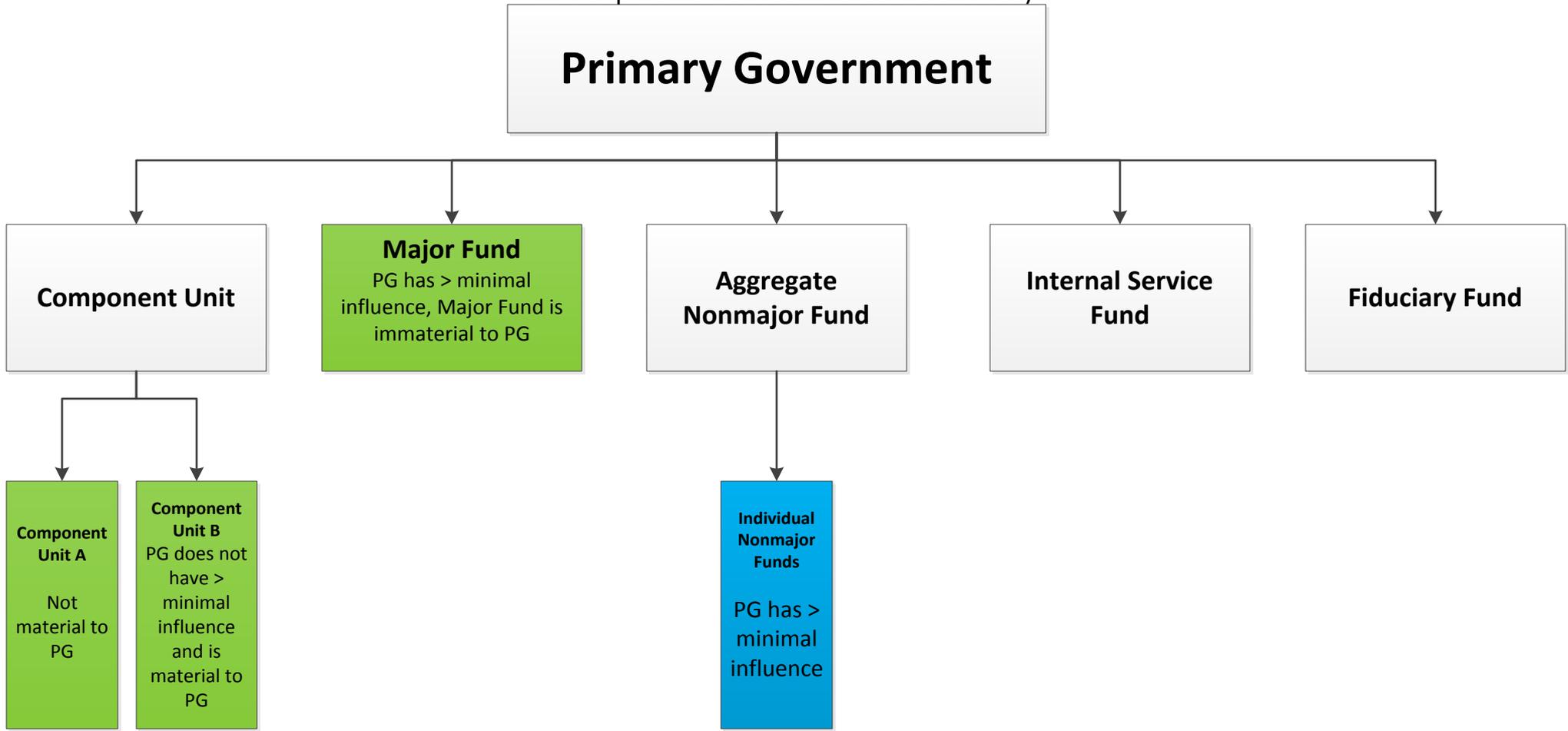
Entities Excluded

(Funds and Component Units that are excluded by the Primary Government under the applicable framework resulting in a departure from standards are shaded)



Entities Excluded

(Funds and Component Units that are excluded by the Primary Government under the applicable framework resulting in a departure from standards are shaded)



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) standards entitled, Responding to 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 recommendations and conclusions.

Summary of Issues

Background

The final NOCLAR pronouncement was approved by the IESBA in April 2016 and will become effective July 15, 2017. Agenda Item 7C contains the final NOCLAR standards issued by IESBA. At the PEEC's July 2016 meeting, the Committee provided feedback to the NOCLAR Convergence Task Force with regard to its preliminary conclusions on convergence with the IESBA standards. Since the July meeting, the NOCLAR Convergence Task Force has held two conference call meetings to consider the Committee's feedback and to draft proposals for purposes of convergence.

The Task Force reviewed the IESBA NOCLAR standards for both professional accountants in public practice (PAPPs) and professional accountants in business (PAIBs) and has drafted two proposed interpretations for the Committee's consideration. The Task Force's recommendations are discussed below. The Committee should note that when referring to NOCLAR in this agenda item, the term NOCLAR includes both identified as well as suspected NOCLAR.

Confidentiality

At the July 2016 meeting, the Committee discussed the NOCLAR provisions that would permit a professional accountant to override the confidentiality requirement for clients and employers if certain conditions were met and the accountant believed it was in the public interest to disclose the NOCLAR to an outside authority and/or external auditor. The Committee considered the fact that the IESBA provisions precluded disclosure if the laws or regulations in the jurisdiction prohibited disclosure. Based on research performed, it was noted that only eight state boards of accountancy would permit a licensee to disclose a NOCLAR to an outside authority. It was further noted that if the PEEC were to permit such disclosure, it would require a change to the Confidential Client Information Rule which requires a membership ballot.

The PEEC generally agreed that based on the fact that most state laws would prohibit disclosure, the AICPA guidance should not converge with the IESBA standard and permit a PAPP or PAIB to disclose a NOCLAR to an outside authority unless required by law or with the client or employer's consent. The Committee further agreed that due to state confidentiality laws, the AICPA guidance should not converge with the IESBA standard by permitting a PAPP to disclose

a NOCLAR to the client's external auditor or successor accountant. The Committee did agree, however, that if the client was also an audit client of the firm, there should be a requirement to disclose the NOCLAR within the firm in accordance with the firm's policies and procedures (or to the audit engagement partner if no such policies exist). To clarify that PAPPs are not permitted to disclose a NOCLAR to the external auditor, the Task Force proposes to add the following paragraph:

"If the member is performing a service for a client that is not a financial statement audit or review client of the firm, except as required by law or regulation, the member is not permitted to communicate the non-compliance or suspected non-compliance to the firm that is the client's external auditor, if any. See "[Confidential Client Information Rule](#)" [1.700.001]"

Finally, the Committee agreed with the IESBA position that a PAIB should be permitted to disclose a NOCLAR to the company's auditor if doing so was part of the PAIB's obligation to provide all relevant facts when dealing with the auditor. The Task Force noted that this would be consistent with the following interpretation:

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.

Some members of the Task Force, however, believed a member in business should be permitted to disclose a NOCLAR to the external auditor regardless of whether the member deals directly with the auditor as part of the audit.

Action Needed:

1. Does the Committee agree that the member should not be permitted to override the confidentiality requirements and disclose a NOCLAR to an outside authority unless required by law or with the client or employer's consent?
2. Does the Committee agree that a member in public practice should not be permitted to override the confidentiality requirements and disclose a NOCLAR to the client's external auditor (i.e., outside the firm) or successor accountant?
3. Does the Committee agree that a member in business should be permitted to disclose a NOCLAR to the company's auditor:
 - a. If doing so was part of the member's obligation to provide all relevant facts when dealing with the auditor?
 - b. Regardless of whether the member deals directly with the auditor as part of his or her responsibilities?
4. Does the Committee agree with the additional paragraph to clarify that members in public practice are prohibited from disclosing the NOCLAR?

Audit vs. All Other Services

The IESBA standard for PAPPs differentiates between requirements for the auditor and requirements for professional accountants performing all other services (including review and other assurance services). PAPPs who are auditors are subject to more stringent requirements, including required documentation and disclosure to group/component auditors. In the explanatory memorandum of the NOCLAR exposure draft, the IESBA provided the following rationale:

81. Pursuant to a matter raised during consultation with the IESBA CAG, the Board considered whether the approach to responding to NOCLAR or suspected NOCLAR for PAs in public practice should be distinguished between assurance engagements more broadly (including audit and review engagements) and non-assurance engagements, rather than between audits and other services. It was noted at the CAG in particular that PAs performing review engagements generally have the same access to TCWG as those performing audit engagements.

82. The Board does not believe that making the split between assurance and non-assurance engagements for the proposed framework is appropriate. This is because the provision of review and other assurance engagements other than audits of financial statements varies significantly around the world, as does the level of public reliance on them. Also, audits tend to be significantly more legislated or regulated than other assurance engagements.

83. Jurisdictions would not be precluded from extending the proposed framework to cover specific types of assurance engagement other than audits should they believe that doing so would be appropriate for their national contexts.

The Task Force considered whether the AICPA guidance should be consistent with the IESBA standard in differentiating between audit and all other clients. The Task Force noted that the AICPA Code generally does not differentiate between types of clients. Exceptions exist however with respect to certain interpretations such as for network firms and client affiliates. Specifically, the network firm requirements apply to financial statement audit and review clients and the client affiliates interpretation applies to financial statement attest clients. The Task Force concluded that since it was not proposing to incorporate provisions that would permit disclosure to an external auditor or outside authority, there was no need to have separate sections and requirements for auditors versus non-auditors.

Action Needed:

5. Does the Committee agree that the guidance for members in public practice should not include separate sections and requirements for auditors and non-auditors?

Communication with respect to Group Audits

The Task Force considered whether the IESBA provisions related to group audits should be expanded to cover all group attest engagements. The Task Force believed there was no reason to limit the disclosure requirements to group audits only and therefore, is proposing that the provisions apply for all group attest engagements.

Action Needed:

6. Does the Committee agree that the requirements should apply to all group attest engagements?

Communication with Auditor

Under the IESBA standard, if a PAPP is performing a service for an audit client of the firm (or a component of an audit client), the PAPP is required to communicate the NOCLAR within the firm so that the audit engagement partner is informed of the NOCLAR. The Task Force believes this requirement should be extended to cover review clients of the firm as well.

With respect to network firms, the IESBA standard states that if a PAPP is performing a service for an audit client of a network firm (or a component of an audit client of a network firm), the PAPP should consider whether to communicate the NOCLAR to the network firm. The Task Force believes this requirement should be extended to cover review clients of the network firm as well. The Task Force also considered whether the requirement should apply to all attest clients of the network firm but believed it was not necessary to go beyond audit and review clients. It was noted that expanding the scope could be impractical since many networks only monitor financial

statement audit and review clients as this is the scope of the network firm independence interpretation.

Action Needed:

7. Does the Committee agree that communication within the firm should apply to financial statement audit and review clients of the firm?
8. Does the Committee agree that the communication with respect to clients of a network firm should apply to financial statement audit and review clients?

Documentation

The IESBA standard require the auditor to document certain matters in addition to the documentation requirements under applicable auditing standards. For all other PAPPs, the IESBA standard encourages documentation. With regard to PAIBs, documentation of certain matters is encouraged.

The Task Force considered whether documentation should be required or encouraged for each classification of professional accountant. The Task Force noted that documentation is required under the AICPA Breaches Interpretation while other interpretations, such as conflicts of interest, encourage documentation. The Task Force believes that due to the significance of a NOCLAR and potential impact on the public, all members in public practice should be required to document certain matters regardless of the type of service provided, in addition to complying with any documentation requirements under applicable professional standards,

With regard to members in business, the Task Force believes a requirement encouraging members to document certain matters would be appropriate, noting that there are no existing provisions in the Code relevant to members in business requiring documentation.

Action Needed:

9. Does the Committee agree that documentation should be required for all members in public practice regardless of the type of service provided?
10. Does the Committee agree that documentation should be encouraged for both senior members in business as well as non-senior members?

Further Action Needed

Under the IESBA standard, a PAPP is required to consider whether further action is needed in the public interest. Further action 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.

Due to the fact that the proposed AICPA guidance would not permit disclosure to an outside authority, the only example of a “further action” available to a member in public practice would be to withdraw from the engagement. The Task Force, therefore, has changed references to “further action needed” to “withdrawing from the engagement and the professional relationship.” The guidance therefore discusses factors to consider in determining whether withdrawal from the engagement might be needed. The Task Force also believes that in determining the need to withdraw from the engagement, the member should take into account the views of a reasonable and informed third party.

With regard to PAIBs, the IESBA standard requires a senior PAIB to determine if further action is needed in the public interest. Further action 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.

For purposes of the AICPA guidance, the Task Force is proposing that the term “further action” continue to be used since the examples of actions available to a member in business includes informing the management of the parent entity as well as resigning from the employing organization (i.e., more than one action is available).

Action Needed:

11. Does the Committee agree that for members in public practice, the proposed guidance should refer to “determining the need to withdraw from the engagement” rather than “further action”?
12. Does the Committee agree that in determining the need to withdraw from the engagement, the member should take into account the views of a reasonable and informed third party?

Placement within the Code

The Task Force is proposing that the NOCLAR guidance for members in public practice and members in business be added as new sections/interpretations under the Integrity and Objectivity rule in Part 1 and Part 2 of the AICPA Code, respectively (1.170.010 and 2.170.010).

Action Needed:

13. Does the Committee agree with the proposed placement of the interpretations in the AICPA Code?

Other matters

In addition to various editorial changes made to the IESBA standards, the Task Force has also expanded the scope of laws and regulatory provisions that may address NOCLAR by adding the following bold and italicized text:

.03 Some regulators, such as the Securities and Exchange Commission or state boards of accountancy, may have regulatory provisions governing how a member should address non-compliance or suspected non-compliance which may differ from or go beyond this interpretation, ***and state and federal civil and criminal laws, in some circumstances, may impose additional requirements.***

Materials Presented

Agenda 7A – This Agenda Item

Agenda 7B – Proposed NOCLAR Interpretations

Agenda 7C – IESBA NOCLAR Standards (Final)

DRAFT NOCLAR INTERPRETATIONS

1.170 Responding to Non-Compliance with Laws and Regulations

1.170.010 Responding to Non-Compliance with Laws and Regulations

.01 When a member encounters or is made aware of non-compliance or suspected non-compliance with laws and regulations in the course of providing a professional service to a client, threats to compliance with the “Integrity and Objectivity Rule” [1.100.001] may exist. The purpose of this interpretation is to set out the member’s responsibilities when encountering such non-compliance or suspected non-compliance, and guide the member in assessing the implications of the matter and the possible courses of action when responding to it.

.02 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.

.03 Some regulators, such as the Securities and Exchange Commission or state boards of accountancy, may have regulatory provisions governing how a member should address non-compliance or suspected non-compliance which may differ from or go beyond this interpretation, and state and federal civil and criminal laws, in some circumstances, may impose additional requirements. When encountering such non-compliance or suspected non-compliance, a member 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.

.04 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 a member are:

- (a) To comply with the “Integrity and Objectivity Rule” [1.100.001];
- (b) By alerting management or, where appropriate, those charged with governance of the client, to enable them to:
 - (i) 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.
- (c) To determine whether withdrawal from the engagement and the professional relationship is needed, where permitted by law and regulation.

.05 This interpretation sets out the approach to be taken by a member 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.

.06 Examples of laws and regulations which this interpretation addresses include those that deal with:

- Fraud, corruption and bribery.
- Money laundering.
- 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.

.07 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 interpretation, 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.

.08 A member 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 interpretation with respect to such matters.

.09 This interpretation 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 member 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.

A member may nevertheless find the guidance in this interpretation helpful in considering how to respond in these situations.

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

.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 Members in Public Practice

.11 Where a member becomes aware of a matter to which this interpretation applies, the steps that the member takes to comply with this interpretation should be taken on a timely basis, having regard to the member'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.

Obtaining an Understanding of the Matter

.12 If a member engaged to perform professional services 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 member should obtain an understanding of the matter, including the nature of the act and the circumstances in which it has occurred or may occur.

.13 A member 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 member may consult on a confidential basis with others within the firm, a network firm or a professional body, or with legal counsel.

.14 If the member identifies or suspects that non-compliance has occurred or may occur, the member should 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.

.15 Such discussion serves to clarify the member'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.

.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.

.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 a member believes that management is involved in the non-compliance or suspected non-compliance, the member should discuss the matter with those charged with governance. The member may also consider discussing the matter with internal auditors, where applicable. In the context of a group attest engagement, the appropriate level may be management at an entity that controls the client.

Addressing the Matter

.18 In discussing the non-compliance or suspected non-compliance with management and, where appropriate, those charged with governance, the member should 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.

.19 The member should 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 member may suggest appropriate sources of information or recommend that they obtain legal advice.

.20 The member should 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 or other professional 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 Group Attest Engagements

.21 A member may:

- (a) For purposes of a group attest engagement, be requested by the group engagement team to perform work on financial or other information related to a component of the group; or
- (b) Be engaged to perform an attest engagement of a component for purposes other than the group attest engagement, for example, a statutory audit.

Where the member becomes aware of non-compliance or suspected non-compliance in relation to the component in either situation, the member should, in addition to responding to the matter in accordance with the provisions of this interpretation, 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 attest engagement, whether and, if so, how it should be addressed in accordance with the provisions in this interpretation.

- .22 Where the group engagement partner becomes aware of non-compliance or suspected non-compliance in the course of a group attest engagement, including as a result of being informed of such a matter in accordance with paragraph .21, the group engagement partner should, in addition to responding to the matter in the context of the group attest engagement in accordance with the provisions of this interpretation, consider whether the matter may be relevant to one or more components:
- (a) Whose financial or other information is subject to procedures performed for purposes of the group attest engagement; or
 - (b) Whose financial or other information is subject to procedures performed for purposes other than the group attest engagement, for example, a statutory audit.

If so, the group engagement partner should 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 should be made (either of management or from publicly available information) as to whether the relevant component(s) is subject to attest procedures and, if so, to ascertain to the extent practicable the identity of the accountant. 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 interpretation.

Determining Whether Withdrawal from the Engagement Is Needed

.23 The member should assess the appropriateness of the response of management and, where applicable, those charged with governance.

.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.

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- The non-compliance or suspected non-compliance has been disclosed to an appropriate authority where appropriate and, if so, whether the disclosure appears adequate.

.25 In light of the response of management and, where applicable, those charged with governance, the member should determine if withdrawing from the engagement and the professional relationship is needed, where permitted by law and regulation.

.26 The determination of whether withdrawing from the engagement and the professional relationship is needed, 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 member 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.

.27 Examples of circumstances that may cause a member no longer to have confidence in the integrity of management and, where applicable, those charged with governance include situations where:

- The member suspects or has evidence of their involvement or intended involvement in any non-compliance.
- The member 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.

.28 In determining the need to withdraw from the engagement and the professional relationship, a member should exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the member at the time, would be likely to conclude that the member has acted appropriately and in the public interest.

.29 As consideration of the matter may involve complex analysis and judgments, a member may consider consulting internally, obtaining legal advice to understand the member'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.

Communicating the Matter to the Client's Auditor

.30 If the member is performing a service for a financial statement audit or review client of the firm, or a component of a financial statement audit or review client of the firm, the member

should communicate the non-compliance or suspected non-compliance within the firm. The communication should be made in accordance with the firm's protocols or procedures or, in the absence of such protocols and procedures, directly to the audit or review engagement partner.

- .31 If the member is performing a service for a financial statement audit or review client of a network firm, or a component of a financial statement audit or review client of a network firm, the member should consider whether to communicate the non-compliance or suspected non-compliance to the network firm. Where the communication is made, it should be made in accordance with the network's protocols or procedures or, in the absence of such protocols and procedures, directly to the audit or review engagement partner.
- .32 If the member is performing a service for a client that is not a financial statement audit or review client of the firm, except as required by law or regulation, the member is not permitted to communicate the non-compliance or suspected non-compliance to the firm that is the client's external auditor, if any. See "[Confidential Client Information Rule](#)" [1.700.001]
- .33 In all cases, the communication is to enable the audit or review 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 interpretation.

Documentation

- .34 In relation to an identified or suspected act of non-compliance that falls within the scope of this interpretation, the member should, in addition to complying with the documentation requirements under applicable professional standards, 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 member considered, the judgments made and the decisions that were taken, having regard to the reasonable and informed third party perspective.

2.170 Responding to Non-Compliance with Laws and Regulations

2.170.010 Responding to Non-Compliance with Laws and Regulations

Purpose

Applicable to all Members in Business

.01 When a member in business encounters or is made aware of non-compliance or suspected non-compliance with laws and regulations in the course of carrying out professional activities, threats to compliance with the “Integrity and Objectivity Rule” [2.100.010] may exist. The purpose of this interpretation is to set out the professional accountant’s responsibilities when encountering such non-compliance or suspected non-compliance, and guide the member in assessing the implications of the matter and the possible courses of action when responding to it. This interpretation applies regardless of the nature of the employing organization.

.02 Non-compliance with laws and regulations (“non-compliance”) comprises acts of omission or commission, intentional or unintentional, committed by the member’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.

.03 Some regulators, for example, the Securities and Exchange Commission or state boards of accountancy, may have provisions governing how professional accountants should address non-compliance or suspected non-compliance which may differ from or go beyond this interpretation, and state and federal civil and criminal laws, in some circumstances, may impose additional requirements.. When encountering such non-compliance or suspected non-compliance, the member 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.

.04 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 member are:

- (a) To comply with the “Integrity and Objectivity Rule [2.100.010];
- (b) By alerting management or, where appropriate, those charged with governance of the employing organization, to enable them to:
 - (i) 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

.05 This interpretation sets out the approach to be taken by a member 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.

.06 Examples of laws and regulations which this interpretation addresses include those that deal with:

- Fraud, corruption and bribery.
- Money laundering.
- 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.

.07 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.

.08 A member 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 interpretation with respect to such matters.

.09 This interpretation 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 member 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

.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 Members in Business

.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 member's employing organization, the member should consider them in determining how to respond to such non-compliance.

.12 Where a member becomes aware of a matter to which this interpretation applies, the steps that the member takes to comply with this section shall be taken on a timely basis, having regard to the member'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 Members who are Senior Professional Accountants in Business

.13 Members who are senior professional accountants in business 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

.14 If, in the course of carrying out professional activities, a member who is a senior professional accountant becomes aware of information concerning an instance of non-compliance or suspected non-compliance, the member should 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

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- (c) The potential consequences to the employing organization, investors, creditors, employees or the wider public.

.15 A member who is 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 member'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 member may cause, or take appropriate steps to cause, the matter to be investigated internally. The member may also consult on a confidential basis with others within the employing organization or a professional body, or with legal counsel.

Addressing the Matter

.16 If the member who is a senior professional accountant identifies or suspects that non-compliance has occurred or may occur, the member should, subject to paragraph .11, discuss the matter with the member's immediate superior, if any, to enable a determination to be made as to how the matter should be addressed. If the member's immediate superior appears to be involved in the matter, the member should discuss the matter with the next higher level of authority within the employing organization.

.17 The member who is a senior professional accountant should 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.

.18 In addition to responding to the matter in accordance with the provisions of this interpretation, the member who is a senior professional accountant should determine whether disclosure of the matter to the employing organization's external auditor, if any, is needed pursuant to the member's duty or legal obligation to provide all information necessary to enable the auditor to perform the audit. See the *Obligation of a Member to His or Her Employer's External Accountant* interpretation for additional guidance [2.130.030].

Determining Whether Further Action Is Needed

.19 The member who is a senior professional accountant should assess the appropriateness of the response of the member's superiors, if any, and those charged with governance.

.20 Relevant factors to consider in assessing the appropriateness of the response of the member'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.

.21 In light of the response of the member's superiors, if any, and those charged with governance, the member should determine if further action is needed in the public interest.22The 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 member who is a senior professional accountant continues to have confidence in the integrity of the member'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.

.22 Examples of circumstances that may cause the member who is a senior professional accountant no longer to have confidence in the integrity of the member's superiors and those charged with governance include situations where:

- The member 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.

.23 In determining the need for, and nature and extent of any further action needed, the member who is a senior professional accountant should exercise professional judgment and take into account whether a reasonable and informed third party, weighing all the specific facts and circumstances available to the member at the time, would be likely to conclude that the member has acted appropriately in the public interest.

.24 Further action by the member who is a senior professional accountant may include:

- Informing the management of the parent entity of the matter if the employing organization is a member of a group.
- Resigning from the employing organization.

.25 Where the member who is a 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 member's objectives under this section.

.26 As consideration of the matter may involve complex analysis and judgments, the member who is a senior professional accountant may consider consulting internally, obtaining legal advice to understand the member'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.

Documentation

.27 In relation to an identified or suspected act of non-compliance that falls within the scope of this interpretation, the member who is a senior professional accountant is encouraged to have the following matters documented:

- The matter.
- The results of discussions with the member's superiors, if any, and those charged with governance and other parties.
- How the member's superiors, if any, and those charged with governance have responded to the matter.
- The courses of action the member considered, the judgments made and the decisions that were taken.
- How the member is satisfied that the member has fulfilled the responsibility set out in paragraph .21.

Responsibilities of Members Other than those who are Senior Professional Accountants in Business

.28 If, in the course of carrying out professional activities, a member becomes aware of information concerning an instance of non-compliance or suspected non-compliance, the member should 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.

.29 The member 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 member'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 member may consult on a confidential basis with others within the employing organization or a professional body, or with legal counsel.

.30 If the member identifies or suspects that non-compliance has occurred or may occur, the member should, subject to paragraph .11, inform an immediate superior to enable the superior to take appropriate action. If the member's immediate superior appears to be involved in the matter, the member should inform the next higher level of authority within the employing organization.

.31. In addition to responding to the matter in accordance with the provisions of this interpretation, the member should determine whether disclosure of the matter to the employing organization's

external auditor, if any, is needed pursuant to the member's duty or legal obligation to provide all information necessary to enable the auditor to perform the audit. See the *Obligation of a Member to His or Her Employer's External Accountant* interpretation for additional guidance [2.130.030].

Documentation

.32 In relation to an identified or suspected act of non-compliance that falls within the scope of this interpretation, the member is encouraged to have the following matters documented:

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

AGENDA 7C

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.

RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS

- 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

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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~~ ethicals 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 improveing 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

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

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

<p><u>Attendance:</u> Samuel L. Burke, Chair Carlos Barrera Stanley Berman Michael Brand Tom Campbell Richard David Robert E. Denham* Anna Dourdourekas Jana Dupree Janice Gray</p>	<p>Greg Guin Brian S. Lynch William Darrol Mann Andrew Mintzer Jarold Mittleider Steven Reed James Smolinski Laurie Tish Shelly Van Dyne Blake Wilson</p>
<p><u>Staff:</u> Lisa Snyder, Director James Brackens, VP - Ethics & Practice Quality Mike Jones, Assistant General Counsel Jason Evans, Sr. Technical Manager Shelley Truman, Coordinator</p>	<p>Ellen Gorla, Sr. 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><u>Guests:</u> Jeff Lewis, Chair, Independence/Behavioral Standards Subcommittee Ian Benjamin, Chair, Technical Standards Subcommittee Nancy Miller, KPMG Dan Dustin, VP State Board Relations, NASBA Catherine Allen, Audit Conduct Vincent DiBlanda, DT Sonja Araujo, PwC George Dietz, PwC* Edith Yaffe, E&Y* Vassilios Karapanos, SEC* Karen Liu, SEC*</p> <p style="text-align: right;">*Via Phone</p>	

1. Definition of Client

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

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

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

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

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

2. Sale, Transfer or Discontinuance of Practice

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

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

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

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

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

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

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

3. Commissions and Referral Fees

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

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

4. Leases

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

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

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

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

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

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

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

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

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

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

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

5. Information Technology and Cloud Services

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

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

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

7. IESBA Update

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

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

8. Cybersecurity Services

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

9. Part C Task Force – IESBA Convergence

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

Section 320 - Preparation and Presentation of Information

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

Section 370 – Pressure to Breach the Fundamental Principles

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

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

10. Non-compliance with Laws and Regulations (NOCLAR) Task Force

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

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

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

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

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

11. Nonattest Services Toolkit

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

12. Minutes of the Professional Ethics Executive Committee Open Meeting

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

Compilation of Pro-Forma Financial Information and Specified Procedures Engagements

Staff

Michael Glynn, Senior Technical Manager – Audit & Attest Standards Team

Reason for Agenda Item

The AICPA Audit and Attest Standards Team, the Accounting and Review Services Committee (ARSC) and the Auditing Standards Board (ASB) respectfully request that the PEEC consider certain independence issues related to current and proposed attest engagements.

Summary of Issues

Issue #1 - Independence and Compilation of Pro Forma Financial Information

A practitioner engaged to perform an examination or a review of pro forma financial information would perform such engagement in accordance with Statements on Standards for Attestation Engagements (SSAEs). In such instances, the Code of Professional Conduct provides the following interpretation to the independence Rule:

1.297.010 Application of the Independence Rule to Engagements Performed in Accordance With Statements on Standards for Attestation Engagements

- .01 The “[Independence Rule](#)” [1.200.001] and its *interpretations* apply to all *attest engagements*. However, when performing engagements to issue reports in accordance with Statements on Standards for Attestation Engagements (SSAEs), when *independence* is required or when the *member’s* compilation report does not disclose a lack of *independence*, the *covered member* needs to be independent with respect to the responsible party(ies), as defined in the SSAEs.
- .02 If the individual or entity that engages the *covered member* is not the responsible party, the *covered member* need not be independent of that individual or entity. However, the *covered member* should consider the “[Conflicts of Interest](#)” interpretation [1.110.010] of the “Integrity and Objectivity Rule” [1.100.001], with regard to any relationships that may exist with the individual or entity that engages the *covered member* to perform these services.
- .03 In addition, application of the “[Independence Rule](#)” [1.200.001] is further modified as set forth in the “[Agreed-Upon Procedures Engagements in Accordance With SSAEs](#)” interpretation [1.297.020] and the “[Engagements, Other Than AUPs, Performed in Accordance With SSAEs](#)” interpretation [1.297.030] of the “Independence Rule.” [Prior reference: paragraph .13 of ET section 101]

As a result of the issuance of SSARS No. 23, the standards related to compilation of prospective financial information were relocated to the Standards for Accounting and Review Services (SSARSs). Accordingly, in paragraph .01 the phrase “or when the *member’s* compilation report does not disclose a lack of *independence*” should be deleted effective May 1, 2017 as the clarified SSAEs will no longer include any compilation requirements or guidance. .

Additionally, the exemption that allows for the practitioner to not have to be independent of the engaging party if the engaging party is not the responsible party in an engagement performed in accordance with the SSAEs should flow to compilations of pro forma financial information.¹

To illustrate the issue, assume that a practitioner is engaged to perform a service on pro forma financial information intended to illustrate the possible effects of a business combination between company A and company B. If the engagement is an examination or review (which are assurance engagements), the practitioner would perform the engagement in accordance with the SSAEs and would have to be independent of only the engaging entity (presumably either company A or company B). However, if the practitioner was engaged to perform the non-assurance compilation engagement, then the engagement would be performed in accordance with the SSARSs, the exemption provided by the SSAEs would not apply, and the practitioner would have to be independent of both parties.

The ARSC and the Audit and Attest Standards staff question the appropriateness of the independence requirements with respect to a non-assurance compilation engagement being more restrictive than the requirements with respect to an assurance service on the same subject matter.

Question for the Committee

The PEEC is asked to consider the apparent inconsistency in the literature with respect to independence when the practitioner is engaged to perform an examination or review versus a compilation of pro forma financial information.

Issue #2 - Independence and Specified Procedures Engagements

The second issue concerns a proposed standard for a new attest service with respect to which the ARSC and the ASB have commenced a joint project. The Task Force developing the proposed standard was charged with developing a new SSAE that would result in a new service, similar to an agreed-upon procedures (AUP) engagement, in which CPAs would perform procedures and report findings. This new service would be similar to an AUP engagement with certain exceptions including that the practitioner would not be required to request or obtain an assertion from the responsible party nor would the practitioner be required to restrict the use of the report (although restriction would be optional).

As the proposed standard is developed and ultimately exposed for public comment, it would be helpful if the ASB and the ARSC had an indication as to whether the independence interpretation (included below) with respect to AUP engagements would be expected to be extended to cover the proposed specified procedures service.

The AUP interpretation reads as follows:

1.297.020 Agreed-Upon Procedure Engagements Performed in Accordance With SSAEs

- .01 For purposes of this interpretation, subject matter is as defined in the SSAEs.
- .02 When performing agreed-upon procedures (AUP) engagements in accordance with the SSAEs, the application of the “Independence Rule” [1.200.001] is modified, as described in the “Application of the Independence Rule to Engagements Performed in Accordance

¹ SSARS No. 14, *Compilation of Pro Forma Financial Information* issued July 2005.

With Statements in Standards for Attestation Engagements” interpretation [1.297.010] of the “Independence Rule” and this interpretation.

- .03 When providing nonattest services that would otherwise *impair independence* under the *interpretations* of the “Nonattest Services” subtopic [1.295] under the “Independence Rule” [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*, provided that the nonattest services do not relate to the specific subject matter of the SSAE engagement. *Threats* would be at an *acceptable level* and *independence* would also not be *impaired* if the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule” were not applied when providing the nonattest services, provided that the nonattest services do not relate to the specific subject matter of the AUP engagement.
- .04 In addition, when performing an AUP engagement under the SSAEs, *threats* would be at an *acceptable level* and *independence* would not be *impaired*, if the following *covered members* and their *immediate families* are independent of the responsible party(ies):
 - a. Individuals participating on the AUP engagement team
 - b. Individuals who directly supervise or manage the AUP engagement *partner* or *partner equivalent*
 - c. Individuals who consult with the *attest engagement team* regarding technical or industry-related issues specific to the AUP engagement
- .05 Furthermore, *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 the *firm* had a material financial relationship with the responsible party(ies) that was covered by any of the following interpretations of the “Independence Rule”:
 - a. Paragraph .02 of “Overview of Financial Interests” [1.240.010]
 - b. “Trustee or Executor” [1.245.010]
 - c. “Jointly Held Investments” [1.265.020]
 - d. “Loans” [1.260.010] [Prior reference: paragraph .13 of ET section 101]

Action Requested of the Committee
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To provide feedback as to its initial thoughts as to the independence requirements that would apply to the proposed specified procedures engagement.
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Agenda Item 10A

Transfer of Files and Return of Client Records in Sales, Transfer, Discontinuance or Acquisition of Practice

Staff

Ellen Gorla, Senior Manager, Independence and Special Projects

Reason for Agenda Item

Staff received an inquiry from a state CPA society about the new [Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of Practice](#) interpretation and seeks the Committee's input on whether another FAQ should be issued to assist members with applying the new interpretation.

Background

Recently, the following two FAQs were issued related to this interpretation:

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*. [August 2016]

FORM OF COMMUNICAITON

Question. The "[Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice](#)" interpretation [1.400.205] requires certain communications to the *client* be in writing. Would electronic communications such as email be an acceptable form of communication?

Answer. Yes, provided electronic communication is considered an acceptable form of written notice to the *client* under the applicable state law. [August 2016]

Summary of Issues

The hypothetical situation presented to Staff was whether the requirements of the interpretation would need to be complied with when one firm (Firm A) is acquired by another firm (Firm B) and only some of the partners from Firm A become partners of Firm B. Mr. Barrera and Mr. Guin believe that the intent of the interpretation was that as long as at least one partner from Firm A would become a partner in Firm B, the requirements of the interpretation did not apply. Does the Committee agree and if so, does it believe it would be helpful if the following FAQ was issued to assist members with applying the new interpretation?

TRANSFER OF CLIENT FILES IN A MERGER

Question. Firm B acquires Firm A and only some of the partners of Firm A will become partners of Firm B. 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 the requirements of the "Transfer of Files and Return of Client Records in Sales, Transfer, Discontinuance or Acquisition of Practice" interpretation do not need to be complied with since at least one of the partners of Firm A will become a partner of Firm B.

Action Needed

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1. Does the Committee's agree with the position reflected in the proposed FAQ and if so, should it be issued as non-authoritative guidance?
 2. Assuming the Committee does agree with the position reflected in the proposed FAQ, would the same answer apply in a scenario where Firm A merged with Firm B to form new Firm C and only some of the partners of Firm A became partners of Firm C?

Materials Presented

Agenda 10B – 1.400.205

Agenda 10C – Practice Continuation Agreements – Practice Survival Kit (FYI Only)

1.400.205 Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice

Sale or Transfer of Member's Practice

- .01 A *member* or *member's firm* (member) 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 any ownership in the practice should do all of the following:
- Submit a written request to each *client* subject to the sale or transfer, requesting the *client's* consent to transfer its files to the successor firm and, notify the *client* that its consent may be presumed if it does not respond to the member's request within a period of not less than 90 days, unless prohibited by law, including but not limited to the rules and regulations of the applicable state boards of accountancy. The member should not transfer any *client* files to the successor firm until either the *client's* consent is obtained or 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.
 - With respect to files not subject to the sale or transfer, 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.
- .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 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:
- Notify each *client* in writing of the discontinuance of the practice. The member is encouraged to retain evidence of notification made to *clients*. The member is not required to provide notification to former *clients* of the *firm*.
 - 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.

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, as required in [paragraph .01](#), consented to the member's continuation of *professional services* and retention of any *client* files or records the successor firm retains
- .06 A member will 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 This interpretation is effective June 30, 2017. Early implementation is allowed.

Nonauthoritative questions and answers related to form of communication and transfer of client files to another partner in the firm are available in the FAQ document at www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf.



Practice Continuation Agreements: A Practice Survival Kit

A resource prepared by the American Institute of CPAs (AICPA) and the National Association of State Boards of Accountancy (NASBA), adapted from the original AICPA publication by John A. Eads, CPA.

What would happen to your clients and practice if you were to become incapacitated or unexpectedly pass away? Do you have a plan in place to ensure your clients' services and your employees' salaries continue uninterrupted? Unfortunately, few sole practitioners do. In fact, a 2016 survey by the AICPA Private Companies Practice Section (PCPS) found that only 7% of sole practitioners have a practice continuation agreement in place.¹

A practice continuation agreement is a contract that ensures your practice is transferred to another CPA firm or individual in the event of your disability or death. These agreements make arrangements for both temporary and permanent situations, thereby protecting your clients, your staff and your family. Practice continuation agreements ensure that there is no significant break in your clients' accounting and tax services, provide your staff with some assurance of immediate future employment and offer your family financial support and peace of mind when they need it the most.

¹ American Institute of CPAs. (2016). AICPA PCPS Succession Survey, single-owner firms.

Board of Accountancy Considerations

Boards of accountancy throughout the 56 U.S. jurisdictions are responsible for the licensure and regulation of CPAs and public accounting firms. Before entering into a practice continuation agreement, it is important that you and your attorney familiarize yourselves with the laws and rules of your jurisdiction to determine what restrictions, if any, exist regarding the creation and implementation of a practice continuation agreement.

For a list of boards of accountancy, go to the NASBA website at nasba.org/stateboards.

Types of Practice Continuation Agreements

While individual agreements can vary considerably, the three most common types of practice continuation agreements include:

- ▶ **One-on-one agreements** — A continuation agreement made between two sole practitioners — usually in the form of a buy/sell agreement or cross-purchase agreement
- ▶ **Group agreements** — Several CPAs act as successors to each other's firms; when death or disability strikes a member of the group, his or her clients are asked to select a new CPA from among the surviving members
- ▶ **State society plans** — Also known as an emergency assistance plan, these help the surviving spouse or heirs with the disposition of a member CPA's practice if that member failed to make his or her own arrangements ahead of time

For more detailed information on what to include in your agreement and for sample plans, access the AICPA Practice Survival Toolkit at aicpa.org/PracticeSurvivalKit.

Working Toward a Practice Continuation Plan: Key Steps

01

PRACTICE ANALYSIS

A realistic review of your firm's goals, procedures and characteristics prepares you to compare practice philosophies, clients, marketing techniques and personnel policies with prospective successors.

Firm Basics

Honestly evaluate your firm's:

- Reputation
- Staff
- Specialties
- Location
- Rates
- Profitability
- Efficiency

Financial Considerations

There are significant control statistics that indicate a practice's financial health and should be discussed during negotiations with potential successors. For a sample list of these, go to AICPA's Survival Kit website at aicpa.org/SurvivalKit.

Client Information

A critical step in preparing for practice continuation discussions is to summarize basic data about each client. This includes information on each client's type of business, years with firm and billings by type of services rendered. Client profiles may also include an assessment of client personalities, business philosophies, and goals.

*Sample valuation methods
are available at
aicpa.org/PracticeSurvivalKit.*

02

PLACING A VALUE ON YOUR PRACTICE

In a normal buy/sell situation, the seller actively participates in the negotiations at the time of the sale. However, this is not possible when death or some types of disability occur. As such, both parties to any continuation agreement will need to agree to the valuation method as part of that agreement. There are several methods for assessing the value of a practice, but the balance sheet and income statement from operations are vital components of any valuation.

03

IDENTIFYING A POTENTIAL SUCCESSOR

The ideal successor is a practitioner you have known for a number of years and with whom you have discussed a wide range of practice issues, including personnel-related and engagement-related matters. You should consider the following when assessing a potential successor:

- ▶ **Professional qualifications** — Recent peer review, organizational and planning abilities, proper monitoring and control of engagements, technical proficiency, client satisfaction, ability to train and develop staff, ability to generate fees and knowledge of the value of the services performed, ability to bill and collect promptly, and sense of professional responsibility
- ▶ **Personal qualifications** — The appearance and presentation of the firm and its personnel, leadership within the firm, evidence of oral and written communications skills, good relations with colleagues and clients, gradations of expertise within the firm, useful mixture of personalities within the firm, and growth potential
- ▶ **Community and professional standing** — The firm's image, leadership in the community and profession, ability to bring in new clients through individual contacts, and accomplishments

Constructing an Agreement

Once you place a value on your practice and identify your successor, you are ready to begin negotiating and constructing the agreement. You may want to consult with an attorney as part of the negotiation process, as your contract will cover many technical legal areas. At a minimum, your contract should address the following:

- Definitions (temporary disability, permanent disability, death, retirement, etc.)
- Assumption of a practice on a temporary basis (in the event of disability)
 - Assignment of staff and other employees
 - Compensation arrangement with the successor
 - Conclusion arrangement
- Assumption of a practice on a permanent basis
- List of clients
- Working papers (tax and accounting standards applied to each client)
- Files (billing, personnel, etc.)
- Books and financial statements
- Work in process and accounts receivable
- Equipment and supplies
- Existing leases
- Employee records
- Liabilities and malpractice insurance
- Property and casualty insurance
- Fees and billing information
- Payment for the practice
- Noncompetition clause
- Termination of the agreement
- Arbitration
- Client notification, including transfer of files

Once the agreement is completed and signed, make sure to inform your attorney, staff and spouse of the details to ensure the smooth transfer of the practice. You should also inform your clients at the time you enter into a practice continuation agreement so as to prevent any surprises down the road.

Payment Methods

Generally, you must be willing to agree to multiple installments to get a good price, as your successor may have minimal available funds or be unwilling to make a full commitment to the terms of the agreement until they can be sure of client retention. The most common method of paying for an accounting practice is to spread the payments over a period of five to seven years. Some agreements have called for payments in as few as three years, and others in as many as 10. Down payments are between 10% and 20%. Outright cash payments for an accounting practice are uncommon unless severely discounted.

Make it as easy and financially undemanding as possible for the successor to pay for the practice. Remember, the successor must pay your staff immediately — long before receiving fees from the clients transferred.

Developing a Practice Continuation Agreement

Sample Action Plan

This action plan can be modified to suit your purposes, and resources for each step are available at aicpa.org/PracticeSurvivalKit.

1. Review the kinds of practice continuation agreements

- Summarize the pros and cons of one-on-one and group plans and decide what's best for you
- If your state society has an emergency assistance program, review it to determine its benefits

2. Make basic preparations

- Determine what effect your business and personal objectives will have on your choice of successor, the valuation of your firm and your preparations for negotiation
- Conduct an assessment of your firm's reputation, specialties, rates, efficiency, profitability, location and staff
- Get your practice into shape. Update your client files and prepare client information for review by your successor

3. Assess the value of your practice

- Choose a valuation method, and consider using more than one to establish a range of values for negotiations
- Prepare a valuation of your fixed assets, accounts receivable and work in process

4. Search for a successor

- Consider the options: your staff, other sole practitioners, previous employers or a larger firm
- Draw up a list of possible candidates and then reduce the list to the most likely prospects.
- Approach the candidates and hold preliminary talks — avoid any rush decisions

5. Begin formal negotiations

- Determine the subjects of negotiation
- Set limits on how much you are willing to compromise

6. Implement the plan once negotiations are completed

- Contact your attorney to prepare a draft agreement
- Discuss your plans with your spouse and attorney
- Finalize letters of instruction to spouse, clients, attorney and staff to be delivered in the event of your death
- Communicate in writing to all parties what their roles in the transfer will be
- Ensure that all copies of the agreement and relevant documents are secure
- Set up a meeting with your successor
- Set up a date for the first annual review of the agreement