

**AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS  
DIVISION OF PROFESSIONAL ETHICS  
PROFESSIONAL ETHICS EXECUTIVE COMMITTEE  
OPEN MEETING MINUTES  
NOVEMBER 3-4, 2016  
AUSTIN, TX**

The Professional Ethics Executive Committee (Committee) held a duly called meeting on November 3-4, 2016. The meeting convened 8:30 a.m. and concluded at 5:00 p.m. on November 3<sup>rd</sup> and reconvened at 8 a.m. and concluded at 10:00 a.m. on November 4<sup>th</sup>.

<p><b><u>Attendance:</u></b> Samuel L. Burke, Chair Coalter Baker* Carlos Barrera Stanley Berman Michael Brand Tom Campbell Richard David Robert E. Denham Anna Dourdourekas Janice Gray Greg Guin Brian S. Lynch</p>	<p>William Darrol Mann Andrew Mintzer Jarold Mittleider Steven Reed* (November 4<sup>th</sup> only) James Smolinski Laurie Tish Shelly Van Dyne Blake Wilson</p> <p><b><u>Not In Attendance:</u></b> Jana Dupree</p>
<p><b><u>Staff:</u></b> Lisa Snyder, Director Susan Coffey, Exec. VP – Public Practice James Brackens, VP - Ethics &amp; Practice Quality Jason Evans, Sr. Technical Manager</p>	<p>Shelley Truman, Coordinator Ellen Gorla, Sr. Manager Brandon Mercer, Technical Manager* April Sherman, Technical Manager* Shannon Ziemba, Technical Manager* James West, Technical Manager*</p>
<p><b><u>Guests:</u></b> Jeff Lewis, Chair, Independence/Behavioral Standards Subcommittee Ian Benjamin, Chair, Technical Standards Subcommittee Kelly Hnatt, Counsel Nancy Miller, KPMG Dan Dustin, VP State Board Relations, NASBA Catherine Allen, Audit Conduct (November 3<sup>rd</sup> only) Sonja Araujo, PwC Harrison Greene, FDIC David L. Patrick, Cyber Accountants George Dietz, PwC* Vassilios Karapanos, SEC* Debra Hann, GT* Cynthia Waer, Deloitte* Jennifer Beneke, EY* (November 3<sup>rd</sup> only) Vince DiBlanda, Deloitte* (November 4<sup>th</sup> only) *Via Phone</p>	

**1. Definition of Client**

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Mr. Mintzer gave an overview of the Task Force's recommended edits to the definition of client and attest client. Mr. Mintzer explained that the Task Force is not fundamentally changing the definition of client but recommends making two clarifying changes to the definition. One change is to clarify to members that when the engaging entity and target entity are not the same, there are two clients, not one. The other clarification is to relocate the government exception from the client definition to the simultaneous employment interpretation. The Committee expressed concern over the use of the term "target entity" since it is not a defined term and some believed it had too many connotations. It was recommended and agreed to use the term "subject entity" instead of "target entity." To accommodate the proposed change of potentially having two clients as part of one engagement, the Task Force recommended revisions to the Records Request interpretation and clarifications on how the Confidential Client Information Rule should be applied in this situation.

Mr. Mintzer explained that the Task Force is recommending that the term "attest client" only be the "subject entity" of an attest engagement. The Committee agreed with the Task Force that the independence rules and interpretations should only be applied to the subject entity. Mr. Mintzer further explained to the Committee that if the engaging entity is not the subject entity, then the member would only be required to be objective and free of conflicts of interest with regard to the engaging entity which is similar to the treatment for engaging entities in the Application of the Independence Rule to Engagements Performed in Accordance With SSAEs" [1.297.010] when the engaging entity and responsible party are not the same.

The Committee moved, seconded and unanimously approved to expose the revised definitions of client and attest client, the Records Request interpretation, the Disclosing Information to Persons or Entities Associated with Clients interpretation of the Confidential Client Information Rule as well as the other related changes proposed by the Task Force. It was further agreed that the exposure draft should be issued as soon as possible and the comment period should run through May 15, 2017.

## **2. Information Technology and Cloud Services**

### *Hosting Services*

Due to time constraints, the Committee did not have an opportunity to provide the Task Force with feedback on many of the questions posed by the Task Force. However, the Committee did recommend that the Task Force clarify what components of "management responsibilities" are impacted when providing hosting services and to develop guidance, authoritative or otherwise, that if the member was the sole repository of the client's schedules or ledgers, the member would be providing hosting services.

### *Information Technology Services*

Although the Committee did not have time to discuss the strawman, it was suggested that the Task Force consider the appearance of independence when providing information technology services associated with a large commercial off-the-shelf (COTS) such as, Oracle.

## **3. Cybersecurity Services**

Ms. Tish reported that the while the Cybersecurity Task Force believes that the guidance in the Nonattest Services subtopic appears to be sufficient for use by members to determine if their cybersecurity related services would impair independence, the Task Force could develop non-authoritative guidance, such as FAQs related to cybersecurity. The Committee agreed that it would be beneficial for members if FAQs were developed to address common

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cybersecurity-related nonattest services. The Task Force was asked to develop FAQs for the Committee to consider at its February 2017 meeting.

#### **4. Part C Task Force – IESBA Convergence**

Mr. Berman noted that at the July 2016 meeting of the PEEC, the Task Force reviewed the revisions made by the IESBA to Part C of the IESBA Code. The newly revised and new sections of the IESBA Code are titled: Section 320, *Preparation and Presentation of Information* and Section 370, *Pressure to Breach the Fundamental Principles*. Mr. Berman noted that based on the feedback of the PEEC from the previous meeting, the Task Force proposed revisions to the *Knowing Misrepresentations in the Preparation and Presentation of Information* interpretation and drafted a new proposed interpretation, *Pressure to Breach the Rules*. Mr. Berman stated that the AICPA's Business and Industry Executive Committee reviewed the proposed standards and presented no concerns.

Mr. Berman reviewed the content of the proposed revisions in the *Knowing Misrepresentations in the Preparation and Presentation of Information* interpretation and asked the Committee for feedback. A member of the PEEC questioned a bullet point in proposed paragraph .04 which states that a member should not use discretion to achieve inappropriate outcomes in: "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." The PEEC member inquired as to why the proposed guidance would put into question the use of accounting policies that are permitted under the applicable financial reporting framework.

Mr. Evans noted that the Task Force proposed deletion of the respective bullet point at the previous meeting of the PEEC, however, one member of the Committee had requested its inclusion.

Ms. Snyder noted that while the IESBA was developing the guidance, results of studies were presented showing that CFOs had admitted to using certain accepted accounting policies to present positive financial results for their company.

After review and discussion of all of the bullet points (i.e., examples) within the respective paragraph in question, the Committee agreed to remove all of the bullet points due to fact that that they place into question the acts of a member who is performing accepted practices within the profession, which could create confusion. The PEEC did agree, however, to include two specific examples within the exposure draft document to explain the meaning of the paragraph.

Mr. Berman reviewed the content of the new proposed interpretation, *Pressure to Breach the Rules*, and asked the Committee for feedback. Mr. Burke inquired if the Task Force deliberately changed the term "inducements," as used in the IESBA Code, to "gifts" as used in the proposed guidance. Ms. Snyder replied noting that the term "gifts" is used in the extant AICPA Code and the term "inducements" was previously viewed by the PEEC as having a negative connotation.

Ms. Coffey asked if the Task Force believed the IESBA Code's guidance is broader due to the use of the term "inducements" as opposed to "gifts." Ms. Snyder confirmed that

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inducements is a broader term, however, the IESBA is presently drafting guidance concerning inducements which will be considered by the PEEC upon release.

There being no further discussion or comments, it was moved, seconded and unanimously approved to expose the proposed guidance, as amended above, with an effective date of the last day of the month in which the guidance is published in the Journal of Accountancy.

## 5. Leases

Mr. Wilson reported on the activities of the Leases Task Force.

### *Revision Option 2 – Capital Leases and Material Operating Leases Impair Independence*

Mr. Wilson discussed the Task Force's position on issues raised with Revision Option 2. Revision Option 2 retained the extant standard's reference to GAAP lease categorization, while adding language to indicate that materiality is also a factor. Mr. Wilson indicated that the Task Force's discussions on these issues resulted in the formulation of Revision Option 3, which retained materiality as a factor but proposed elimination of the concept of capital/finance and operating leases from the standard (see below).

### *Normal Course of Business*

The Task Force recommended excluding the term "normal course of business" from the guidance. Mr. Wilson explained that the Task Force viewed usage of the term as likely to add confusion, and 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." It was noted that the extant AICPA Code uses "normal business operations" to describe loan operations of a lending institution in the Loans and Leases Interpretation. One PEEC member expressed concern that if this is the only lease an audit client makes, it may not be at arm's length, and the extant language regarding "comparable" terms and conditions with other similar natured leases may not address that concern. Another PEEC member questioned how to compare leases of a similar nature if the entity is not in the business of leasing, and expressed concern of applying such a safeguard when there are no other leases to compare, other than leases of other entities. After brief discussion of additional topics (see below), the PEEC did not come to a consensus to include or exclude the term "normal course of business" in the revision(s), but will further discuss the issue as the project proceeds.

### *Materiality*

Mr. Wilson noted that PEEC previously expressed its preference for a revised standard that is conceptual or principles-based in nature and that PEEC did not disagree with the Task Force's view that leases are similar to other business relationships where materiality is a significant factor impacting independence, while the GAAP categorization of the lease is not. Mr. Wilson noted that materiality drives objectivity much more so than whether the lease meets GAAP criteria for a capital lease.

In the course of discussing materiality, Mr. Wilson noted that the extant AICPA standard is not consistent in this regard with IESBA, SEC, or GAO. Mr. Wilson further noted that GASB is issuing its final leases standard in 2016, pointing out that the GASB standard does not include the concept of finance or operating leases. PEEC members agreed that if the concept of GAAP lease categories remains in the Code, and GAAP is revised again in the future, PEEC may need to revise the Code again as well. PEEC agreed after some discussion that principles-based guidance without reference to capital/finance/operating leases is

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appropriate. Mr. Wilson noted that the Task Force had prepared a Revision Option 3 that reflected this approach. Mr. Wilson presented Option 3 and indicated the Task Force's support of the conceptual approach in Option 3, which eliminates the extant references to GAAP lease categorization.

During the PEEC discussion, one member expressed concerns that the construct of Option 3 provided a safe harbor for other leases that are immaterial leases, and felt that the criteria a.-c. should be deleted. The member stated (and another agreed) that the revision should take a threats/safeguards approach to *all* leases; i.e. For both material and other leases, a threats/safeguards approach should be applied with certain minimal requirements. After brief discussion, PEEC requested that the Task Force revise the guidance to reflect this approach. In addition, the PEEC requested that the Task Force provide examples that will facilitate discussion of the approach and threats to independence. Mr. Wilson agreed that the Task Force would revisit the issues discussed and bring a revised proposal to the next meeting with some examples to assist in the discussion.

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

Ms. Miller provided the Committee with an overview of the Task Force's current direction including its proposed definition of a "primary government". She noted that the proposed revisions would provide guidance related to the independence requirements when a fund or component unit is excluded from the financial reporting entity but is required to be included under the financial reporting framework.

Ms. Miller also explained that the revised guidance would require independence be maintained with respect to entities that members presently do not have to remain independent of. For example, when considering "downstream" entities, the Task Force believes that even when a member makes reference to another auditor's report for a fund or component unit, independence should be maintained with respect to any fund or component unit that is material to the primary government and the primary government has more than minimal influence over the fund or component unit's accounting or financial reporting process. In this situation, however, the Task Force believes that members could still provide the fund or component unit with nonattest services that would impair independence provided it is reasonable to conclude the nonattest services will not be subject to the attest procedures.

Ms. Miller also explained that with regard to "upstream" entities, the Task Force believes that independence should be maintained when the financial statement attest client is material to the primary government and the primary government has more than minimal influence over the accounting or financial reporting process of the financial statement attest client.

Ms. Miller went on to explain that the Task Force believes the interpretation should clarify when members need to extend the independence rules to investments held by state and local government entities.

The Committee requested that the Task Force obtain feedback on the proposal from practitioners in the SLG discipline including smaller firm practitioners.

## **7. IESBA Update**

Ms. Snyder reported on the IESBA's September 2016 meeting. She noted the following:

*Long Association of Audit Firm Personnel with an Audit Client*

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The IESBA unanimously approved final changes to the Code relating to the three remaining issues that were included in the February 2016 re-Exposure Draft, *Limited Re-exposure of Proposed Changes to the Code Addressing the Long Association of Personnel with an Audit Client*. She explained that these issues were: the duration of the cooling-off period for the engagement quality control reviewer (EQCR) on the audit of a public interest entity (PIE); whether to allow a reduction in the cooling-off period for engagement partners (EPs) and EQCRs on PIE audits where jurisdictions have established alternative requirements to address threats created by long association; and how long an individual should cool off from a PIE audit after having served in a combination of EP, EQCR or other key audit partner roles. Ms. Snyder explained that the revised provisions are subject to approval by the Public Interest Oversight Board (PIOB).

#### *Review of Safeguards in the Code*

The IESBA considered and provided feedback on a revised draft of the text of Phase 1 of its Safeguards project, comprising revisions to the provisions in the extant Code relating to the conceptual framework and the application of the conceptual framework to professional accountants in public practice (PAPPs). Topics discussed included: the description of the reasonable and informed third party; the description of the term “safeguards;” and the relationship between conditions, policies and procedures established by the profession, legislation, regulation and the firm, and the professional accountant’s identification and evaluation of threats. Ms. Snyder reported that the IESBA also considered a second-read draft of revisions to proposed Section 600, *Provisions of Non-assurance Services to an Audit Client* (Phase 2) and safeguards-related conforming amendments to other areas of the Code.

#### *Structure of the Code*

The IESBA considered a further analysis of respondents’ comments on its December 2015 Exposure Draft *Improving the Structure of the Code of Ethics for Professional Accountants – Phase 1* (ED-1) and related Task Force proposals on Phases 1 and 2 of the project, including a revised draft of the restructured text in ED-1. The IESBA broadly supported the direction of the Task Force’s proposals. Topics discussed included: clarification of the provisions in the introductions to the sections of the restructured Code regarding compliance with the fundamental principles, maintaining independence where required and applying the conceptual framework; avoidance of repetition regarding the requirement to apply the conceptual framework; the ordering of requirements and application material; clarification of the scope of the International Independence Standards with respect to audits of specific elements, accounts or items of a financial statement; and the title of the restructured Code.

#### *Review of Part C of the Code*

The IESBA considered a third read of the restructured text of the Part C Phase 1 close-off document, including conforming amendments arising from the Safeguards project, and a revised explanatory paragraph clarifying how Part C applies to PAPPs. The IESBA also discussed proposed refinements to the glossary definition of the term “professional accountant in business” (PAIB). The IESBA broadly supported the revised restructuring proposals.

The IESBA also considered a revised “straw man” outlining a proposed approach to developing enhancements to extant Section 350, *Inducements*.

#### *Responding to Non-Compliance with Laws and Regulations (NOCLAR)*

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The IESBA considered a draft of the restructured text of its recently issued Sections 225 and 360 on NOCLAR, prepared using the proposed new Structure format for the Code. The IESBA also provided input on draft IESBA Staff Q&A publications intended to form part of the tools and resources it has agreed to commission to facilitate implementation of the NOCLAR provisions.

#### *Professional Skepticism*

The IESBA was briefed on feedback to the International Auditing and Assurance Standards Board's (IAASB's) Invitation to Comment, *Enhancing Audit Quality in the Public Interest: A Focus on Professional Skepticism* as it relates to professional skepticism. The IESBA considered preliminary recommendations from the joint IAASB-IESBA-International Accounting Education Standards Board (IAESB) Professional Skepticism Working Group (PSWG) regarding actions that the three standard-setting boards could take, individually and in coordination, to enhance the application of professional skepticism in their respective standards. It also considered a "straw man" that outlined how the concept of professional skepticism could be enhanced in the Code. In addition, it discussed the merits of a short-term initiative to develop enhancements to the Code relating to the application of professional skepticism as it pertains to audit and other assurance engagements. The IESBA asked its representatives on the PSWG to explore the feasibility of developing the short-term enhancements for potential inclusion in an Exposure Draft to be issued contemporaneously with the Phase 2 Exposure Draft of the restructured Code, scheduled for approval at the December 2016 IESBA meeting.

### **8. Compilation of Pro-Forma Financial Information and Specified Procedures Engagements**

Mr. Glynn explained that when performing an examination or review of pro-forma financial information, the engagement is performed under the SSAEs and so the modified level of independence is applicable. However, now that the standards related to compilations of pro-forma financial information were moved out of the SSAEs and into the SSARS, this lower level engagement is not afforded the modifications to independence. The Committee agreed that a Task Force should review the independence guidance applicable to engagements under the SSAEs and determine if it needs to be updated.

Mr. Glynn also explained that a project to develop a new service referred to as "Specified Procedures" is underway. He explained that while similar to an AUP engagement, it would provide more flexibility because the member would not be required to obtain an assertion from management or the responsible party. However, unlike AUPs, the report would not be required to be restricted. Mr. Glynn explained the project team would appreciate the Committee's input regarding whether it believes this new service would be afforded modified independence. He noted that the new standard is expected to be exposed in May 2017.

### **9. Non-compliance with Laws and Regulations (NOCLAR) Task Force**

Mr. Denham began presenting the topic noting that the Task Force provided two draft interpretations for the PEEC's consideration: 1.170.010, *Responding to Non-Compliance with Laws and Regulations* (for members in public practice) and 2.170.010 – *Responding to Non-Compliance with Laws and Regulations* (for members in business).

Mr. Denham spoke of highlights in the proposed guidance noting:

- A member in public practice is required to raise the issue of a NOCLAR within the ranks of the client;

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- If the member in public practice is not comfortable with how a NOCLAR is addressed, the member should consider resigning from the engagement; and,
  - A member in public practice is required to raise the issue of a NOCLAR within the firm

Mr. Denham addressed the topic of overriding confidentiality in order to report a NOCLAR to an appropriate authority. At its previous meeting, the PEEC concluded that due to state confidentiality laws restricting such disclosure, the guidance should not permit such disclosure unless required by law. A member suggested that the guidance should include a statement that a member would be permitted to disclose a NOCLAR to an appropriate authority if done so with the consent of the client. Mr. Denham confirmed that the Task Force would amend the proposed guidance to include a reference to permitted disclosures included in the Confidential Client Rule.

There being no further discussion, Mr. Denham closed the discussion noting the Task Force would consider all comments of PEEC when revising the proposed guidance.

#### **10. Transfer of Client Files**

Mr. Mann raised concerns that the *Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice* interpretation was inconsistent with the Confidential Client Information Rule in that it would permit a member to disclose confidential client information to the owners of the successor firm (without client consent) provided the member retained an ownership interest in the successor firm. Mr. Mann believes the Rule would require consent so if the Committee believes consent is not required if the member complies with the *Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice* interpretation, the FAQ should specify such. The Committee directed staff to work with Mr. Mann to revise the FAQ to clarify that compliance with the interpretation would not result in violation of the Rule.

#### **11. Minutes of the Professional Ethics Executive Committee Open Meeting**

It was moved, seconded and unanimously carried to approve the minutes from the July 2016 open meeting.

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