



Professional Ethics Executive Committee

**February 4, 2016 Open Meeting Agenda
New Orleans, Louisiana**

**AICPA Professional Ethics Executive Committee
Open Meeting Agenda
February 4-5, 2016
New Orleans, Louisiana**

February 4 th	Open Meeting Begins	
9:00 a.m. – 10:30 a.m.	Definition of Client Mr. Mintzer and Ms. Ziemba will seek the Committee’s approval to expose proposed revisions to the definitions of “client” and “attest client” as well as changes to various interpretations resulting from these proposed changes.	Agenda Item 1A Agenda Item 1B
10:30 a.m. – 10:45 a.m.	AM Break	
10:45 a.m. – 11:45 a.m.	Information Technology and Cloud Services Ms. VanDyne and Ms. Gorla will seek the Committee’s feedback.	Agenda Item 2A Agenda Item 2B
11:45 a.m. - Noon	IESBA Update Ms. Snyder will update the Committee on the November 30- December 4, 2015 meeting of the IESBA.	
	LUNCH	
1:00 p.m. – 2:30 p.m.	Entities Included In State and Local Government Financial Statements Ms. Miller will Ms. Gorla will report on the Task Force’s deliberations, preliminary conclusions and planned next steps.	Agenda Item 3A Agenda Item 3B
2:30 p.m. – 2:50 p.m.	PEEC Planning Subgroup Mr. Burke and Ms. Snyder will report on the joint ASB/PRB/PEEC meeting. The most current version of the Committee’s three-year agenda is available at: ❖ <i>External Link - Project Agenda</i>	
2:50 p.m. – 3:05 p.m.	Afternoon Break	
3:05 p.m. – 3:35 p.m.	Compliance with Standards Ms. Snyder will seek the Committee’s feedback on an issue involving the application of the Compliance with Standards rule when there are no applicable technical standards promulgated by bodies designated by Council.	Agenda Item 4A Agenda Item 4B
3:35 p.m. – 4:05 p.m.	Applicability of Professional Standards for CPAs Preparing Financial Statements for Clients in Non-CPA Firm Ms. Snyder seeks the Committee’s input on a member inquiry regarding CPAs providing professional services for clients of non-CPA firms.	Agenda Item 5A Agenda Item 5B Agenda Item 5C
4:05 p.m. – 4:35 p.m.	Application of App. B, Council Resolution to Certain Attestation Engagements	Agenda Item 6A Agenda Item 6B

	Ms. Snyder will seek the Committee's input on how Appendix B should be applied.	
4:35 p.m. – 5:05 p.m.	<p>IESBA Exposure Drafts on Safeguards and Structure of the Code</p> <p>Mr. Evans will provide an overview of the recent proposals issued by the IESBA in December 2015 and request the Committee's feedback.</p>	<p>Agenda Item 7A Agenda Item 7B Agenda Item 7C Agenda Item 7D</p>
5:05 p.m. – 5:10 p.m.	<p>Minutes of the Professional Ethics Executive Committee Open Meeting</p> <p>The Committee is asked to approve the minutes from the October 2015 meeting.</p>	Agenda Item 8
	<i>Open Meeting Concludes</i>	
	<p>Future Meeting Dates</p> <ul style="list-style-type: none"> • May 5-6, 2016 – Durham, NC • July 12-13, 2016 – TBD • November 3-4, 2016 – Austin, TX 	

Definition of Client

Task Force Members

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

Staff: Shannon Ziemba and Ellen Gorla

Task Force Charge

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

Reason for Agenda Item

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

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

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

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

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

Summary of Issues

Definition of Client

The Task Force recommends that the definition of client should only be the person or entity that engages the member and not include the entity the member is performing the professional services on (target entity) if that target entity does not engage the member. In addition, the Task Force recommends that the government provision be moved from the client definition to an interpretation into the Independence section of the Code since the government provision involves

independence and attest engagements. 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.

Question for the Committee

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

Definition of Attest Entity

As discussed at the July 2015 Committee meeting, it was decided that the definition of an attest entity should only include the person or entity that the member is performing the attest engagement on and as such, should not be considered a subset of the client definition since doing so would then pull in the engaging entity.

At the October 2015 Committee meeting, it was discussed at length that it may be confusing to use the term attest client when the attest client is not always a client (that is, the engaging entity). Therefore, it was recommended to change the term to attest entity. A majority of the Committee agreed with that recommendation.

Staff looked at other standard setting bodies to see comparable terms. Following is what staff found:

- IESBA – audit client (which refers to both audit and review clients) – an entity in respect of which a firm conducts an audit engagement. Client is also used but it is not a defined term.
- PCAOB - audit client defined as “the entity whose financial statements or other information is being audited, reviewed, or attested and any affiliates of the audit client.” Auditing standards use “client” and “entity”
- SEC – audit client
- GAO - in the yellow book, “entity” and “audited entity”, in the financial audit manual mostly use “the entity”. Client is used to establish an understanding with the client section
- SSARS – the “entity” – use phrases such as “the entity whose financial statements are the subject of the [audit, review, or compilation] engagement”
- Auditing Standards – mostly use “the entity”. Client is used in the client acceptance section
- QC Standards – mostly use client and engagement however entity is in the standards a couple of times. Engagement is used in context to what is subject to the QC standards

As recommended by the Committee, the Task Force added a sentence to the attest entity definition that explains a client who is also an attest entity can also be referred to as an attest client.

At the October 2015 Committee meeting, it was decided that the Commissions and Referral Fees Rule should be applied to attest entities. Therefore, the Task Force recommends adding a note to the attest entity definition and the Application of the “Commissions and Referral Fees Rule” to Attest Entities interpretation [1.520.015] under the Commissions and Referral Fees Rule informing the member of that. There will also be an interpretation under the Rule which informs the member

to apply the Rule to attest entities. The Task Force could not come up with a scenario where a member would have a contingent fee agreement with an entity that was not also the engaging entity (i.e., client) so did not include the Contingent Fee Rule [1.510.001] in this note.

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

Attest entity. Any person or entity, whether or not a *client*, with respect to which a *member* performs an *attest engagement*.

In practice, when the attest entity is also the entity that engages the *member* to perform the *attest engagement*, the attest entity can also be referred to as an attest client.

In addition to applying the “Commissions and Referral Fees Rule” [1.520.001] to clients (that is, the entity that engages the member to perform any of the services specified in those rules), members should apply the rule to any person or entity with respect to which a member performs one of the attest services specified in the rule.

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

Question for the Committee

1. Given how the other standard setting bodies comparable terms, is the Committee comfortable using the term “attest entity” instead of “attest client”?
2. Can the Committee come up with a scenario where a member would have a contingent fee agreement with an entity that was not also the engaging entity (i.e., client)? If not, then is the Committee comfortable not also including a reference to the Contingent Fee Rule [1.510.001]?
3. Does the Committee approve the proposed revisions to the “attest client/entity” 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 issue is related to simultaneous employment therefore the Task Force determined the most logical place to place the government provision in the Independence section was in the Simultaneous Employment or Association With an Attest 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 to the definition 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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| <ol style="list-style-type: none">1. Does the Committee approve the relocating the government provision to Simultaneous Employment or Association with an Attest Entity interpretation?2. Does the Committee approve exposing this to membership? |
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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 entity in the Code to determine if any revisions were needed based on the above edits to those definitions. The Task Force does not recommend any changes where attest entity is used in the Code. The changes to the use of the term client recommended by the Task Force can be grouped into three categories:

Category 1. This category mainly includes situations where the Task Force believes changes are necessary since an attest entity is no longer considered a subset of a client. In the situations where the Task Force believes the guidance intended to include both the entity that engages the member as well as the target entity, the Task Force took one of two actions. If the guidance could stand on its own without mentioning either term “client or attest entity”, then the term “client” was removed. However, if the guidance could not stand on its own, then the Task Force ensured both terms were used. This was achieved by adding the term “attest entity”.

Category 2. The Task Force determined that based on the revised definitions of client and attest entity that phrase “perform professional services for an attest entity” is not grammatically correct. Grammatically speaking, members can perform professional services for clients but can only perform professional services on attest entities, who may or may not be the client. Therefore, some of the recommended revisions by the Task Force are changing from “a client for whom the member performs a service” to “an attest entity with respect to which the member performs a service”.

The exception to this is in the Nonattest Services Subtopic. In this subtopic, it was decided that grammatically the attest entity would also be a client since the member is performing nonattest services along with an attest engagement. Since this subtopic addresses independence concerns the Task Force believes it is better if the term attest entity is used (e.g., 1.295.040.01 says “When a member performs a nonattest service for an *attest entity*, *threats* to the member’s compliance with the “Independence Rule” [1.200.001] may exist”).

Category 3. The Task Force found a couple of places where a reference to other sections of the Code needed to be changed or added based on the edits to the definitions.

Category 4. Conforming changes based on changing attest client to attest entity.

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

Question for Committee

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

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

As discussed and tentatively approved at the July and the October PEEC meetings, the Task Force recommends adding the following interpretation to the Code to address the potential unintended consequence where a member receives information from an attest entity that is not also a client. Since the requirements contained in the *Records Request* interpretation [1.400.200] do not extend to attest entities that are not also clients, the Task Force recommends an additional paragraph be added to the *Use of Confidential Information From Nonclient Sources* interpretation [1.400.240]. It would align with the requirement from the *Records Request* interpretation that members return original records upon request. So that the reader does not skip over this

guidance, the Task Force further recommends that the title of the interpretation be changed to ~~Use of Confidential~~ Information **Obtained** From Nonclient Sources. The Task Force's recommendations for this unintended consequence are:

1.400.240 ~~Use of Confidential~~ Information **Obtained** From Nonclient Sources

.01 If a *member* discloses confidential information obtained from a prospective *client* or a nonclient without consent, the *member* would be in violation of the "Acts Discreditable Rule" [1.400.001]. [Prior reference: paragraphs .027-.028 of ET section 391 and new content].

.02 If a *member* receives accounting or other records from a prospective *client* or a nonclient (including an attest entity that is not also a client) and does not return those original records upon request, the *member* would be in violation of the "Acts Discreditable Rule" [1.400.001].

When discussing the above addition, the Task Force noted that members may consult the *Requests Request* interpretation looking for guidance when they receive information from an attest entity that is not also a client. To assist them in locating the guidance on point, the Task Force recommends adding new paragraph .12 to the *Records Request* interpretation that will direct the reader to the appropriate information. The additional paragraph would read as follows (a marked version of the changes to the definition appear in Agenda Item 2B):

1.400.200.12 Refer to the Information Obtained From Nonclient Sources interpretation [1.400.240] of the "Acts Discreditable Rule" [1.400.001] for additional guidance regarding a disclosure of information obtained from a prospective *client* and a nonclient (including an attest entity that is not also a client).

When reviewing the interpretations under the Confidential Client Information Rule, the Task Force noted that since members will no longer apply the Confidential Client Information Rule to attest entities that aren't also clients, and that while members will still have to keep information obtained from the non-client confidential to avoid a violation under the Acts Discreditable Rule as described above in interpretation 1.400.240, that some of the specific guidance explained in certain interpretations would no longer be available to members providing services on these non-client entities. Following are the interpretations under the Confidential Client Information Rule that would not apply to attest entities that aren't also clients

- The Disclosing Client Names interpretation [1.700.090] will no longer specifically indicate that it would be a violation of the code to disclose the name of an attest entity that isn't also a client if doing so would result in disclosing confidential client information such as when your firm only does work for clients in bankruptcy. While the member might be able to get there by using the *Information Obtained From Nonclient Sources* interpretation (1.400.240) there wouldn't be specific interpretive guidance relating to this available to members who have attest entities that aren't also clients.
- The Client Competitors interpretation [1.700.010] indicates that to reduce the threat of disclosing confidential client information to a competitor, the member should emphasize to all relevant parties, including employees of the firm and affected clients that the "Confidential Client Information Rule" prohibits members from revealing to others any confidential client information obtained in their professional capacity. So in a situation where the member is retained by a third party to audit an entity and the firm

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- has a tax client that is a direct competitor of the entity that the member would be auditing, the provisions of this interpretation would only apply to the entity that engages the member to provide the audit services and the tax client.
- The Disclosing Information from Previous Engagements interpretation [1.700.020]. This interpretation reminds members that when sharing knowledge and experience with a prospective client, the member should be careful not to disclose information that would allow the prospective client to determine the source of the information. It also reminds members that if contacted by a successor firm after withdrawing from an engagement the member should request the successor firm obtain consent for the member to discuss all matters freely with the successor firm and should seek legal advice where necessary.
 - The Disclosing Information to Persons or Entities Associated With Clients interpretation [1.700.030]. A portion of the interpretation explains that if a member is providing executives of an entity with professional services, the member would be in violation of the rule if he or she disclosed the executive's information to their company without the executive's consent.
 - The Disclosing Information to a Third-Party Service Provider interpretation [1.700.040]. This interpretation requires members to either obtain the client's consent to disclose its information to the third party service provider or to enter into a contractual agreement with the third-party service provider to maintain the confidentiality of the information and provide reasonable assurance that the third-party service provider has appropriate procedures in place to prevent the unauthorized release of confidential information to others.
 - The Disclosing Client Information in Connection with a Review of the Member's Practice interpretation [1.700.050] would only apply to confidential client information and not information received from an attest entity that isn't otherwise a client. This interpretation explains that a member must take appropriate precautions to help ensure that the prospective purchaser does not disclose any confidential client information obtained in the course of the review and if the member is the reviewer, reminds them they may not use the information they saw to their advantage.
 - The Disclosure of Client Information to Third Parties interpretation [1.700.060]. This interpretation provides guidance regarding providing information to a third party for things like conducting a benchmarking study.
 - The Disclosing Client Information During Litigation interpretation [1.700.070]. This interpretation explains that it would not violate the rule if a member disclosed confidential information to his or her liability carrier in order to assist in the defense against an actual or potential claim against the member.
 - The Disclosing Client Information in Director Positions interpretation [1.700.080] would only apply to confidential client information and not information received from an attest entity that isn't otherwise a client. This interpretation provides guidance to members regarding potential issues they could encounter while holding a fiduciary role at a bank. [Ellen thinks it would be helpful to extend to attest entities that aren't also client's]
 - The Disclosing Confidential Client Information as a Result of a Subpoena or Summons interpretation [1.700.100]. This interpretation explains that the member is not required to notify a client that its records have been subpoenaed or that a summons related to the client's records has been issued and that complying with a valid subpoena or summons would not be a violation of the rule.

At the October 2015 PEEC meeting, it was determined that Commissions and Referral Fees Rule should extend to the attest entities and not just clients. Given the fact that rules cannot be change without a vote by membership, the Task Force is recommending the addition of the following interpretation:

1.520.015 Application of the “Commissions and Referral Fees Rule” to Attest Entities

- .01 In addition to applying the Commissions and Referral Fees Rule” [1.520.001] to clients (that is, the entity that engages the member to perform any of the services specified in those rules), members should apply the rule to any person or entity with respect to which a member performs one of the attest services specified in the rule.

Another issue relates to the Confidential Information topic. For several meetings the Task Force believed that there was an unintended consequence in this topic. Specifically, since this topic only uses the term client, the Task Force was concerned that when an attest entity is not also a client, members may not know what their confidentiality responsibilities are to attest entities. Recently the Task Force remembered that 1.400.240 could be used to cover the situation where an attest entity is not also a client. However, since 1.400.240 appears in the Acts Discreditable topic and not the Confidential Information topic, the Task Force had overlooked it. So that members don't overlook 1.400.240, the Task Force recommends adding an interpretation to the Confidential Information topic entitled “Disclosing Information from a Prospective Client or a Nonclient [1.700.035]” that will contain a cross reference to 1.400.240. The Task Force notes that a similar “cross reference only interpretation” was added by the Committee to the Fees and Other Types of Remuneration topic so members did not miss the Unpaid Fees interpretation [1.500.008] found in the Independence topic. The new interpretation would read:

1.700.035 Disclosing Information from a Prospective Client or a Nonclient

- .01 Refer to the *Information Obtained From Nonclient Sources* interpretation [1.400.240] of the “Acts Discreditable Rule” [1.400.001] for guidance regarding disclosure of information obtained from a prospective *client* and a nonclient (including an attest entity that is not also a client).

Questions For the Committee

1. Does the Committee believe it is clear that a nonclient includes an attest entity that is not also a client? If not, then should the following parenthetical phrase be added after the term “nonclient” “(including an attest entity that is not also a client” be added after the term “nonclient)”?
2. Does the Committee believe unintended consequences are created by not replicating the existing interpretations under the Confidential Client Information Rule in the interpretations under the “Acts Discreditable Rule” or does the Committee believe that the general guidance provided for in the *Information Obtained From Nonclient Sources* interpretation (1.400.240) is sufficient to address these consequences? If so, does the Committee believe State Boards and other regulatory bodies will agree?
3. Does the Committee approve the proposed revisions to 1.400.240 for exposure to membership?
4. Does the Committee approved the proposed addition to 1.400.200 for exposure to membership?
5. Does the Committee approve the proposed addition to 1.520.015 for exposure to membership?

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| <ol style="list-style-type: none">6. Does the Committee agree that Commissions and Referral Fee Rule notation to include attest entity in the Rule should be in both the definition and an interpretation of the Commissions and Referral Fee section [1.520]? Or does it only need to be in the interpretation?7. Does the Committee approved the proposed addition of 1.700.035 for exposure to membership? |
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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.

<p>Question For the Committee</p> <ol style="list-style-type: none">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?
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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

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| <p>Agenda Item 1B</p> | <p>Complete Listing of the Proposed New Interpretations and Proposed Revised Definitions, Application of the AICPA Code, and Interpretations</p> |
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Agenda Item 1B

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

0.400.03 Attest entity client. A ~~client~~ that engages a ~~member~~ to perform an ~~attest engagement~~ of **Any person or entity, whether or not a client**, with respect to which a member performs an attest engagement.

In practice, when the attest entity is also the entity that engages the member to perform the attest engagement, the attest entity can also referred to as an attest client.

In addition to applying the Commissions and Referral Fees Rule” [1.520.001] to clients (that is, the entity that engages the member to perform any of the services specified in that rule), members should apply the rule to any person or entity with respect to which a member performs any of the attest services specified in the rule.

See paragraph .03 of the “Client Affiliate” interpretation [1.224.010] for acquisitions and business combinations that involve a *financial statement attest **entity client***.

Effective Date

This definition is effective December 15, 2014.

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

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

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

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

Text of Proposed Revised Definitions

(Additions appear in boldface italic and deletions are stricken)

[Refer to the Excel File Named: Client Task Force -Recommended Changes for Rational]

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

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

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

Rationale for edit – Category 4

0.400.12 Covered member. All of the following:

- a. an individual on the *attest engagement team*.
- b. an *individual in a position to influence the attest engagement*.
- c. a *partner, partner equivalent, or manager* who provides more than 10 hours of nonattest services to the *attest entity client* within any fiscal year. Designation as *covered member* ends on the later of (i) the date that the *firm* signs the report on the *financial statements* for the fiscal year during which those services were provided or (ii) the date he or she no longer expects to provide 10 or more hours of nonattest services to the *attest entity client* on a recurring basis.
- d. a *partner or partner equivalent* in the *office* in which the lead *attest engagement partner* or *partner equivalent* primarily practices in connection with the *attest engagement*.
- e. the *firm*, including the *firm's* employee benefit plans.
- f. an entity whose operating, financial, or accounting policies can be *controlled* by any of the individuals or entities described in items a–e or two or more such individuals or entities if they act together. [Prior reference: paragraph .07 of ET section 92]

[Rationale for edit – Category 4](#)

0.400.16 Financial statement attest entity client. An entity whose *financial statements* are audited, reviewed, or compiled when the *member's* compilation report does not disclose a lack of *independence*. This term is used in the “Client Affiliates” interpretation [1.224.010] of the “Independence Rule” [1.200.001] and in the definition of an affiliate [0.400.02]. [Prior reference: paragraph .20 of ET section 101]

[Rationale for edit – Category 4](#)

0.400.17 Financial statements. A presentation of financial data, including accompanying disclosures, if any, intended to communicate an entity's economic resources or obligations, or both, at a point in time or the changes therein for a period of time, in accordance with the applicable financial reporting framework. Incidental financial data to support recommendations to a *client by a member* or in (a) documents for which the reporting is governed by SSAEs and (b) tax returns and supporting schedules do not, for this purpose, constitute financial statements. The statement, affidavit, or signature of preparers required on tax returns neither constitutes an opinion on financial statements nor requires a disclaimer of such opinion. [Prior reference: paragraph .10 of ET section 92]

[Rationale for edit – Category 1](#)

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

[Rationale for edit – Category 1](#)

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 – Category 1](#)

0.400.30 Manager. A professional employee of the *firm* who has continuing responsibility for the planning and supervision of **specific** engagements ~~for specified clients~~. [Prior reference: paragraph .20 of ET section 92]

[Rationale for edit – Category 1](#)

0.400.36 Office. A reasonably distinct subgroup within a *firm*, whether constituted by formal organization or informal practice, in which personnel who make up the subgroup generally serve the same group of *clients* **or attest entities** or work on the same categories of matters. Substance should govern the office classification. For example, the expected regular personnel interactions and assigned reporting channels of an individual may well be more important than an individual's physical location. [Prior reference: paragraph .26 of ET section 92]

[Rationale for edit – Category 1](#)

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 "begins to perform an attest engagement for a client" – Category 1](#)

[Rationale for no edit "ends with the formal or information notification, either by member or client – Category 2](#)

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 entity** ~~client~~ under such regulations. [Prior reference: paragraph .20 of ET section 100-1]

[Rationale for edit– Category 1](#)

0.400.47 Third-party service provider. All of the following:

- a. An entity that the *member* does not *control*, individually or collectively with his or her *firm* or with *members* of his or her *firm*.
- b. An individual not employed by the *member* who assists the *member* in providing *professional services to clients* (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions). [Prior reference: paragraphs .224–.225 of ET section 191, .023–.024 of ET section 291, and .001–.002 of ET section 391]

Rationale for edit – Category 1

Text of Proposed Revised “Application of the AICPA Code”

(Additions appear in boldface italic and deletions are stricken)

[Refer to the Excel File Named: Client Task Force -Recommended Changes for Rational]

0.200.020.05 The *independence* of a *member* in *public practice* or a *covered member* may be impaired with respect to ***an attest entity 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 – Category 1

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.

[Refer to the Excel File Named: Client Task Force -Recommended Changes for Rational]

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

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

[No prior reference: new content]

1.000.010.23 j. A means for informing *partners* and professional staff of *attest entities clients* and related entities from which they must be independent.

Rationale for edit – Category 4

1.000.010.23 y. Policies that preclude audit *partners* or *partner equivalents* from being directly compensated for selling nonattest services to the *attest entity client*.

Rationale for edit – Category 4

1.110.010.02 A conflict of interest creates adverse interest and self-interest *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001]. For example, *threats* may be created when

- a. the *member* or the *member's firm* provides a *professional service* related to a particular matter involving two or more *clients or attest entities* whose interests with respect to that matter are in conflict, or
- b. the interests of the *member* or the *member's firm* with respect to a particular matter and the interests of **the attest entity or the client** for whom the *member* or the *member's firm* provides a *professional service* related to that matter are in conflict.

Rationale for edit "to a particular matter involving two or more *client or attest entities*" – Category 1

Rational for no edit "the interest of the *client* for whom the *member* or the *member's firm* provides a professional services" – Category 2

1.110.010.05 Before accepting a new *client* relationship, **attest** engagement, or business relationship, a *member* should take reasonable steps to identify circumstances that might create a conflict of interest including identification of

- a. the nature of the relevant interests and relationships between the parties involved and
- b. the nature of the service and its implication for relevant parties.

Rationale for edit – Category 1

1.110.010.06 The nature of the relevant interests and relationships and the services may change during the course of the engagement. This is particularly true when a *member* is asked to conduct an engagement for a *client* in a situation that may become adversarial with respect to another *client or attest entity* or the *member* or *member's firm*, even though the parties who engage the *member* may not initially be involved in a dispute. A *member* should remain alert to such changes for the purpose of identifying circumstances that might create a conflict of interest.

Rational for no edit "to conduct an engagement for a *client*" – Category 2

Rationale for edit "with respect to another *client or attest entity or the member or member's firm*" – Category 1

1.110.010.07 For the purpose of identifying interests and relationships that might create a conflict of interest, having an effective conflict identification process assists a *member* in identifying actual or potential conflicts of interest that may create significant *threats* to compliance with the "Integrity and Objectivity Rule" [1.100.001] prior to determining whether to accept an engagement and throughout an engagement. This includes matters identified by external parties, for example **potential or existing clients or attest entities**, or ~~potential clients~~. The earlier an actual or potential conflict of interest is identified, the greater the likelihood of a *member* being able to apply *safeguards* to eliminate or reduce significant *threats* to an *acceptable level*. The process to identify actual or potential conflicts of interest will depend on such factors as

- a. the nature of the *professional services* provided,

- b. the size of the *firm*,
- c. the size and nature of the *client* base, and
- d. the structure of the *firm*, for example the number and geographic location of offices.

Rationale for edits – Category 1

1.110.010.10 If the *member* concludes that the *threat* is not at an *acceptable level*, the *member* should apply *safeguards* to eliminate the *threat* or reduce it to an *acceptable level*. Examples of *safeguards* include the following:

- a. Implementing mechanisms to prevent unauthorized disclosure of confidential information when performing *professional services* related to a particular matter for two or more *clients* whose interests with respect to that matter are in conflict. This could include
 - i. using separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality;
 - ii. creating separate areas of practice for specialty functions within the *firm*, which may act as a barrier to the passing of *confidential client information* from one practice area to another within a *firm*;
 - iii. establishing policies and procedures to limit access to *client* files, the use of confidentiality agreements signed by employees and *partners* of the *firm* and the physical and electronic separation of confidential information.
- b. Regularly reviewing the application of *safeguards* by a senior individual not involved with the *client* engagement or engagements.
- c. Having a member of the *firm* who is not involved in providing the service or otherwise affected by the conflict, review the work performed to assess whether the key judgments and conclusions are appropriate.
- d. Consulting with third parties, such as a professional body, legal counsel, or another professional accountant.

Rationale for edit – Category 1

1.110.010.12 When a conflict of interest exists, the *member* should disclose the nature of the conflict of interest to *clients*, **attest entities**, and other appropriate parties affected by the conflict and obtain their consent to perform the *professional services*. The *member* should disclose the conflict of interest and obtain consent even if the *member* concludes that *threats* are at an *acceptable level*.

Rationale for edit – Category 1

1.110.010.13 Disclosure and consent may take different forms. The following are examples:

- a. General disclosure to *clients* **or attest entities** of circumstances in which the *member*, in keeping with common commercial practice, does not provide services exclusively for any one *client* (for example, in a particular service in a particular market sector) in order for the *client* **member to obtain** to provide general consent accordingly. Such disclosure might be made in a *member's* standard terms and conditions for the engagement.
- b. Specific disclosure to **the affected parties** *clients* of the circumstances of the particular conflict including an explanation of the situation and any planned safeguards, sufficient to enable the **affected party** *client* to make an informed decision with respect to the matter and to provide specific consent.

Rationale for edits – Category 1

1.110.010.15 When a *member* has requested specific consent from a *client* **or attest entity** and that consent has been refused ~~by the client~~, the *member* should (a) decline to perform or discontinue *professional services* that would result in the conflict of interest; or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the *threat* or reduce it to an

acceptable level, such that consent can be obtained, after applying any additional *safeguards*, if necessary.

Rationale for edits – Category 1

1.110.010.17 When addressing conflicts of interest, including making disclosures and seeking guidance of third parties, a *member* should remain alert to the requirements of the "Confidential Client Information Rule" [1.700.001], ~~and~~ the "Confidential Information Obtained From Employment or Volunteer Activities" interpretation [1.400.070] **and the "Information Obtained from Nonclient Sources" interpretation [1.400.240]** of the "Acts Discreditable Rule" [1.400.001]. In addition, federal, state, or local statutes, or regulations concerning confidentiality of ~~client~~ information may be more restrictive than the requirements contained in the Code of Professional Conduct.

Rationale for edit "and the "Information Obtained from Nonclient Sources" interpretation [1.400.240]" – Category 3

Rationale for edit "concerning confidentiality of ~~client~~ information" – Category 1

1.110.020.01 When a *member* serves as a director of an entity, such as a bank, the *member's* fiduciary responsibilities to the entity may create *threats* to the *member's* compliance with the "Integrity and Objectivity Rule" [1.100.001] and the "Confidential Client Information Rule" [1.700.001]. For example, an adverse interest *threat* to the *member's* objectivity may exist if the *member's clients or attest entities* are customers of the entity or likely to engage in significant transactions with the entity. A *member's* general knowledge and experience may be very helpful to an entity in formulating policies and making business decisions. Nevertheless, if the *member's clients or attest entities* are likely to engage in significant transactions with the entity, it would be more appropriate for the *member* to serve as a consultant to the board. Under such an arrangement, the *member* could limit activities to those that do not *threaten* the *member's* compliance with these rules. If, however, the *member* serves as a board member, the *member* should evaluate the significance of any *threats* and apply *safeguards*, when necessary, to eliminate or reduce the *threats* to an *acceptable level*.

Rationale for edits – Category 1

1.120.010.01 For purposes of this interpretation, a client includes ~~the~~ **a client, an attest entity**, an individual in a *key position* with ~~the~~ **at either a client or an attest entity**, or an individual owning 10 percent or more of ~~the~~ **a client's or an attest entity's** outstanding equity securities or other ownership interests.

Rationale for edits – Category 1

1.140.010.01 An advocacy *threat* to compliance with the "Integrity and Objectivity Rule" [1.100.001] may exist when a *member* or the *member's firm* is engaged to perform nonattest services, such as tax and consulting services, that involve acting as an advocate for the *client* or **attest entity** or to support a *client's* or **attest entity's** position on accounting or financial reporting issues either within the *firm* or outside the *firm* with standard setters, regulators, or others.

Rationale for edits – Category 1

1.150.040.02 *Clients and attest entities* might not have an expectation that a *member* would use a *third-party service provider* to assist the *member* in providing the *professional services*. Therefore, before disclosing ~~confidential client information~~ **confidential information** to a *third-party service provider*, the *member* should inform the *client and attest entity, as appropriate*, preferably in writing, that the *member* may use a *third-party service provider*. If the *client or attest entity* objects to the *member's* use of a *third-party service provider*, the *member* either should not

use the *third-party service provider* to perform the *professional services* or should decline to perform the engagement.

[Rationale for edits – Category 1](#)

1.150.040.03 A *member* is not required to inform the *client* **or attest entity** when he or she uses a *third-party service provider* to provide administrative support services to the *member* (for example, record storage, software application hosting, or authorized e-file tax transmittal services).

[Rationale for edits – Category 1](#)

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

[Rationale for edit – Category 4](#)

1.210.010.12 *Adverse interest threat*. The *threat* that a *member* will not act with objectivity because the *member's* interests are in opposition to the interests of an *attest entity client*. An example is either the *attest entity client* or the *member* commencing litigation against the other or expressing the intent to commence litigation

[Rationale for edit – Category 4](#)

1.210.010.13 *Advocacy threat*. The *threat* that a *member* will promote an *attest entity's client's* interests or position to the point that his or her *independence* is compromised. Examples of *advocacy threats* include the following:

- a. A *member* promotes the *attest entity's client's* securities as part of an initial public offering
- b. A *member* provides expert witness services to an *attest entity client*.
- c. A *member* represents an *attest entity client* in U.S. tax court or other public forum.

[Rationale for edit – Category 4](#)

1.210.010.14 *Familiarity threat*. The *threat* that, because of a long or close relationship with an *attest entity client*, a *member* will become too sympathetic to the *attest entity's client's* interests or too accepting of the *attest entity's client's* work or product. Examples of *familiarity threats* include the following:

- a. A *member* of the *attest engagement team* has an *immediate family* member or *close relative* in a *key position* at the *attest entity client*, such as the *attest entity's client's* CEO.
- b. A *partner* or *partner equivalent* of the *firm* has been a *member* of the *attest engagement team* for a prolonged period.
- c. A *member* of the *firm* has recently been a *director* or an *officer* of the *attest entity client*.
- d. A *member* of the *attest engagement team* has a *close friend* who is in a *key position* at the *attest entity client*.

[Rationale for edit – Category 4](#)

1.210.010.15 *Management participation threat*. The *threat* that a *member* will take on the role of *attest entity client* management or otherwise assume management responsibilities for an *attest entity client*. Examples of *management participation threats* include the following:

- a. A *member* serves as an *officer* or a *director* of the *attest entity client*.
- b. A *member* accepts responsibility for designing, implementing, or maintaining internal controls for the *attest entity client*.
- c. A *member* hires, supervises, or terminates the *attest entity's client's* employees.

Rationale for edit – Category 4

1.210.010.16 *Self-interest threat.* The *threat* that a *member* could benefit, financially or otherwise, from an interest in, or relationship with, an *attest entity client* or persons associated with the *attest entity client*. Examples of self-interest *threats* include the following:

- a. A *member* has a *direct financial interest* or material *indirect financial interest* in the *attest entity client*
- b. A *member* has a loan from the *attest entity client*, an officer or a director of the *attest entity client*, or an individual who owns 10 percent or more of the *attest entity's client's* outstanding equity securities.
- c. A *member* or his or her *firm* relies excessively on revenue from a single *attest entity client*.
- d. A *member* or *member's firm* has a material joint venture or other material joint business arrangement with the *attest entity client*.

Rationale for edit – Category 4

1.210.010.17 *Self-review threat.* The *threat* that a *member* will not appropriately evaluate the results of a previous judgment made, or service performed or supervised by the *member* or an individual in the *member's firm* and that the *member* will rely on that service in forming a judgment as part of an *attest engagement*. Certain self-review *threats*, such as preparing *source documents* used to generate the *attest entity's client's financial statements* [1.295.120], pose such a significant self-review *threat* that no *safeguards* can eliminate or reduce the *threats* to an *acceptable level*.

Rationale for edit – Category 4

1.210.010.18 *Undue influence threat.* The *threat* that a *member* will subordinate his or her judgment to that of an individual associated with an *attest entity client* or any relevant third party due to that individual's reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the *member*. Examples of undue influence *threats* include the following:

- a. Management threatens to replace the *member* or *member's firm* over a disagreement on the application of an accounting principle.
- b. Management pressures the *member* to reduce necessary audit procedures in order to reduce audit fees.
- c. The *member* receives a gift from the *attest entity client*, its management, or its significant shareholders.

Rationale for edit – Category 4

1.210.010.19 *Safeguards* may partially or completely eliminate a *threat* or diminish the potential influence of a *threat*. The nature and extent of the *safeguards* applied will depend on many factors, including the size of the *firm* and whether the *attest entity client* is a *public interest entity*. To be effective, *safeguards* should eliminate the *threat* or reduce it to an *acceptable level*.

Rationale for edit – Category 4

1.210.010.20 The following are three broad categories of *safeguards*:

- a. *Safeguards* created by the profession, legislation, or regulation.
- b. *Safeguards* implemented by the *attest entity client*. It is not possible to rely solely on *safeguards* implemented by the *attest entity client* to eliminate or reduce significant *threats* to an *acceptable level*.
- c. *Safeguards* implemented by the *firm*, including policies and procedures to implement professional and regulatory requirements.

Rationale for edit – Category 4

1.210.010.21 The effectiveness of a *safeguard* depends on many factors, including those listed here:

- a. The facts and circumstances specific to a particular situation
- b. The proper identification of *threats*
- c. Whether the *safeguard* is suitably designed to meet its objectives
- d. The party(ies) that will be subject to the *safeguard*
- e. How the *safeguard* is applied
- f. The consistency with which the *safeguard* is applied
- g. Who applies the *safeguard*
- h. How the *safeguard* interacts with a *safeguard* from another category
- i. Whether the attest **entity** *client* is a *public interest entity*

Rationale for edit – Category 4

1.220.010.04 A *network firm* is required to comply with the “Independence Rule” [1.200.001] with respect to the *financial statement* audit and review *clients* of the other network firms if the use of the audit or review report for the *client* is not restricted, as defined by professional standards. For all other attest **entities** *clients*, the *covered member* should consider any *threats* that the *covered member* knows or has reason to believe may be created by another *network firm*’s interests and relationships. If those *threats* are not at an *acceptable level*, the *covered member* should apply *safeguards* to eliminate the *threats* or reduce them to an *acceptable level*. If *safeguards* cannot be applied to eliminate or reduce the *threats* to an *acceptable level*, *independence* will be *impaired*. Entities within the *network* that meet the definition of a *network firm* are subject to the “Independence Rule.”

Rationale for edit – Category 4

1.220.010.14 Examples of professional resources include the following:

- a. Common systems that enable *firms* to exchange information, such as *client engagement* data, billing, and time records
- b. *Partners* and staff
- c. Technical departments to consult on technical or industry-specific issues, transactions, or events for assurance engagements
- d. Audit methodology or audit manuals
- e. Training courses and facilities

Rationale for edits – Category 1

1.220.010.15 When shared professional resources involve the exchange of *client engagement* information or personnel, such as when staff are drawn from a shared pool or a common technical department is created within the association to provide participating *firms* with technical advice that the *firms* are required to follow, a reasonable and informed third party who is aware of the relevant information would be expected to conclude that the shared professional resources are significant.

Rationale for edits – Category 1

1.220.010.16 When the entities within the association do not share a significant amount of human resources (for example, a *firm* occasionally uses personnel of another member *firm* to assist with an engagement, such as observing a *client*’s physical inventory count) or significant *client* or **attest entity** information (for example, *client* data, billing, and time records) and have the ability to make independent decisions regarding technical matters, audit methodology, training, and the like, the entities are not considered to be sharing a significant part of professional resources.

Rationale for edits – Category 1

1.220.010.17 When the shared professional resources are limited to a common audit methodology, audit manuals, training courses, or facilities and do not include a significant amount of human resources or *clients engagement* or markets *information*, the shared professional resources are not considered significant.

Rationale for edits – Category 1

1.220.020.06 The example APS in this interpretation is one in which an existing CPA practice (Oldfirm) is sold by its owners to another (possibly public) entity (PublicCo). PublicCo has subsidiaries or divisions, such as a bank, an insurance company, or a broker-dealer. It also has one or more professional service subsidiaries (PSS) or divisions that offer nonattest services (for example, tax, personal financial planning, and management consulting) to *clients*. The owners and employees of Oldfirm become employees of one of PublicCo's subsidiaries or divisions and may provide those nonattest services. In addition, the owners of Oldfirm form a new CPA firm (Newfirm) to provide attest services. CPAs, including the former owners of Oldfirm, own a majority of Newfirm (with regard to voting and financial interests). Attest services are performed by Newfirm and supervised by its owners. The arrangement between Newfirm and PublicCo (or one of its subsidiaries or divisions) includes the lease of employees, office space, and equipment; the performance of back-office functions, such as billing and collections; and advertising. Newfirm pays a negotiated amount for these services.

Rationale for edit – Category 1

1.220.020.09 *Threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level*, could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* when the following individuals or entities fail to apply the “Independence Rule” and *interpretations* with respect to attest *entities clients* of Newfirm:

- a. Covered members of Newfirm
- b. Direct superiors of any *partner* or *manager* who is a covered member of Newfirm and entities within the APS over which such individuals can exercise *significant influence*

Rationale for edit – Category 4

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

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

- c. Financial relationships of indirect superiors or other public company entities allow such persons or entities to exercise significant influence over the *attest entity client* during the *period of the professional engagement*. In making the test for significant influence, financial relationships of all indirect superiors and other public company entities should be aggregated.
- d. Other public company entities or any of their employees are connected with an *attest entity client* of Newfirm as a promoter, an underwriter, a voting trustee, a director, or an officer during the *period of the professional engagement* or during the period covered by the *financial statements*.

Rationale for edit – Category 4

1.220.020.11 Indirect superiors and other public company entities may provide services to an *attest entity client* of Newfirm that would *impair independence* if performed by Newfirm, except as noted in paragraph .10d.

Rationale for edit – Category 4

1.220.020.13 If an *attest entity client* of Newfirm holds an investment in PublicCo that is material to the *attest entity client* or that allows the *attest entity client* to exercise significant influence over PublicCo during the *period of the professional engagement*, *threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards*. Accordingly, *independence* would be *impaired*.

Rationale for edit – Category 4

1.220.040.01 When (1) a *member’s firm* merges with or acquires another firm or entity or all or part of the business thereof (acquired firm) or (2) a *member’s firm*, or all or part of the business thereof, is merged with or acquired by another *firm* (acquiring firm), *threats* to compliance with the “Independence Rule” [1.200.001] may exist as a result of employment or association with, or the provision of nonattest services to, an *attest entity client* of the acquired or acquiring firm.

Rationale for edit – Category 4

Employment or Association With an Attest **Entity Client**

1.220.040.03 If a *partner* or professional employee was formerly employed by or associated with an entity as a director, officer, employee, promoter, underwriter, voting trustee, trustee of any pension or profit-sharing trust of the entity, or in any capacity equivalent to that of a member of management and that entity becomes an *attest entity client* through a merger or acquisition, then *threats* will be at an *acceptable level* and *independence* will not be *impaired* provided all of the following *safeguards* are met:

- a. The *partner* or professional employee terminates the relationship with the *attest entity client* (for example, resigns as a director) prior to the closing date of the merger or acquisition.
- b. The *partner* or professional employee does not participate on the *attest engagement team* and is not an *individual in a position to influence the attest engagement* for the *attest entity client* when the attest engagement covers any period that includes his or her former employment or association with that *attest entity client*.
- c. The applicable disassociation *safeguards* in paragraph .04 of the “Former Employment or Association With an **Attest Entity Client**” interpretation [1.277.010] are implemented prior to the closing date of the merger or acquisition.
- d. As soon as practicable under the circumstances but before issuing the attest report, a responsible individual within the *firm* assesses the prior relationship of the *partner* or professional employee with the *attest entity client*, as well as the position he or she

holds at the *firm*, to determine if *threats* are created that are not at an *acceptable level*. If the responsible individual determines that *threats* are not at an *acceptable level*, he or she should be satisfied that *safeguards* are applied to eliminate or reduce the *threats* to an *acceptable level*. *Threats* will not be at an *acceptable level* if

- i. the *partner* or professional employee will have interaction with members of the *attest engagement team* regarding the *attest entity client* or
- ii. the *attest engagement team* is placed in a position of evaluating the *partner* or professional employee's representations and work while he or she was employed or associated with the *attest entity client*.

In such situations, an individual within the *firm* with the appropriate stature, expertise, and objectivity should review the subsequent *attest engagement* prior to issuing the attest report to determine whether the *attest engagement team* maintained integrity; objectivity; and, as appropriate, professional skepticism.

- e. As soon as practicable under the circumstances but before issuing the attest report, the nature of the relationship and any *safeguards* that were applied are discussed with *those charged with governance*. Documentation of the substance of the discussion with *those charged with governance* is encouraged.

Rationale for edit – Category 4

1.220.040.04 Nonattest services provided to an entity that becomes an *attest entity client* through a merger or an acquisition may create self-review, management participation, and advocacy *threats* to the *member's* compliance with the "Independence Rule" [1.200.001]. Specifically, *threats* may exist if, during the *period of the professional engagement* or the period covered by the *financial statements*, nonattest services that would otherwise *impair independence* (prohibited nonattest services) under the interpretations of the "Nonattest Services" subtopic [1.295] are performed by

- a. the acquiring firm, with respect to an *attest entity client* of the acquired firm or
- b. the acquired firm, with respect to an *attest entity client* of the acquiring firm.

Rationale for edit – Category 4

1.220.040.05 If the acquiring firm provided prohibited nonattest services to an *attest entity client* of the acquired firm during the period covered by the *financial statements*, *threats* to compliance with the "Independence Rule" [1.200.001] will not be at an *acceptable level* and cannot be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, the acquiring firm's *independence* will be *impaired* with respect to the *attest entity client*.

Rationale for edit – Category 4

1.220.040.06 If the acquired firm provided prohibited nonattest services to an *attest entity client* of the acquiring firm prior to the financial statement period covered by the acquiring firm's next attest report, the acquiring firm's *independence* would not be *impaired*.

Rationale for edit – Category 4

1.220.040.07 If the acquired firm provided prohibited nonattest services to an *attest entity client* of the acquiring firm during the *period of the professional engagement* (except as provided for in paragraph .06) or the period covered by the *financial statements*, the acquiring firm's *independence* would be *impaired* unless all of the following conditions are satisfied:

- a. The acquired firm terminates the prohibited nonattest services (or modifies the service offerings such that they would not *impair independence*) prior to the closing date of the merger or acquisition.

- b. Any individual who participated in the engagement to provide the prohibited nonattest services is neither on the *attest engagement team* nor an *individual in a position to influence the attest engagement*.
- c. An evaluation of the *threats* is performed and *threats* are determined to be at an *acceptable level* or reduced to an *acceptable level* by the application of *safeguards*. The evaluation should be conducted on the basis of the attribution of the results of the nonattest services to the acquiring firm. That is, if the nonattest services
 - i. can be attributed to the acquiring firm because the acquiring firm will assume responsibility for the results of the nonattest services, then the evaluation should assess all prohibited nonattest services that the acquired firm performed for the *attest entity client* during the financial statement period to be covered by the acquiring firm's next attest report; or
 - ii. cannot be attributed to the acquiring firm, then the evaluation should assess all prohibited nonattest services that the acquired firm performed for the *attest entity client* during the period in which the merger or acquisition was pending (that is, from the commencement of negotiations through the closing date of the merger or acquisition).

Rationale for edit – Category 4

1.220.040.08 In evaluating the significance of any *threats*, consideration should also be given to the following:

- a. Whether the nonattest service is attributed to the acquiring firm and whether the work performed or its results will be subject to attest procedures.
- b. The significance of the results of the nonattest service to the *attest entity's client's financial statements*.
- c. The extent to which the *attest entity client* and its management were involved in overseeing the nonattest services performed (including making any significant judgments and decisions with respect to the nonattest services) and whether the *attest entity client* and its management possessed the suitable skill, knowledge and/or experience to oversee such services.
- d. Whether the nonattest services involved the assumption of a management responsibility.

Rationale for edit – Category 4

Other Interests in and Relationships With an Attest **Entity-Client**

Rationale for edit – Category 4

1.220.040.12 This interpretation addresses only *threats* to *independence* that may arise as a result of a merger or an acquisition relating to employment or association with, or the provision of nonattest services to, an *attest entity client*. However other interests in, and relationships with, an *attest entity client* may also result in *threats* to compliance with the "Independence Rule" [1.200.001] or other rules during a merger or acquisition. Accordingly, *members* should take whatever pre-merger actions are necessary to be satisfied that the *firm* is in compliance with all relevant rules prior to the closing date of the merger or acquisition.

Rationale for edit – Category 4

1.224.010.01 *Financial interests* in, and other relationships with, *affiliates* of a *financial statement attest entity client* may create *threats* to a *member's* compliance with the "Independence Rule" [1.200.001].

Rationale for edit – Category 4

1.224.010.02 When an **attest entity client** is a *financial statement attest entity client*, members should apply the “Independence Rule” [1.200.001] and related *interpretations* applicable to the *financial statement attest entity client* to their *affiliates*, except in the following situations:

- a. A *covered member* may have a *loan* to or from an individual who is an officer, a director, or a 10 percent or more owner of an *affiliate* of a *financial statement attest entity client* during the *period of the professional engagement* unless the *covered member* knows or has reason to believe that the individual is in such a position with the *affiliate*. If the *covered member* knows or has reason to believe that the individual is an officer, a director, or a 10 percent or more owner of the *affiliate*, the *covered member* should evaluate the effect that the relationship would have on the *covered member’s independence* by applying the “Conceptual Framework for Independence” [1.210.010].
- b. A *member* or the *member’s firm* may provide prohibited nonattest services to entities described under items *c–l* of the definition of *affiliate* during the *period of the professional engagement* or during the period covered by the *financial statements*, provided that it is reasonable to conclude that the services do not create a self-review *threat* with respect to the *financial statement attest entity client* because the results of the nonattest services will not be subject to *financial statement attest* procedures. For any other *threats* that are created by the provision of the nonattest services that are not at an *acceptable level* (in particular, those relating to management participation), the *member* should apply *safeguards* to eliminate or reduce the *threats* to an *acceptable level*.
- c. A *firm* will only have to apply the “Subsequent Employment or Association With an Attest **Entity Client**” interpretation [1.279.020] of the “Independence Rule” if the former employee, by virtue of his or her employment at an entity described under items *c–l* of the definition of *affiliate*, is in a *key position* with respect to the *financial statement attest entity client*. *Individuals in a position to influence the attest engagement* and on the *attest engagement team* who are considering employment with an *affiliate* of a *financial statement attest entity client* will still need to report consideration of employment to an appropriate person in the *firm* and remove themselves from the *financial statement attest engagement*, even if the position with the *affiliate* is not a *key position*.
- d. A *covered member’s immediate family members* and *close relatives* may be employed in a *key position* at an entity described under items *c–l* of the definition of *affiliate* during the *period of the professional engagement* or during the period covered by the *financial statements*, provided they are not in a *key position* with respect to the *financial statement attest entity client*.

Rationale for edit – Category 1

1.224.010.03 A *member* must expend best efforts to obtain the information necessary to identify the *affiliates* of a *financial statement attest entity client*. If, after expending best efforts, a *member* is unable to obtain the information to determine which entities are *affiliates* of a *financial statement attest entity client*, *threats* would be at an *acceptable level* and *independence* would not be *impaired* if the *member* (a) discusses the matter, including the potential impact on *independence*, with *those charged with governance*; (b) documents the results of that discussion and the efforts taken to obtain the information; and (c) obtains written assurance from the *financial statement attest entity client* that it is unable to provide the *member* with the information necessary to identify the *affiliates* of the *financial statement attest entity client*.

Rationale for edit – Category 4

1.224.010.04 This interpretation does not apply to a *financial statement attest entity client* that is covered by the “Entities Included in State and Local Government Financial Statements” interpretation [1.224.020] of the “Independence Rule” [1.200.001]. [Prior reference: paragraph .20 of ET section 101]

Rationale for edit – Category 4

Acquisitions and Other Business Combinations That Involve a Financial Statement Attest **Entity Client**

Rationale for edit – Category 4

1.224.010.05 The exception in paragraph .06 would apply when (1) a *financial statement attest entity client* is acquired during the *period of the professional engagement* by either a non-client or a nonattest client (acquirer), (2) the *attest engagement* covers only periods prior to the acquisition, and (3) the *member* or *member's firm* will not continue to provide *financial statement attest services* to the acquirer.

Rationale for edit – Category 4

1.224.010.06 *Independence* will not be considered *impaired* with respect to the *financial statement attest entity client* because a *member* or *member's firm* has an interest in or relationship with the acquirer that may otherwise *impair independence* as a result of the requirements of this interpretation or the definition of "*attest entity client*" ~~(as it relates to the entity or person that engages the member or member's firm to perform the attest engagement).~~

Rationale for edit – Category 4

1.224.010.07 Notwithstanding paragraph .06, a *member* should give consideration to the requirements of the "Conflicts of Interest" interpretation [1.110.010], under the "Integrity and Objectivity Rule" [1.100.001], with regard to any relationships that the *member* knows or has reason to believe exist with the acquirer, the *financial statement attest entity client*, or the *firm*.

Rationale for edit – Category 4

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 – Category 3

1.228.010.01 *Threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* and a *covered member's independence* would not be *impaired* if the *covered member* includes in engagement letters a clause that provides that its *attest entity client* would release, indemnify, defend, and hold the *covered member* (and the *covered member's partners*, heirs, executors, personal representatives, successors, and assigns) harmless from any liability and costs resulting from knowing misrepresentations by management. [Prior reference: paragraphs .188–.189 of ET section 191]

Rationale for edit – Category 4

1.228.020 Indemnification of an Attest **Entity Client**

Rationale for edit – Category 4

1.228.020.01 *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* if the *covered member* enters into an agreement providing, among other things, that the *covered member* indemnifies the *attest entity client* for damages, losses, or costs arising from lawsuits, claims, or settlements that relate, directly or indirectly, to the *attest entity’s client’s* acts. The *covered member’s independence* would be *impaired* under these circumstances. [Prior reference: paragraphs .204–.205 of ET section 191]

[Rationale for edit – Category 4](#)

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

[Rationale for edit – Category 4](#)

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

[Rationale for edit – Category 4](#)

1.230.010.01 The existence of unpaid fees to a *covered member* for *professional services* previously rendered to an *attest entity client* may create self-interest, undue influence, or advocacy *threats* to the *covered member’s* compliance with the “Independence Rule” [1.200.001].

[Rationale for edit – Category 4](#)

1.230.010.02 *Threats* to the *covered member’s* compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if a *covered member* has unpaid fees from an *attest entity client* for any previously rendered *professional service* provided more than one year prior to the date of the current-year report. Accordingly, *independence* would be *impaired*. Unpaid fees include fees that are unbilled or a note receivable arising from such fees.

[Rationale for edit – Category 4](#)

1.230.010.03 This interpretation does not apply to fees outstanding from an *attest entity client* in bankruptcy. [Prior reference: paragraphs .103–.104 of ET section 191]

[Rationale for edit – Category 4](#)

1.240.010.01 If a *covered member* had or was committed to acquire any *direct financial interest* in an *attest entity client* during the *period of the professional engagement*, the self-interest *threat* to the *covered member’s* compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of

safeguards. Accordingly, *independence* would be *impaired*. [Prior reference: paragraphs .02A(1) and .17 of ET section 101]

[Rationale for edit – Category 4](#)

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

[Rationale for edit – Category 4](#)

1.240.010.03 If a *partner* or professional employee of the *firm*, his or her *immediate family*, or any group of such persons acting together owned more than 5 percent of an *attest entity's client's* outstanding equity securities or other ownership interests during the *period of the professional engagement*, the self-interest *threat* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*. [Prior reference: paragraph .02B of ET section 101]

[Rationale for edit – Category 4](#)

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

[Rationale for edit – Category 4](#)

1.240.040.08 See the “Plan Is an Attest *Entity Client* or Is Sponsored by an Attest *Entity Client*” interpretation [1.250.010] and the “Former Employment or Association With an Attest *Entity Client*” interpretation [1.277.010] of the “Independence Rule” [1.200.001] and the interpretations of the “Family Relationships With Attest *Entities Clients*” subtopic [1.270] under the “Independence Rule.” [Prior reference: paragraph .17 of ET section 101]

[Rationale for edit – Category 4](#)

1.240.070.03 *Savings plan*. A *covered member* who is the account owner of a Section 529 savings plan is considered to have a *direct financial interest* in both the plan and the plan's underlying investments because the account owner elects which sponsor's Section 529 savings plan to invest in, and prior to making the investment decision, the *covered member* has access to information about the plan's investment options or funds. However, if the Section 529 savings plan does not hold *financial interests* in an *attest entity client* at the time of the investment but the plan subsequently invests in that *attest entity client*, the financial interest *threat* would be at an *acceptable level* and *independence* would not be *impaired* if the *covered member* applies both of the following *safeguards*:

[Rationale for edit – Category 4](#)

1.245.010.01 The designation of a *covered member* to serve as a trustee of a trust or an executor or administrator of an estate that held, or was committed to acquire, any *direct financial interest* or any material *indirect financial interest* in an *attest entity client* during the *period of the professional engagement* does not in itself create a self-interest *threat* to the *covered member's*

compliance with the “Independence Rule” [1.200.001]. [Prior reference: paragraphs .021–.022 of ET section 191]

[Rationale for edit – Category 4](#)

1.245.010.02 However, when the *covered member* serves as the trustee or executor during the *period of the professional engagement*, *threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if

- a. the *covered member* (individually or with others) has the authority to make investment decisions for the trust or estate,
- b. the trust or estate owned or was committed to acquire more than 10 percent of the *attest entity’s client’s* outstanding equity securities or other ownership interests, or
- c. the value of the trust’s or estate’s holdings in the *attest entity client* exceeds 10 percent of the total assets of the trust or estate.

Accordingly, in these situations, *independence* would be *impaired*. [Prior reference: paragraph .02A(2) of ET section 101]

[Rationale for edit – Category 4](#)

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

[Rationale for edit – Category 4](#)

1.250.010.01 When a *covered member* participates in an employee benefit plan that is an *attest entity client* or is sponsored by an *attest entity client*, during the *period of the professional engagement* or during the period covered by the *financial statements*, the self-interest *threat* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level*. *Independence* with respect to the employee benefit plan and the sponsor would be *impaired* except in the following specific situations:

- a. *Governmental organization*. When a *covered member* is an employee of a governmental organization that sponsors, cosponsors, or participates with other governmental organizations in a public employee retirement plan (the plan) and the *covered member* is required by law, rule, or regulation to audit the plan, *threats to independence* would be at an *acceptable level* if all of the following *safeguards* are met:
 - i. The *covered member* is required to participate in the plan as a condition of employment.
 - ii. The plan is offered to all employees in comparable employment positions.
 - iii. The *covered member* is not associated with the plan in any capacity prohibited by the “Simultaneous Employment or Association With an Attest **Entity Client**” interpretation [1.275.005] of the “Independence Rule.”
 - iv. The *covered member* has no influence or control over the investment strategy, benefits, or other management activities associated with the plan.
- b. *Former employment or association with the attest entity client*. The requirements of paragraph .04 of the “Former Employment or Association With an Attest **Entity Client**” interpretation [1.277.010] must be met. [Prior reference: paragraphs .214–.215 of ET section 191]

[Rationale for edit – Category 4](#)

1.250.010.02 When an *immediate family* member participates as a result of his or her employment, in an employee benefit plan that is an *attest entity client* or is sponsored by an *attest entity client* the requirements of the “Immediate Family Member Participation in an Employee Benefit Plan That Is an Attest **Entity Client** or Is Sponsored by an Attest **Entity Client** (Other Than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans)”

interpretation [1.270.030] of the “Independence Rule” [1.200.001] must be met. [Prior reference: paragraph .17 of ET section 101]

[Rationale for edit – Category 4](#)

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

[Rationale for edit – Category 4](#)

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

[Rationale for edit – Category 4](#)

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

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

[Rationale for edit – Category 4](#)

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

[Rationale for edit – Category 4](#)

1.257.010.02 If during the *period of the professional engagement*, a *covered member* owns an insurance policy with no investment option issued by an *attest entity client*, a self-interest *threat* to the *covered member's* compliance with the “Independence Rule” [1.200.001] may exist. *Threats* would not be at an *acceptable level*, and could not be reduced to an *acceptable level* through the application of *safeguards*, if the *covered member* purchased the policy not under the normal terms, procedures, and requirements. Accordingly, *independence* would be *impaired*. [Prior reference: paragraph .17 of ET section 101]

[Rationale for edit – Category 4](#)

1.257.020.01 If during the *period of the professional engagement* the *covered member* owns an insurance policy with investment options issued by an *attest entity client*, but the *covered member* did not purchase the policy under the insurance company's normal terms, procedures, and requirements, *threats* 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 – Category 4](#)

1.257.020.03 If the *covered member* has the ability to select the policy's underlying investments or the authority to supervise or participate in the investment decisions and the *covered member* invests in an *attest entity client* during the *period of the professional engagement*, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired* because the investment would be considered a *direct financial interest*. For example, if the *covered member* invested the policy's cash value into a mutual fund that is an *attest entity client*, the investment in the mutual fund would be considered a *direct financial interest* and *independence* would be *impaired*. However, the mutual fund's underlying investments are considered to be *indirect financial interests*.

Rationale for edit – Category 4

1.260.010.01 If a *covered member* has a *loan* to or from an *attest entity client*, any officer or director of the *attest entity client*, or any individual owning 10 percent or more of the *attest entity's client's* outstanding equity securities or other ownership interests, a self-interest *threat* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. *Threats* would not be at an *acceptable level* and *independence* would be *impaired* if the *loan* exists during the *period of the professional engagement*, except as provided for in the "Loans and Leases With Lending Institutions" interpretation [1.260.020] of the "Independence Rule." [Prior reference: paragraph .02A(4) of ET section 101]

Rationale for edit – Category 4

1.260.020.01 The "Loans" interpretation [1.260.010] of the "Independence Rule" [1.200.001] provides that a self-interest *threat* would not be at an *acceptable level* and *independence* would be *impaired* if a *covered member* had a *loan* to or from an *attest entity client*, any officer or director of the *attest entity client*, or any individual owning 10 percent or more of the *attest entity's client's* outstanding equity securities or other ownership interests, except as provided for in this interpretation.

Rationale for edit – Category 4

1.260.020.02 *Home mortgages, secured loans, and immaterial unsecured loans.* However, *threats* would be at an *acceptable level* and *independence* would not be *impaired* if a *covered member* or his or her *immediate family* has an unsecured *loan* that is not material to the *covered member's* net worth (that is, immaterial unsecured *loan*), a home mortgage, or a secured *loan* from a *lending institution attest entity client*, if all the following *safeguards* are met:

- a. The home mortgage, secured *loan*, or immaterial unsecured *loan* was obtained under the *lending institution's normal lending procedures, terms, and requirements*. In determining when the home mortgage, secured *loan*, or immaterial unsecured *loan* was obtained, the date a commitment or line of credit is granted must be used, rather than the date a transaction closes or funds are obtained.
- b. The home mortgage, secured *loan*, or immaterial unsecured *loan* was obtained
 - i. from the lending institution prior to its becoming an *attest entity client*,
 - ii. from a *lending institution* for which *independence* was not required and was later sold to an *attest entity client*,
 - iii. after May 31, 2002, from a *lending institution attest entity client* by a borrower prior to his or her becoming a *covered member* with respect to that *attest entity client*, or
 - iv. prior to May 31, 2002 and the requirements of the loan transition provision in www.aicpa.org/interestareas/professionalethics/community/downloadabledocuments/transistion%20periods.pdf are met.
- c. After becoming a *covered member*, any home mortgage, secured *loan*, or immaterial unsecured *loan* must be kept current regarding all terms at all times, and the terms may

not change in any manner not provided for in the original agreement. Examples of changed terms are a new or extended maturity date, a new interest rate or formula, revised collateral, and revised or waived covenants.

- d. The estimated fair value of the collateral for a home mortgage or other secured *loan* must equal or exceed the outstanding balance during the term of the home mortgage or other secured *loan*. If the estimated fair value of the collateral is less than the outstanding balance of the home mortgage or other secured *loan*, the portion that exceeds the estimated fair value of the collateral may not be material to the *covered member's* net worth.

Rationale for edit – Category 4

1.260.030.01 The self-interest *threat* to compliance with the “Independence Rule” [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired* if a *lending institution* attest **entity client** services a *loan* originally extended to a *covered member* by another *lending institution*. [Prior reference: paragraphs .134–.135 of ET section 191]

Rationale for edit – Category 4

1.260.040.01 If a *covered member* enters into a leasing agreement with an attest **entity 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].

Rationale for edit – Category 4

1.260.040.02 *Threat* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the 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 **entity 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]

Rationale for edit – Category 4

1.260.050.01 If a *covered member* is an officer, a director, or a shareholder of an entity and ~~the~~ **that** entity has a *loan* to or from an attest **entity client** during the *period of the professional engagement*, a self-interest *threat* to the *covered member's* compliance with the “Independence Rule” [1.200.001] may exist. *Threats* to compliance with the “Independence Rule” would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if the *covered member* has *control* over the entity. Accordingly, *independence* would be *impaired* because the ~~lease~~ **loan** would be considered to be a *loan* with an attest **entity client**. This paragraph excludes a lending relationship that is permitted under the “Loans and Leases With Lending Institutions” interpretation [1.260.020] of the “Independence Rule.”

Rationale for edit – Category 4

1.260.050.02 If any *partner* or professional employee of the *firm* is an officer, a director, or a shareholder of an entity and the entity has a *loan* to or from an attest **entity client**, *threats* to the

partner's or professional employee's objectivity may exist. If the *partner* or professional employee is able to exercise *significant influence* over the entity but is not a *covered member* who can *control* the entity (see paragraph .01), the *partner* or professional employee should consider the "Conflicts of Interest" interpretation [1.110.010] of the "Integrity and Objectivity Rule" [1.100.001].

[Rationale for edit – Category 4](#)

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

[Rationale for edit – Category 4](#)

1.265.010.02 A cooperative arrangement exists when a *member* or the *member's firm* and an *attest entity client* jointly participate in a business activity. However, a cooperative arrangement would not exist when all of the following *safeguards* are met:

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

[Rationale for edit – Category 4](#)

1.265.010.03 Examples of cooperative arrangements include the following:

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

[Rationale for edit – Category 4](#)

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

[Rationale for edits – Category 1](#)

1.270 Family Relationships With Attest *Entities Clients*

[Rationale for edit – Category 4](#)

1.270.010.01 The *immediate family* of a *covered member* must comply with the “Independence Rule” [1.200.001] and its *interpretations*, except as permitted in the following interpretations:

- a. Immediate Family Member Is Employed by the Attest **Entity Client**” [1.270.020]
- b. Immediate Family Member Participation in an Employee Benefit Plan That Is an Attest **Entity Client** or Is Sponsored by an Attest **Entity Client** (Other Than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans)” [1.270.030]
- c. Immediate Family Member Participation in an Employee Benefit Plan With Financial Interests in an Attest **Entity Client**” [1.270.040]
- d. Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Beneficially Owned Financial Interests in Attest **Entity Client**” [1.270.050]
- e. Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest **Entity Client**” [1.270.060]
- f. Immediate Family Member Participation in Share-Based Compensation Arrangements Based Upon Stock Appreciation” [1.270.070]
- g. Immediate Family Member Participation in a Nonqualified Deferred Compensation Plan” [1.270.080]

Rationale for edit – Category 4

1.270.020 Immediate Family Member Is Employed by the Attest **Entity Client**

Rationale for edit – Category 4

1.270.020.01 When an individual in a *covered member’s immediate family* is employed by an *attest entity client*, management participation, familiarity, and self-interest *threats* to the *covered member’s* compliance with the “Independence Rule” [1.200.001] may exist.

Rationale for edit – Category 4

1.270.020.02 If a *covered member’s immediate family* is employed by an *attest entity client* but is not in a *key position*, *threats* would be at an *acceptable level* and *independence* would not be *impaired*.

Rationale for edit – Category 4

1.270.020.03 If a *covered member’s immediate family* is in a *key position* with an *attest entity client* during the period covered by the *financial statements* or during the *period of the professional engagement*, *threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.

Rationale for edit – Category 4

1.270.030 Immediate Family Member Participation in an Employee Benefit Plan That Is an Attest **Entity Client** or Is Sponsored by an Attest **Entity Client** (Other Than Certain Share-Based Arrangements or Nonqualified Deferred Compensation Plans)

Rationale for edit – Category 4

1.270.030.01 If during the period covered by the *financial statements* or during the *period of the professional engagement*, an *immediate family member* of a *covered member* participates in an employee benefit plan (plan) that is an *attest entity client* or is sponsored by an *attest entity client* (other than an *attest entity’s client’s share-based compensation arrangement* and nonqualified deferred compensation plan), *threats* would be at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* were met:

- a. The *immediate family* member does not serve in a *key position* for the *attest entity client*, as discussed in the “Immediate Family Member Is Employed by the Attest **Entity Client**” interpretation [1.270.020] of the “Independence Rule” [1.200.001].
- b. The plan is offered to all employees in comparable employment positions.
- c. The *immediate family* member does not serve in a position of governance (for example, board of trustees) for the plan.
- d. The *immediate family* member does not have the ability to supervise or participate in the plan’s investment decisions or in the selection of the investment options made available to plan participants. [Prior reference: paragraph .02 of ET section 101]

Rationale for edit – Category 4

1.270.030.02 *Share-based compensation arrangements* and nonqualified deferred compensation plans are discussed in the following interpretations:

- a. Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Beneficially Owned Financial Interests in Attest **Entities Clients**” interpretation [1.270.050] of the “Independence Rule” [1.200.001]
- b. Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest **Entity Client**” interpretation [1.270.060] of the “Independence Rule”
- c. Immediate Family Member Participation in Share-Based Compensation Arrangements Based Upon Stock Appreciation” interpretation [1.270.070] of the “Independence Rule”
- d. Immediate Family Member Participation in a Nonqualified Deferred Compensation Plan” interpretation [1.270.080] of the “Independence Rule”

Rationale for edit – Category 4

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

Rationale for edit – Category 4

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

- a. The *covered member* neither participates on the *attest engagement team* nor is an *individual in a position to influence the attest engagement*.
- b. Such investment is an unavoidable consequence of such participation. Unavoidable consequence means that the *immediate family* member has no other investment options available for selection, including money market or invested cash options, except for selecting an investment option in an *attest entity client*.
- c. In the event that a plan provides an option that permits the *immediate family* member to invest in a nonattest *client* or a non-client investment option that becomes available, the *immediate family* member is required to select the investment option in the non-client or nonattest *client* and dispose of *financial interests* in the *attest entity client* as soon as practicable but no later than 30 days after such option becomes available. When legal or other similar restrictions exist on an *immediate family* member’s right to dispose of a *financial interest* at a particular time, the *immediate family* member need not dispose of the interest until the restrictions have lapsed. For example, an *immediate family* member is not required to dispose of a *financial interest* in an *attest entity client* if doing so would violate an employer’s policies on insider trading. On the other hand, waiting for more

advantageous market conditions to dispose of the interest would not fall within this exception. [Prior reference: paragraph .02 of ET section 101]

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

[Rationale for edit – Category 4](#)

1.270.040.02 *Share-based compensation arrangements* and nonqualified deferred compensation plans are discussed in the following interpretations:

- a. “Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Beneficially Owned Financial Interests in Attest **Entities Clients**” interpretation [1.270.050] of the “Independence Rule” [1.200.001]
- b. “Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest **Entity Client**” interpretation [1.270.060] of the “Independence Rule”
- c. “Immediate Family Member Participation in Share-Based Compensation Arrangements Based Upon Stock Appreciation” interpretation [1.270.070] of the “Independence Rule”
- d. “Immediate Family Member Participation in a Nonqualified Deferred Compensation Plan” interpretation [1.270.080] of the “Independence Rule”

[Rationale for edit – Category 4](#)

1.270.050 Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Beneficially Owned Financial Interests in Attest **Entities Clients**

[Rationale for edit – Category 4](#)

1.270.050.01 If during the *period of the professional engagement*, an *immediate family member* of a *covered member* participates in a *share-based compensation arrangement* of an *attest entity client*, such as an ESOP, that results in the *immediate family member* holding a *financial interest* in an *attest entity client* that is *beneficially owned*, *threats* are at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* were met:

- a. The *immediate family member* does not serve in a *key position* for the *attest entity client*, as discussed in the “Immediate Family Member Is Employed by the Attest **Entity Client**” interpretation [1.270.020] of the “Independence Rule” [1.200.001].
- b. The *covered member* neither participates on the *attest engagement team* nor is an *individual in a position to influence the attest engagement*.
- c. The *immediate family member* does not serve as a trustee for the *share-based compensation arrangement* and does not have the ability to supervise or participate in the selection of any investment options made available to plan participants.
- d. When the *financial interests* that are *beneficially owned* are distributed or the *immediate family member* has the right to dispose of the *financial interests*, the *immediate family member* is required to do one of the following:
 - i. Dispose of the *financial interests* as soon as practicable but no later than 30 days after he or she has the right to dispose of the *financial interests*.
 - ii. Exercise his or her put option to require the employer to repurchase the *financial interests* as soon as permitted by the terms of the *share-based compensation arrangement*. In addition, any repurchase obligation due to the *immediate family member* arising from exercise of the option that is outstanding for more than 30 days needs to be immaterial to the *covered member* during the payout period. When legal or other similar restrictions exist on an *immediate family member’s* right to dispose of a *financial interest* at a particular time, the *immediate family member* need not dispose of the interest until the restrictions have lapsed. For example, an *immediate family member* does not have to dispose of a *financial interest* in an *attest entity client* if

- doing so would violate an employer's policies on insider trading. On the other hand, waiting for more advantageous market conditions to dispose of the interest does not qualify for this exception.
- e. Benefits payable from the *share-based compensation arrangement* to the *immediate family member* upon termination of employment, whether through retirement, death, disability, or voluntary or involuntary termination, are funded by investment options other than the employer's *financial interests*, and any unfunded benefits payable are immaterial to the *covered member* at all times during the payout period. [Prior reference: paragraph .02 of ET section 101]

Rationale for edit – Category 4

1.270.060 Immediate Family Member Participation in Share-Based Compensation Arrangements Resulting in Rights to Acquire Shares in an Attest **Entity Client**

Rationale for edit – Category 4

1.270.060.01 If during the *period of the professional engagement* an *immediate family member* of a *covered member* participates in a *share-based compensation arrangement* resulting in a right to acquire shares in an *attest entity client*, such as an ESOP or restricted stock rights plan, *threats* are at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* were met:

- a. The *immediate family member* does not serve in a *key position* for the *attest entity client*, as discussed in the “Immediate Family Member Is Employed by the Attest **Entity Client**” interpretation [1.270.020] of the “Independence Rule” [1.200.001].
- b. The *covered member* neither participates on the *attest engagement team* nor is an *individual in a position to influence the attest engagement*.
- c. The *immediate family member* exercises or forfeits these rights once he or she is vested, and the closing market price of the underlying stock equals or exceeds the exercise price for 10 consecutive days (market period). The exercise or forfeiture should occur as soon as practicable but no later than 30 days after the end of the market period. In addition, if the *immediate family member* exercises his or her right to acquire shares in the *attest entity client*, he or she should dispose of the shares as soon as practicable but no later than 30 days after the exercise date. Also, note the following:
 - i. When legal or other similar restrictions exist on an *immediate family member's* right to dispose of a *financial interest* at a particular time, the *immediate family member* need not dispose of the interest until the restrictions have lapsed. For example, an *immediate family member* does not have to dispose of a *financial interest* in an *attest entity client* if doing so would violate an employer's policies on insider trading. On the other hand, waiting for more advantageous market conditions to dispose of the interest would not qualify for this exception.
 - ii. If the employer repurchases the shares, any employer repurchase obligation due to the *immediate family member* that is outstanding for more than 30 days needs to be immaterial to the *covered member* during the payout period.

Rationale for edit – Category 4

1.270.070.01 If during the *period of the professional engagement* an *immediate family member* of a *covered member* participates in a *share-based compensation arrangement* based on the appreciation of an *attest entity's client's* underlying shares, such as a stock appreciation plan or phantom stock plan, *threats* are at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* were met:

- a. The *immediate family* member does not serve in a *key position* for the *attest entity client*, as discussed in the “Immediate Family Member Is Employed by the Attest **Entity Client**” interpretation [1.270.020] of the “Independence Rule” [1.200.001].
- b. The *share-based compensation arrangement* does not provide for the issuance of rights to acquire the employer’s *financial interests*.
- c. The *covered member* neither participates on the *attest engagement team* nor is an *individual in a position to influence the attest engagement*.
- d. The *immediate family* member exercises or forfeits these rights once he or she is vested, if the underlying price of the employer’s shares equals or exceeds the exercise price for 10 consecutive days (market period). Exercise or forfeiture should occur as soon as practicable but no later than 30 days after the end of the market period.
- e. Any resulting compensation payable to the *immediate family* member that is outstanding for more than 30 days is immaterial to the *covered member* during the payout period. [Prior reference: paragraph .02 of ET section 101]

Rationale for edit – Category 4

1.270.080.01 If during the *period of the professional engagement* an *immediate family* member of a *covered member* participates in a nonqualified deferred compensation plan of an *attest entity client* as a result of his or her employment, *threats* are at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* were met:

- a. The *immediate family* member does not serve in a *key position* for the *attest entity client*, as discussed in the “Immediate Family Member Is Employed by the Attest **Entity Client**” interpretation [1.270.020] of the “Independence Rule” [1.200.001].
- b. The *covered member* neither participates on the *attest engagement team* nor is an *individual in a position to influence the attest engagement*.
- c. The amount of the deferred compensation payable to the *immediate family* member is funded through life insurance, an annuity, a trust, or similar vehicle, and any unfunded portion is immaterial to the *covered member*.
- d. Any funding of the deferred compensation does not include *financial interests* in the *attest entity client*. [Prior reference: paragraph .02 of ET section 101]

Rationale for edit – Category 4

1.270.100.01 When a *close relative* of a *covered member* is employed by an *attest entity client* or has *financial interests* in an *attest entity client*, management participation, familiarity, and self-interest *threats* to the *covered member’s* compliance with the “Independence Rule” [1.200.001] may exist.

Rationale for edit – Category 4

1.270.100.02 *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 an individual participating on the *attest engagement team* has a *close relative* who has either of the following:

- a. A *key position* with the *attest entity client* during the period covered by the *financial statements* or during the *period of the professional engagement*.
- b. A *financial interest* in the *attest entity client* during the *period of the professional engagement* that
 - i. the individual knows or has reason to believe was material to the *close relative* or
 - ii. enabled the *close relative* to exercise *significant influence* over the *attest entity client*.

Rationale for edit – Category 4

1.270.100.03 *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 will be impaired if an individual in a position to influence the attest engagement or any partner or partner equivalent in the office in which the lead attest engagement partner or partner equivalent primarily practices in connection with the attest engagement has a close relative who has either of the following:*

- a. *A key position with the attest entity client during the period covered by the financial statements or during the period of the professional engagement.*
- b. *A financial interest in the attest entity client during the period of the professional engagement that*
 - i. *the individual, partner, or partner equivalent knows or has reason to believe was material to the close relative and*
 - ii. *enabled the close relative to exercise significant influence over the attest entity client.*

[Rationale for edit – Category 4](#)

1.275 Current Employment or Association With an Attest Entity Client

[Rationale for edit – Category 4](#)

1.275.005 Simultaneous Employment or Association With an Attest Entity Client

[Rationale for edit – Category 4](#)

1.275.005.01 *In this interpretation, simultaneous employment or association with an attest entity 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 entity client, or in any capacity equivalent to that of a member of management of an attest entity client during the period covered by the financial statements or the period of the professional engagement.*

[Rationale for edit – Category 4](#)

1.275.005.02 *If a partner or professional employee of the member’s firm is simultaneously employed or associated with an attest entity 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]*

[Rationale for edit – Category 4](#)

1.275.005.03 *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 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 **Entity Client**” interpretation [1.277.010] of the “Independence Rule” [1.200.001]. [Prior reference: paragraph .21 of ET section 101]

[Rationale for edit – Category 4](#)

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

[Rationale for edit – Category 4](#)

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

[Rationale for edit – Category 4](#)

1.275.015.01 If a *partner* or professional employee of a *member’s firm* serves on an advisory board of an *attest entity client*, familiarity, self-review, or management participation *threats* to the *member’s* compliance with the “Independence Rule” [1.200.001] may exist. However, *threats* would be at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* are met:

- a. The responsibilities of the advisory board are in fact advisory in nature.
- b. The advisory board has no authority to make nor does it appear to make management decisions on behalf of the *attest entity client*.
- c. The advisory board and those having authority to make management decisions, including the board of directors or its equivalent, are distinct groups with minimal, if any, common membership. [Prior reference: paragraphs .144–.145 of ET section 191]

[Rationale for edit – Category 4](#)

1.275.020.01 If a *partner* or professional employee of the *firm* serves on a citizens’ advisory committee that is studying possible changes in the form of a county government that is an *attest entity client* of the *member’s firm*, familiarity, self-review, or management participation *threats* to the *member’s* compliance with the “Independence Rule” [1.200.001] may exist. However, *threats* would be at an *acceptable level* and *independence* would not be *impaired* with respect to the county.

[Rationale for edit – Category 4](#)

Campaign Organization Is Attest **Entity Client**

[Rationale for edit – Category 4](#)

1.275.025.02 If during the *period of the professional engagement* or during the period covered by the *financial statements*, a *partner* or professional employee of a *member’s firm* serves as a campaign treasurer and the campaign organization is an *attest entity client*, the management participation *threat* 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*.

[Rationale for edit – Category 4](#)

Candidate Running for Election of a Governmental Entity That Is an Attest **Entity Client**

[Rationale for edit – Category 4](#)

1.275.025.03 If, during the *period of the professional engagement* or during the period covered by the *financial statements*, a *partner* or professional employee serves as a campaign treasurer for either (a) an elected official of a governmental entity that is an *attest entity client*, or (b) for a candidate who is running for election but is not yet an elected official of such *attest entity client*, then advocacy, adverse interest, and familiarity *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 – Category 4](#)

Political Party Is Attest **Entity Client**

[Rationale for edit – Category 4](#)

1.275.025.04 If during the *period of the professional engagement* or during the period covered by the *financial statements* a *partner* or professional employee serves as a campaign treasurer for a candidate and the political party for which the candidate is a member is an *attest entity client*, advocacy and familiarity *threats* may exist. Accordingly, a responsible individual within the *firm* should evaluate the significance of the *threats* to determine if the *threats* are at an *acceptable level*. If the responsible individual within the *firm* determines that *threats* are not at an *acceptable level*, he or she should apply *safeguards* to eliminate or reduce the *threats* to an *acceptable level*. However, *threats* 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 candidate is a member of one of the political party’s governing bodies.

[Rationale for edit – Category 4](#)

1.275.025.05 In the state and local government environment, *members* should consult the “Entities Included in State and Local Government Financial Statements” interpretation [1.224.020] to determine which entities related to their *attest entity client* require the *member’s independence*. Also refer to the “Conflicts of Interest for Members in Public Practice” interpretation [1.110.010] of the “Integrity and Objectivity Rule” [1.100.001] for additional guidance. In addition, *members* in such positions should consider their obligations as *members in business* under part 2 of the code. [Prior reference: paragraphs .164–.165 of ET section 191]

[Rationale for edit – Category 4](#)

1.275.030.01 When a *partner* or professional employee of a *member’s firm* serves as a director or an officer of a federated fund-raising organization, such as United Way (the organization), during the period covered by the *financial statements* or during the *period of the professional engagement*, and a charity that receives funds from the organization is an *attest entity client* of the *member’s firm*, management participation or self-review *threats* to the *member’s* compliance with the “Independence Rule” [1.200.001] may exist.

[Rationale for edit – Category 4](#)

1.275.035.01 When a *partner* or professional employee of a *member’s firm* serves on the board of directors of an organization during the period covered by the *financial statements* or during the *period of the professional engagement* and the organization receives funds from a fund-raising foundation that is an *attest entity client*, management participation or self-review *threats* to the *member’s* compliance with the “Independence Rule” [1.200.001] may exist.

[Rationale for edit – Category 4](#)

1.277 Former Employment or Association With an Attest **Entity Client**

[Rationale for edit – Category 4](#)

1.277.010 Former Employment or Association With an Attest **Entity Client**

Rationale for edit – Category 4

1.277.010.03 If a *covered member* participates on ~~the client's~~ **an attest engagement** or is an *individual in a position to influence the attest engagement* covering any period that includes the *covered member's* former employment or association with the *attest **entity client***, *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*.

Rationale for edit – Category 1

1.277.010.04 If a *member* fails to disassociate from the *attest **entity client*** before becoming a *covered member*, *threats* to the *member's* compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and *independence* would be *impaired* unless all of the following *safeguards* are met:

a. The *covered member* ceases to participate in all employee health and welfare plans sponsored by the *attest **entity client***, unless the *attest **entity client*** is legally required to allow the *member* to participate in the plan (for example, the Consolidated Omnibus Budget Reconciliation Act [COBRA]) and the *member* pays 100 percent of the *member's* portion of the cost of participation on a current basis.

b. The *covered member* ceases to participate in all other employee benefit plans by liquidating or transferring, at the earliest date permitted under the plan, all vested benefits in the *attest **entity's client's*** defined benefit plans, defined contribution plans, *share-based compensation arrangements*, deferred compensation plans, and other similar arrangements.

However, when a *covered member's* participation in one of these plans results from former employment or association with an *attest **entity client***, *threats* would be at an *acceptable level* and *independence* would not be *impaired* provided the liquidation or transfer of any vested benefits is either not permitted under the terms of the plan or would result in a penalty significant to the benefits being imposed upon such liquidation or transfer and the *covered member*

i. does not participate on the *attest engagement team* or

ii. is not an *individual in a position to influence the attest engagement*.

A penalty includes an early withdrawal penalty levied under the applicable tax law but excludes other income taxes that would be owed, or market losses that may be incurred, as a result of such liquidation or transfer.

c. The *covered member* disposes of any *direct financial interest* or material *indirect financial interests* in the *attest **entity client***.

d. The *covered member* collects or repays any *loans* to or from the *attest **entity client***, except for *loans* specifically permitted or grandfathered by the *interpretations* of the "Loans, Leases, and Guarantees" subtopic [1.260] under the "Independence Rule."

e. *Covered members* should evaluate whether other relationships with the *attest **entity client*** create *threats* that require the *member* to apply *safeguards* to reduce those *threats* to an *acceptable level*. [Prior reference: paragraph .02 of ET section 101]

Rationale for edit – Category 4

1.279 Considering or Subsequent Employment or Association With an Attest **Entity Client**

Rationale for edit – Category 4

1.279.010 Considering Employment or Association With an Attest **Entity Client**

Rationale for edit – Category 4

1.279.010.01 This interpretation applies to a member of the *attest engagement team* or an *individual in a position to influence the attest engagement* (individual) who intends to seek or discuss potential employment or association with an *attest entity client* or is in receipt of a specific offer of employment from an *attest entity client*.

Rationale for edit – Category 4

1.279.010.02 The undue influence and self-interest *threats* to compliance with the “Independence Rule” [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired* if all of the following *safeguards* are met:

- a. The individual promptly reports such consideration or offer to an appropriate person in the *firm*.
- b. The individual immediately ceases participation in the engagement and does not provide any services to the *attest entity client* until the employment offer is rejected or employment is no longer sought.
- c. If a *covered member* becomes aware that an individual is considering employment or association with an *attest entity client*, the *covered member* should notify an appropriate person in the *firm*.
- d. The appropriate person in the *firm* should consider whether, based on the nature of the engagement and the individual involved, the *firm* should perform additional procedures to provide reasonable assurance that any work that the individual performed for the *attest entity client* was performed in compliance with the “Integrity and Objectivity Rule” [1.100.001].

Rationale for edit – Category 4

1.279.010.03 If the individual accepts an offer of employment or otherwise becomes associated with the *attest entity client* in a *key position*, see the “Subsequent Employment or Association With an Attest *Entity Client*” interpretation [1.279.020] of the “Independence Rule” [1.200.001] for additional requirements. [Prior reference: paragraph .04 of ET section 101]

Rationale for edit – Category 4

1.279.020 Subsequent Employment or Association With an Attest *Entity Client*

Rationale for edit – Category 4

1.279.020.01 This interpretation applies to *partners* and professional employees who leave their *firms* and are subsequently employed by, or associated with, one of the *firm’s attest entity client* in a *key position*.

Rationale for edit – Category 4

1.279.020.02 The familiarity, self-interest, undue influence, or management participation *threats* to the *member’s* compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and *independence* would be *impaired* unless all of the *safeguards* in items *a–e* of the following list are met:

Individual Safeguards

- a. Amounts due to the former *partner* or professional employee for his or her previous interest in the *firm* and unfunded, vested retirement benefits cannot be material to the *firm*, and the underlying formula used to calculate the payments remain fixed during the payout period. The *firm* may adjust the retirement benefits for inflation and pay interest on amounts due.

- b. The former *partner* or professional employee is not in a position to influence the *firm's* operations or financial policies.
- c. The former *partner* or professional employee does not participate or appear to participate in the *firm's* business and is not otherwise associated with the *firm*, regardless of whether he or she is compensated for such participation or association, once employment or association with the *attest entity client* begins. For example, the individual would appear to participate in, or be associated with, the *firm* if
 - i. the individual provides consultation to the *firm*;
 - ii. the *firm* provides the individual with an *office* and related amenities, such as administrative and technology services;
 - iii. the individual's name is included in the *firm's office* directory; or
 - iv. the individual is identified as a member of the *firm* in membership lists of business, professional, or civic organizations, unless the *member* is clearly designated as retired.

Ongoing Attest Engagement Team Safeguards

- d. The ongoing *attest engagement team* should consider whether to modify the engagement procedures to adjust for the risk that the former *partner's* or professional employee's prior knowledge of the audit plan could reduce audit effectiveness. In addition, if the individual will have significant interaction with the *attest engagement team*, an appropriate individual in the *firm* should evaluate whether the existing *attest engagement team* members have sufficient experience and stature to deal effectively with the individual in conducting the engagement.
- e. If the former *partner* or professional employee joins the *attest entity client* in a *key position* within one year of disassociating from the *firm* and has significant interaction with the *attest engagement team*, an appropriate professional in the *firm* should review the subsequent *attest engagement* to determine whether the engagement team members maintained the appropriate level of skepticism when evaluating the individual's representations and work. The professional applying this *safeguard* should have appropriate stature, expertise, and objectivity. In performing this review, the professional should consider relevant factors, such as the following:
 - i. The position that the individual assumed at the *attest entity client*.
 - ii. The position that the individual held at the *firm*.
 - iii. The nature of the services that the individual provided to the *attest entity client*. The professional should take appropriate actions, as deemed necessary, based on the results of this review.

Rationale for edit – Category 4

1.279.020.03 The procedures performed in applying items *d–e* of paragraph .02 of this interpretation will depend on several factors, including the following:

- a. Whether the individual served on the engagement team
- b. The positions that the individual held at the *firm* and has accepted at the *attest entity client*
- c. The length of time that has elapsed since the individual left the *firm*
- d. The circumstances of the individual's departure

Rationale for edit – Category 4

1.280.010.01 If a *covered member* belongs to a social club (for example, a country club, tennis club) that is a *attest entity client* and is required to acquire a pro rata share of the club's equity or debt securities, then management participation, self-review, and self-interest *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist. *Threats* would be at an *acceptable level* if the club membership is essentially a social matter, because such equity or debt ownership would not be considered to be a *direct financial interest*. Accordingly, *independence* would not be *impaired*.

Rationale for edit – Category 4

1.280.010.02 *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* if a *partner* or professional employee is simultaneously employed or associated with the attest **entity’s client’s** social club as described in the “Simultaneous Employment or Association With an Attest **Entity Client**” interpretation [1.275.005] of the “Independence Rule.” Accordingly, *independence* would be *impaired*. [Prior reference: paragraphs .033–.034 of ET section 191]

Rationale for edit – Category 4

1.280.020.01 If a *covered member* belongs to a trade association that is an attest **entity client**, management participation or self-review *threats* to the *covered member’s* compliance with the “Independence Rule” [1.200.001] may exist.

Rationale for edit – Category 4

1.280.020.02 *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* if a *partner* or professional employee is simultaneously employed or associated with the trade association as described in the “Simultaneous Employment or Association With an Attest **Entity Client**” interpretation [1.275.005] of the “Independence Rule.” Accordingly, *independence* would be *impaired*. [Prior reference: paragraphs .003–.004 of ET section 191]

Rationale for edit – Category 4

1.280.030.03 *Threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and cannot be reduced to an *acceptable level* by the application of *safeguards* if a *partner* or professional employee is simultaneously employed or associated with the CIRA as described in the “Simultaneous Employment or Association With an Attest **Entity Client**” interpretation [1.275.005] of the “Independence Rule.” Accordingly, *independence* would be *impaired*.

Rationale for edit – Category 4

1.280.040.01 When a *covered member* is a member of a credit union that is an attest **entity 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 – Category 1

1.285.010.01 For purposes of this interpretation, the attest **entity client** also includes an individual in a *key position* with the attest **entity client** and individuals owning 10 percent or more of the attest **entity’s client’s** outstanding equity securities or other ownership interests.

Rationale for edit – Category 4

1.285.010.02 Accepting a gift from an attest **entity client** during the *period of the professional engagement* may create undue influence or self-interest *threats* to a *member’s* compliance with the “Independence Rule” [1.200.001]. If a *member’s firm*, a member of the *attest engagement*

team, or an individual in a position to influence the attest engagement accepts a gift from an attest **entity client** and the value is not clearly insignificant to the recipient, the *threat* to the *member's* 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*. Accordingly, *independence* would be *impaired*.

Rationale for edit – Category 4

1.285.010.03 Accepting entertainment from an attest **entity client** during the *period of the professional engagement* may create undue influence or self-interest *threats* to a *member's* compliance with the "Independence Rule" [1.200.001]. If a *covered member* accepts entertainment from an attest **entity client** that is not reasonable in the circumstances, the *threats* to the *member's* 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*. Accordingly, *independence* would be *impaired*.

Rationale for edit – Category 4

1.285.010.04 Offering gifts or entertainment to an attest **entity client** during the *period of the professional engagement* may create a familiarity *threat* to a *member's* compliance with the "Independence Rule" [1.200.001]. If a *covered member* offers a gift or entertainment to an attest **entity client** that is not reasonable in the circumstances, the *threat* to the *member's* 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*. Accordingly, *independence* would be *impaired*.

Rationale for edit – Category 4

1.285.010.05 The *member* should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. Examples of relevant facts and circumstances include the following:

- a. The nature of the gift or entertainment
- b. The occasion giving rise to the gift or entertainment
- c. The cost or value of the gift or entertainment
- d. The nature, frequency, and value of other gifts and entertainment offered or accepted
- e. Whether the entertainment was associated with the active conduct of business directly before, during, or after the entertainment
- f. Whether other attest **entity client** also participated in the entertainment
- g. The individuals from the attest **entity's client's** and *member's firm* who participated in the entertainment

Rationale for edit – Category 4

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

Rationale for edit – Category 4

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

Rationale for edit – Category 4

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

Rationale for edit – Category 4

Litigation Between the Attest *Entity Client* and Member

Rationale for edit – Category 4

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

Rationale for edit – Category 4

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

Rationale for edit – Category 4

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

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

Rationale for edit – Category 4

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 entity 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 – Category 1

1.290.010.08 A *covered member* may also become involved in litigation (primary litigation) in which the *covered member* and the *attest entity client* or its management are defendants. For example, one or more stockholders may bring a stockholders' derivative action or class-action

lawsuit against the *attest entity client* or its management, the *attest entity's client's* officers, directors, or underwriters, and *covered members*.

Rationale for edit – Category 4

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

Rationale for edit – Category 4

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

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

Rationale for edit – Category 4

1.290.010.11 If only the underwriter or officers or directors of other *attest entities 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 – Category 1

1.290.010.12 A *lending institution* or other creditor, security holder, or insurance company that alleges reliance on the *attest entity's client's financial statements* as a basis for having extended credit or insurance coverage to an *attest entity client* may commence third-party litigation against the *covered member* to recover their loss. An example is an insurance company commencing litigation either as a result of receiving an assignment of a claim or under subrogation rights against the *covered member* in the *attest entity's client's* name to recover losses that the insurer reimbursed to the *attest entity client*. If the *attest entity client* is only the nominal plaintiff, *threats* to the *covered member's* compliance with the “Independence Rule” [1.200.001] would be at an *acceptable level* unless other circumstances exist, such as when the *covered member* alleges, as a defense, that present management engaged in fraud or deceit. The *attest entity client* is a nominal plaintiff when the insurance company or lender sues in the name of the *attest entity client* as a result of obtaining subrogation rights or an assignment from the *attest entity client* and the *attest entity client* does not have a beneficial interest in the claim.

Rationale for edit – Category 4

1.290.010.13 If the real party in interest in the litigation (for example, the insurance company) is also the *covered member's attest entity client* (the plaintiff client), *threats* to the *covered member's* compliance with the “Independence Rule” [1.200.001] may exist if the litigation carries

a significant risk of a settlement or judgment in an amount that would be material to the *covered member's firm* or the plaintiff client.

[Rationale for edit – Category 4](#)

1.290.010.14 *Threats* to the *covered member's* compliance with the “Independence Rule” [1.200.001] would be eliminated or reduced to an *acceptable level* when the parties reach a final resolution of the matter(s) at issue and the matter(s) no longer affects the relationship between the *covered member* and the *attest entity client*, as described in paragraph .01 of this interpretation. The *covered member* should determine whether the conditions of such resolution have effectively eliminated such *threats* or reduced them to an *acceptable level*. [Prior reference: paragraph .08 of ET section 101]

[Rationale for edit – Category 4](#)

1.295.010.01 When a *member* performs nonattest services for an *attest entity client*, self-review, management participation, or advocacy *threats* to the *member's* compliance with the “Independence Rule” [1.200.001] may exist. When significant *independence threats* exist during the *period of the professional engagement* or the period covered by the *financial statements* (except as provided for in paragraph .03), *independence* will be *impaired* unless the *threats* are reduced to an *acceptable level* and any requirements included in the *interpretations* of the “Nonattest Services” subtopic [1.295] under the “Independence Rule” have been met.

[Rationale for edit – Category 4](#)

1.295.010.04 *Activities related to attest services*. Performing attest services often involves communications between the member and *client* management regarding

- a. the *client's* selection and application of accounting standards or policies and *financial statement* disclosure requirements;
- b. the appropriateness of the *client's* methods used in determining accounting and financial reporting;
- c. adjusting journal entries that the member has prepared or proposed for *client* management consideration; and
- d. the form or content of the *financial statements*.

These communications are considered a normal part of the *attest engagement* and are not considered nonattest services subject to the “General Requirements for Performing Nonattest Services” [1.295.040] and “Documentation Requirements When Providing Nonattest Services” [1.295.050] interpretations.

[Rationale for edits – Category 1](#)

1.295.010.07 *Engagements subject to independence rules of certain regulatory or standard-setting bodies*. *Threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards* if a member is not in compliance with the *independence* regulations of authoritative regulatory bodies that are more restrictive than the *interpretations* of the “Nonattest Services” subtopic [1.295] under the “Independence Rule” (examples of such authoritative bodies are the SEC, the Government Accountability Office [GAO], the Department of Labor [DOL], the Public Company Accounting Oversight Board [PCAOB], and state boards of accountancy) when a member performs nonattest services for an *attest entity client* and is required to be independent of the *attest entity client* under the regulations of the applicable regulatory body. Independence would be *impaired* under these circumstances. [Prior reference: paragraph .05 of ET section 101]

[Rationale for edit – Category 4](#)

1.295.030.01 If a member were to assume a management responsibility for an *attest entity client*, the management participation *threat* would be so significant that no *safeguards* could reduce the *threat* to an *acceptable level* and *independence* would be *impaired*. It is not possible to specify every activity that is a management responsibility. However, management responsibilities involve leading and directing an entity, including making significant decisions regarding the acquisition, deployment, and control of human, financial, physical, and intangible resources.

Rationale for edit – Category 4

1.295.030.02 Whether an activity is a management responsibility depends on the circumstances and requires the exercise of judgment. Examples of activities that would be considered management responsibilities and, as such, *impair independence* if performed for an *attest entity client*, include

- a. setting policy or strategic direction for the *attest entity client*.
- b. directing or accepting responsibility for actions of the *attest entity's client's* employees except to the extent permitted when using internal auditors to provide assistance for services performed under auditing or attestation standards.
- c. authorizing, executing, or consummating transactions or otherwise exercising authority on behalf of an *attest entity client* or having the authority to do so.
- d. preparing *source documents*, in electronic or other form, that evidence the occurrence of a transaction.
- e. having custody of an *attest entity's client's* assets.
- f. deciding which recommendations of the member or other third parties to implement or prioritize.
- g. reporting to *those charged with governance* on behalf of management.
- h. serving as an *attest entity's client's* stock transfer or escrow agent, registrar, general counsel or equivalent.
- i. accepting responsibility for the management of an *attest entity's client's* project.
- j. accepting responsibility for the preparation and fair presentation of the *attest entity's client's financial statements* in accordance with the applicable financial reporting framework.
- k. accepting responsibility for designing, implementing, or maintaining internal control.
- l. performing ongoing evaluations of the *attest entity's client's* internal control as part of its monitoring activities.

[Prior reference: paragraph .05 of ET section 101]

Rationale for edit – Category 4

1.295.040.01 When a member performs a nonattest service for an *attest entity client*, *threats* to the member's compliance with the "Independence Rule" [1.200.001] may exist. Unless an *interpretation* of the "Nonattest Services" subtopic [1.295] under the "Independence Rule" states otherwise, *threats* would be at an *acceptable level*, and *independence* would not be *impaired*, when all the following *safeguards* are met:

- a. The member determines that the *attest entity client* and its management agree to
 - i. assume all management responsibilities as described in the "Management Responsibilities" interpretation [1.295.030].
 - ii. oversee the service, by designating an individual, preferably within senior management, who possesses suitable skill, knowledge, and/or experience. The member should assess and be satisfied that such individual understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or re-perform the services.
 - iii. evaluate the adequacy and results of the services performed.
 - iv. accept responsibility for the results of the services.

- b. The member does not assume management responsibilities (See the “Management Responsibilities” interpretation [1.295.030] of the “Independence Rule”) when providing nonattest services and the member is satisfied that the *attest entity client* and its management will
- i. be able to meet all of the criteria delineated in item a;
 - ii. make an informed judgment on the results of the member’s nonattest services; and
 - iii. accept responsibility for making the significant judgments and decisions that are the proper responsibility of management.

If the *attest entity client* is unable or unwilling to assume these responsibilities (for example, the *attest entity client* cannot oversee the nonattest services provided or is unwilling to carry out such responsibilities due to lack of time or desire), the member’s performance of nonattest services would *impair independence*.

- c. Before performing nonattest services the member establishes and documents in writing his or her understanding with the *attest entity client* (board of directors, audit committee, or management, as appropriate in the circumstances) regarding
- i. objectives of the engagement,
 - ii. services to be performed,
 - iii. *attest entity’s client’s* acceptance of its responsibilities,
 - iv. member’s responsibilities, and
 - v. any limitations of the engagement.

[Rationale for edit – Category 4](#)

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 entity’s client’s* questions as part of the *attest entity 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 – Category 1](#)

1.295.050.01 Before performing nonattest services, the member should document in writing the member’s understanding established with the *attest entity client*, as described in paragraph .01c of the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule” [1.200.001].

[Rationale for edit – Category 4](#)

1.295.050.02 Failure to prepare the required documentation does not *impair independence* provided that the member did establish the understanding with the *attest entity client*. However, failure to prepare the required documentation would be considered a violation of the “Compliance With Standards Rule” [1.310.001].

[Rationale for edit – Category 4](#)

1.295.050.03 The documentation requirement does not apply to nonattest services performed prior to the *period of the professional engagement* for an *attest entity client*. However, for nonattest services provided during the period covered by the *financial statements*, the member should document in writing that the requirements of the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] were met prior to the *period of the professional engagement*, including the requirement to establish an understanding with the *attest entity client*. [Prior reference: paragraph .05 of ET section 101]

[Rationale for edit – Category 4](#)

1.295.105.01 Self-review or management participation *threats* to compliance with the “Independence Rule” [1.200.001] may exist when a member performs advisory services for an *attest entity client*.

Rationale for edit – Category 4

1.295.110.01 Self-review or management participation *threats* to compliance with the “Independence Rule” [1.200.001] may exist when a member performs appraisal, valuation, or actuarial service for an *attest entity client*.

Rationale for edit – Category 4

1.295.110.02 *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* if the member performs an appraisal, a valuation, or an actuarial service for an *attest entity client* when (a) the services involve a significant degree of subjectivity and (b) the results of the service, individually or when combined with other valuation, appraisal, or actuarial services, are material to the *attest entity’s client’s financial statements*. Accordingly, *independence* would be *impaired* under these circumstances.

Rationale for edit – Category 4

1.295.110.03 When performing appraisal, valuation, and actuarial services for an *attest entity 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 entity client*, and the *attest entity client* is in a position to have an informed judgment on, and accepts responsibility for, the results of the service.

Rationale for edit – Category 4

1.295.110.04 Examples of valuations that generally involve a significant degree of subjectivity include, ESOPs, business combinations, or appraisals of assets or liabilities. Accordingly, if these services produce results that are material to the *attest entity’s client’s financial statements*, *independence* would be *impaired*.

Rationale for edit – Category 4

1.295.110.05 An actuarial valuation of an *attest entity’s client’s* pension or postemployment benefit liabilities generally does not involve a significant degree of subjectivity because reasonably consistent results are produced when the same assumptions and information are used in performing the valuation. Therefore, *threats* would be at an *acceptable level* and *independence* would not be *impaired*.

Rationale for edit – Category 4

1.295.115.01 When a member provides benefit plan administration services to an *attest entity client*, self-review and management participation *threats* to the member’s compliance with the “Independence Rule” [1.200.001] may exist.

Rationale for edit – Category 4

1.295.120.01 When a member provides bookkeeping, payroll, and other disbursement services to an *attest entity client*, self-review and management participation *threats* to the *covered member’s* compliance with the “Independence Rule” [1.200.001] may exist.

Rationale for edit – Category 4

- 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 entity’s 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 entity*** to an ~~*the attest entity’s client’s*~~ general ledger.
 - c. prepare *financial statements* based on information in the *attest entity’s client’s* trial balance.
 - d. post ~~*attest entity client*~~-approved journal or other entries to an *attest entity’s client’s* trial balance.
 - e. propose standard, adjusting, or correcting journal entries or other changes affecting the *financial statements* to the *attest entity 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 entity’s client’s financial statements*.
 - f. generate unsigned checks using *source documents* or other records provided and approved by the *attest entity client*.
 - g. process an *attest entity’s client’s* payroll using payroll time records that the *attest entity client* has provided and approved.
 - h. transmit ~~*attest entity client*~~-approved payroll or other disbursement information to a bank or similar entity subsequent to the *attest entity’s client’s* review and authorization for the member to make the transmission. Prior to such transmission, the *attest entity 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 entity 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 entity’s client’s* evaluation.

Rationale for edit – Category 4

- 1.295.120.03** However, *threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member
- a. determines or changes journal entries, any account coding or classification of transactions, or any other accounting records without first obtaining the *attest entity’s client’s* approval.
 - b. authorizes or approves transactions.
 - c. prepares *source documents*.
 - d. makes changes to *source documents* without the *attest entity’s client’s* approval.
 - e. accepts responsibility to authorize payment of *attest entity client* funds, electronically or otherwise, except for electronic payroll tax payments when the member complies with the requirements of the “Tax Services” interpretation [1.295.160] of the “Independence Rule.”
 - f. accepts responsibility to sign or cosign an *attest entity’s client’s* checks, even if only in emergency situations.
 - g. maintains an *attest entity’s client’s* bank account or otherwise has custody of an *attest entity’s client’s* funds or makes credit or banking decisions for the *attest entity client*.
 - h. approves vendor invoices for payment. [Prior reference: paragraph .05 of ET section 101]

Rationale for edit – Category 4

1.295.125.01 When a member provides business risk consulting services to an *attest entity client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

Rationale for edit – Category 4

1.295.125.02 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. assist management in its assessment of the *attest entity's client's* business risk control processes.
- b. recommend improvements to an *attest entity's client's* business risk control processes and assists in the implementation of these improvements.

Rationale for edit – Category 4

1.295.130.01 When a member provides corporate finance consulting services to an *attest entity client*, self-review, management participation, and advocacy *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

Rationale for edit – Category 4

1.295.130.02 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. assist management in developing its corporate strategies.
- b. assist management in identifying possible sources of capital that meet the *attest entity's client's* specifications or criteria.
- c. introduce management to possible sources of capital that meet the *attest entity's client's* specifications or criteria.
- d. assist management in analyzing the effects of proposed transactions with potential buyers, sellers, or capital sources.
- e. advise an *attest entity client* during its negotiations with potential buyers, sellers, or capital sources.
- f. assist the *attest entity client* in drafting its offering document or memorandum.
- g. participate with management in its transaction negotiations in an advisory capacity.
- h. be named as a financial adviser in an *attest entity's client's* private placement memoranda or offering documents.

Rationale for edit – Category 4

1.295.130.03 However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. commits the *attest entity client* to the terms of a transaction.
- b. consummates a transaction on behalf of the *attest entity client*.
- c. acts as a promoter, an underwriter, a broker-dealer, or a guarantor of an *attest entity's client's* securities or as a distributor of private placement memoranda or offering documents.
- d. maintains custody of an *attest entity's client's* securities. [Prior reference: paragraph .05 of ET section 101]

Rationale for edit – Category 4

1.295.135.01 When a member provides executive or employee recruiting services to an *attest entity client*, self-review and management participation *threats* to the *covered member's* compliance with the “Independence Rule” [1.200.001] may exist.

Rationale for edit – Category 4

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 entity**, such as required education, skills, or experience.
- c. recommend qualified candidates to the *attest entity client* for their consideration based on ~~client-approved~~ criteria **approved by the attest entity**.
- d. participate in employee hiring or compensation discussions in an advisory capacity.

Rationale for edits – Category 1

1.295.135.03 However, *threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. commits the *attest entity client* to employee compensation or benefit arrangements.
- b. hires or terminates the *attest entity's client's* employees. [Prior reference: paragraph .05 of ET section 101]

Rationale for edit – Category 4

1.295.140.02 ~~Attest entity client.~~ For purposes of this interpretation, the term *attest entity client* refers to ~~an underlying party to the litigation for whom~~ **those attest entities 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 entity client* is also an *attest entity 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 – Category 2

1.295.140.03 *Investigative services.* For purposes of this interpretation, investigative services include all forensic services that do not involve actual or threatened litigation, such as performing analyses or investigations that may require the same skills used in litigation services. When a member provides investigative services to an *attest entity client*, self-review and management participation *threats* to the *covered member's* compliance with the “Independence Rule” [1.200.001] may exist. However, if the member applies the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule,” *threats* will be at an *acceptable level* and *independence* will not be *impaired*.

Rationale for edit – Category 4

1.295.140.04 *Litigation services.* For purposes of this interpretation, litigation services recognize the role of the member as an expert or a consultant and consist of providing assistance for actual or potential legal or regulatory proceedings before a trier of fact in connection with the resolution of disputes between parties. Litigation services consist of expert witness services, litigation consulting services, or other litigation services:

- a. *Expert witness services.* For purposes of this interpretation, expert witness services are those litigation services in which a member is engaged to render an opinion before a trier

of fact about the matter(s) in dispute based on the member's expertise, rather than his or her direct knowledge of the disputed facts or events:

- i. Expert witness services create the appearance that a member is advocating or promoting an *attest entity's client's* position. Therefore, the advocacy *threat* would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, if a member is engaged conditionally or unconditionally to provide expert witness services or expert testimony for an *attest entity client*, *independence* would be *impaired*, except as discussed in the following item ii.
 - ii. *Threats* to compliance with the "Independence Rule" [1.200.001] would be at an ***acceptable level*** ~~acceptable level~~, and *independence* would not be *impaired*, if a member provides expert witness services for a large group of plaintiffs or defendants that includes one or more *attest entities clients* of the *firm*, provided that at the outset of the engagement
 1. the member's *attest entities clients* constitute less than 20 percent of the members of the group, voting interests of the group, and the claim;
 2. no *attest entity client* within the group is designated as the lead plaintiff or defendant of the group; and
 3. no *attest entity client* has the sole decision-making power to select or approve the selection of the expert witness.
 - iii. *Fact witness testimony*. Acting as a fact witness (also referred to as a "percipient witness" or "sensory witness") would not be considered a nonattest service. Fact witness testimony is based on the member's direct knowledge of the matters, facts, or events in dispute obtained through the member's performance of prior *professional services* for the *attest entity client*. As a fact witness, the member's role is to provide factual testimony to the trier of fact. While testifying as a fact witness, the trier of fact or counsel may question a member about the member's opinions pertaining to matters within the member's area of expertise. Answering such questions would not *impair* the member's *independence*.
 - iv. In determining whether the member's services are considered expert witness services or fact witness testimony, members should refer to Rules 701–703 of Article VII, "Opinions and Expert Testimony," of the *Federal Rules of Evidence* and also refer to other applicable laws, regulations, and rules.
 - v. When providing expert witness services or fact witness testimony, members are required to comply with the "Integrity and Objectivity Rule" [1.100.001].
- b. *Litigation consulting services*. For purposes of this interpretation, litigation consulting services are those litigation services in which a member provides advice about the facts, issues, or strategy pertaining to a matter. The consultant does not testify as an expert witness before a trier of fact:
- i. When a member provides litigation consulting services, advocacy and management participation *threats* to the *covered member's* compliance with the "Independence Rule" may exist. If the member applies the "General Requirements for Performing Nonattest Services" interpretation [1.295.040] of the "Independence Rule," *threats* would be at an *acceptable level* and *independence* would not be *impaired*. For purposes of complying with paragraph .01b of the "General Requirements for Performing Nonattest Services" interpretation of the "Independence Rule," the *attest entity client* may designate its attorney to oversee the litigation consulting services.
 - ii. However, if the member providing litigation consulting services subsequently agrees to serve as an expert witness, *threats* to the member's 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*. Accordingly, *independence* would be *impaired*.
- c. *Other litigation services*. The advocacy *threat* would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* if a member serves as a trier of fact, a special master, a court-appointed expert, or an arbitrator (including serving on an arbitration panel) in a matter involving an *attest entity client*. These services create the appearance that the member is not independent; accordingly, *independence* would be *impaired*.
 - d. However, if the member applies the “General Requirements for Performing Nonattest Services” interpretation of the “Independence Rule,” *threats* would be at an *acceptable level* and *independence* would not be *impaired* when a member serves as a mediator or any similar role in a matter involving an *attest entity client*, provided that the member is not making any decisions on behalf of the parties but, rather, is acting as a facilitator by assisting the parties in reaching their own agreement. When providing such services, the member should consider the requirements of the “Conflicts of Interest” interpretation [1.110.010] of the “Integrity and Objectivity Rule.” [Prior reference: paragraph .05 of ET section 101]

Rationale for edit – Category 4

1.295.145.01 When a member provides information systems design, implementation, or integration services to an *attest entity client*, self-review and management participation *threats* to the *covered member’s* compliance with the “Independence Rule” [1.200.001] may exist.

Rationale for edit – Category 4

1.295.145.02 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. install or integrate an *attest entity’s client’s* financial information system that the member did not design or develop (for example, an off-the-shelf accounting package).
- b. assist in setting up the *attest entity’s client’s* chart of accounts and *financial statement* format with respect to the *attest entity’s client’s* financial information system.
- c. design, develop, install, or integrate an *attest entity’s client’s* information system that is unrelated to the *attest entity’s client’s financial statements* or accounting records.
- d. provide training and instruction to an *attest entity’s client’s* employees on an information and control system.
- e. perform network maintenance, such as updating virus protection, applying routine updates and patches, or configuring user settings consistent with management’s request.

Rationale for edit – Category 4

1.295.145.03 However, *threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. designs or develops an *attest entity’s client’s* financial information system.
- b. makes other than insignificant modifications to source code underlying an *attest entity’s client’s* existing financial information system.
- c. supervises *attest entity client* personnel in the daily operation of an *attest entity’s client’s* information system.
- d. operates an *attest entity’s client’s* network. [Prior reference: paragraph .05 of ET section 101]

Rationale for edit – Category 4

1.295.150.01 For purposes of this interpretation, internal audit services involve assisting the *attest entity client* in the performance of its internal audit activities, sometimes referred to as “internal audit outsourcing.” When a member provides internal audit services to an *attest entity client*, self-review and management participation *threats* to the *covered member’s* compliance with the “Independence Rule” [1.200.001] may exist.

Rationale for edit – Category 4

1.295.150.02 The *attest entity’s client’s* management is responsible for directing the internal audit function, including the management thereof. Such responsibilities include, but are not limited to, designing, implementing and maintaining internal control. *Threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level*, cannot be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* if the *attest entity client* outsources the internal audit function to the member, whereby the member, in effect, manages the *attest entity’s client’s* internal audit activities.

Rationale for edit – Category 4

1.295.150.03 However, except for the outsourcing services discussed in paragraph .02, *threats* to compliance with the “Independence Rule” [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired* if the member assists the *attest entity client* in performing financial and operational internal audit activities, provided that, in addition to the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule,” the member is satisfied that management

Rationale for edit – Category 4

1.295.150.06 *Threats* to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, in addition to those activities listed in the “Management Responsibilities” interpretation [1.295.030] of the “Independence Rule,” a member

- a. performs ongoing evaluations (see paragraph .10 that follows) or control activities (for example, reviewing *loan* originations as part of the *attest entity’s client’s* approval process or reviewing customer credit information as part of the customer’s sales authorization process) that affect the execution of transactions or ensure that transactions are properly executed or accounted for, or both, and performs routine activities in connection with the *attest entity’s client’s* operating or production processes that are equivalent to those of an ongoing compliance or quality control function.
- b. performs separate evaluations on the effectiveness of a significant control such that the member is, in effect, performing routine operations that are built into the *attest entity’s client’s* business process.
- c. has *attest entity client* management rely on the member’s work as the primary basis for the *attest entity’s client’s* assertions on the design or operating effectiveness of internal controls.
- d. determines which, if any, recommendations for improving the internal control system should be implemented.
- e. reports to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function.
- f. approves or is responsible for the overall internal audit work plan, including the determination of the internal audit risk and scope, project priorities, and frequency of performance of audit procedures.
- g. is connected with the *attest entity client* as an employee or in any capacity equivalent to a member of management (for example, being listed as an employee in the *attest entity’s client’s* directories or other *attest entity client* publications, permitting himself or herself to

be referred to by title or description as supervising or being in charge of the *attest entity's client's* internal audit function, or using the *attest entity's client's* letterhead or internal correspondence forms in communications).

Rationale for edit – Category 4

1.295.150.07 *Monitoring activities.* Designing, implementing, or maintaining the *attest entity's client's* monitoring activities are management responsibilities. Accordingly, *independence* would be *impaired* if a member accepts responsibility for performing such activities. Monitoring activities are procedures performed to assess whether components of internal control are present and functioning. Monitoring can be done through ongoing evaluations, separate evaluations, or some combination of the two. Ongoing evaluations are generally defined, routine operations built in to the *attest entity's client's* business processes and performed on a real-time basis. Ongoing evaluations, including managerial activities and everyday supervision of employees, monitor the presence and functioning of the components of internal control in the ordinary course of managing the business. A member who performs such activities for an *attest entity client* would be considered to be accepting responsibility for maintaining the *attest entity's client's* internal control. Accordingly, the management participation *threat* created by a member performing ongoing evaluations is so significant that no *safeguards* could reduce the *threat* to an *acceptable level*, and thus *independence* would be *impaired*.

Rationale for edit – Category 4

1.295.150.08 Separate evaluations are conducted periodically and generally not ingrained within the business but can be useful in taking a fresh look at whether internal controls are present and functioning. Such evaluations include observations, inquiries, reviews, and other examinations, as appropriate, to ascertain whether controls are designed, implemented, and conducted. The scope and frequency of separate evaluations is a matter of judgment and vary depending on assessment of risks, effectiveness of ongoing evaluations, and other considerations. Because separate evaluations are not built into the *attest entity's client's* business process, separate evaluations generally do not create a significant management participation *threat* to *independence*.

Rationale for edit – Category 4

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 entity 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 – Category 1

1.295.150.11 *Attest-related services.* Services considered extensions of the member's audit scope applied in the audit of the *attest entity's client's financial statements*, such as confirming accounts receivable and analyzing fluctuations in account balances, are not considered internal audit services and would be subject to this interpretation even if the extent of such testing exceeds that required by generally accepted auditing standards (GAAS). In addition, engagements performed under the attestation standards would not be considered internal audit services and, therefore, would not *impair independence*.

Rationale for edit – Category 4

1.295.150.12 When a member performs internal audit services that would not *impair independence* under this interpretation and is subsequently engaged to perform an attestation engagement to report on management's assertion regarding the effectiveness of its internal control, *independence* would not be considered *impaired*, provided the member is satisfied that *attest entity client* management does not rely on the member's work as the primary basis for its assertion. [Prior reference: paragraph .05 of ET section 101]

Rationale for edit – Category 4

1.295.155.01 When a member provides investment advisory or management services to an *attest entity client*, self-review and management participation *threats* to the *covered member's* compliance with the "Independence Rule" [1.200.001] may exist.

Rationale for edit – Category 4

1.295.155.02 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 the *attest entity's client's* allocation of funds among various investments or asset classes based upon the *attest entity's client's* desired rate of return, risk tolerance, or other parameters.
- b. perform recordkeeping and reporting of the *attest entity's client's* portfolio balances, including providing the *attest entity client* with a comparative analysis of the *attest entity's client's* investments to third-party benchmarks.
- c. evaluate the manner in which an *attest entity's client's* portfolio is being managed by investment account managers, including assessing whether the managers are
 - i. following the guidelines of the *attest entity's client's* investment policy statement.
 - ii. meeting the *attest entity's client's* investment objectives.
 - iii. conforming to the *attest entity's client's* stated investment parameters or risk tolerance.
- d. transmit an *attest entity's client's* investment selection, with the *attest entity's client's* consent, to the *attest entity's client's* broker-dealer or equivalent, provided that the *attest entity client* has authorized the broker-dealer or equivalent to execute the transaction.

Rationale for edit – Category 4

1.295.155.03 However, *threats* to compliance with the "Independence Rule" [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if, for example, a member

- a. makes investment decisions on behalf of management or otherwise has discretionary authority over an *attest entity's client's* investments.
- b. executes a transaction to buy or sell an *attest entity's client's* investments.
- c. has custody of an *attest entity's client's* assets, such as taking temporary possession of securities purchased by an *attest entity client*. [Prior reference: paragraph .05 of ET section 101]

Rationale for edit – Category 4

1.296.160.01 For purposes of this interpretation, tax services include preparation of a tax return, transmittal of a tax return, and transmittal of any related tax payment to the taxing authority, signing and filing a tax return, having a power of attorney limited strictly to tax matters; and authorized representation of *attest entity client* in administrative proceedings before a taxing authority.

Rationale for edit – Category 4

1.295.160.03 *Preparation and transmittal.* When a member prepares a tax return and transmits the tax return and related tax payment to a taxing authority in paper or electronic form, self-review and management participation *threats* to the member’s compliance with the “Independence Rule” [1.200.001] may exist. If the member applies the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule,” *threats* would be at an *acceptable level* and *independence* would not be *impaired*, provided that the member does not have custody or control over the *attest entity’s client’s* funds or assets and the individual designated by the *attest entity client* to oversee the tax services

- a. reviews and approves the tax return and related tax payment.
- b. if required for filing, signs the tax return prior to the member transmitting the return to the taxing authority.

The following are not considered having custody or control over an *attest entity’s client’s* funds: making electronic tax payments authorized by an *attest entity client* pursuant to a taxing authority’s prescribed criteria (as discussed in paragraph .04), affixing the *attest entity’s client’s* depository account information on a tax return, or remitting an *attest entity’s client’s* check made payable to the taxing authority.

[Rationale for edit – Category 4](#)

1.295.160.04 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* when a member signs and files a tax return on behalf of management, provided that the member has the legal authority to do so and

- a. the taxing authority has prescribed procedures in place for an *attest entity client* to permit a member to sign and file a tax return on behalf of the *attest entity client* (for example, Forms 8879 or 8453), and such procedures meet, at the minimum, standards for electronic return originators and officers outlined in Form 8879, or
- b. an individual in management who is authorized to sign and file the *attest entity’s client’s* tax return provides the member with a signed statement that clearly identifies the return being filed and represents that such individual
 - i. is authorized to sign and file the tax return.
 - ii. has reviewed the tax return, including accompanying schedules and statements, and it is true, correct, and complete to the best of the individual’s knowledge and belief.
 - iii. authorizes the *member* or another named individual in the *member’s firm* to sign and file the tax return on the *attest entity client* behalf.

[Rationale for edit – Category 4](#)

1.295.160.05 *Authorized representation in administrative proceedings.* 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* if a member acts as the *attest entity’s client’s* authorized representative in administrative proceedings before a taxing authority, provided that the member obtains the *attest entity’s client’s* agreement prior to committing the *attest entity client* to a specific resolution with the taxing authority. [Prior reference: paragraph .05 of ET section 101]

[Rationale for edit – Category 4](#)

1.295.160.06 *Power of attorney.* When a member has an *attest entity’s client’s* power of attorney, the self-review, management participation, and advocacy *threats* to the *covered member’s* compliance with the “Independence Rule” [1.200.001] may exist. If the member applies the “General Requirements for Performing Nonattest Services” interpretation [1.295.040] of the “Independence Rule,” *threats* would be at an *acceptable level* and *independence* would not be

impaired, provided that the member's use of the power of attorney is limited strictly to tax matters and the member does not bind the *attest entity client* to any agreement with a taxing authority or other regulatory agency. [No prior reference: new content]

[Rationale for edit – Category 4](#)

1.295.160.07 *Representation in court.* Threats to compliance with the “Independence Rule” [1.200.001] would not be at an *acceptable level*, and could not be reduced to an *acceptable level* through the application of *safeguards*, and *independence* would be *impaired* if a member represents an *attest entity client* in court to resolve a tax dispute. For purposes of this interpretation, court encompasses a tax, district, or federal court of claims and the equivalent state, local, or foreign forums. [Prior reference: paragraph .05 of ET section 101]

[Rationale for edit – Category 4](#)

1.298.010.07 The responsible individual should evaluate the significance of the breach and its effect on the *attest engagement team's* integrity, objectivity, and professional skepticism and the ability to issue an attest report. The significance of the breach will depend on factors such as the following:

- a. The nature and duration of the breach
- b. The number and nature of any previous breaches with respect to the current *attest engagement*
- c. Whether a *member* of the *attest engagement team* had knowledge of the interest or relationship that caused the breach
- d. Whether the individual who caused the breach is a *member* of the *attest engagement team* or another individual for whom there are *independence* requirements
- e. The role of the individual if the breach relates to a *member* of the *attest engagement team*
- f. The effect of the service, if any, on the accounting records or the *attest entity's client's financial statements* if the breach was caused by the provision of a *professional service*
- g. Whether a *partner* or *partner equivalent* of the *firm* had knowledge of the breach and failed to ensure that the breach was promptly communicated to an appropriate individual within the *firm*
- h. Whether the breach involved solely an *affiliate* of a *financial statement attest entity client* and if so, the nature of the *affiliate* relationship
- i. The extent of the self-interest, advocacy, undue influence, or other *threats* created by the breach

[Rationale for edit – Category 4](#)

1.298.010.09 Examples of actions that the responsible individual may consider include the following:

- a. Removing the relevant individual from the *attest engagement team*
- b. Conducting an additional review of the affected attest work or re-performing that work to the extent necessary; in either case, using different personnel
- c. Recommending that the *attest entity client* engage another *firm* to review or re-perform the affected attest work to the extent necessary
- d. Engaging another *firm* to evaluate the results of the nonattest service or having another firm re-perform the nonattest service to the extent necessary to enable it to take responsibility for the service if the breach relates to a nonattest service that affects the accounting records or an amount that is recorded in the *financial statements*

[Rationale for edit – Category 4](#)

1.298.010.10 Communicating With Those Charged With Governance at the Attest *Entity Client*

[Rationale for edit – Category 4](#)

1.320.040.03 However, the “Accounting Principles Rule” [1.320.001] does not preclude a *member* from preparing or reporting on *client financial statements* that have been prepared pursuant to financial reporting frameworks other than GAAP, such as

- a. financial reporting frameworks generally accepted in another country, including jurisdictional variations of IFRS such that the *client’s financial statements* do not meet the requirements for full compliance with IFRS, as promulgated by the IASB;
- b. financial reporting frameworks prescribed by agreement or a contract, or
- c. other special purpose frameworks, including statutory financial reporting provisions required by law or a U.S. or foreign government regulatory body to whose jurisdiction the entity is subject.

Rationale for edits – Category 1

1.320.040.04 In such circumstances, however, the *client’s financial statements* and *member’s* reports thereon should not purport that the *financial statements* are in accordance with GAAP, and the *financial statements* or reports on those *financial statements*, or both, should clarify the financial reporting framework(s) used. [Prior reference: paragraph .06 of ET section 203]

Rationale for edit – Category 1

1.400.060.03 Refer to the “Indemnification of a Covered Member” [1.228.010] and “Indemnification of an Attest **Entity Client**” [1.228.020] interpretations of the “Independence Rule” [1.200.001] for additional guidance. [Prior reference: paragraph .09 of ET section 501]

Rationale for edit – Category 4

1.400.070.06 d. Disclosure is permitted on behalf of the employer to

- i. obtain financing with lenders;
- ii. communicate with vendors, *clients*, **attest entities**, and customers; or
- iii. communicate with the employer’s external accountant, attorneys, regulators, and other business professionals.

Rationale for edit – Category 1

1.400.240 Use of Confidential Information Obtained From Nonclient Sources

Rationale for edit – Editorial

1.400.240.01 If a *member* discloses confidential information obtained from a prospective *client* or a nonclient (including an attest entity that is not also a client) without consent, the *member* would be in violation of the “Acts Discreditable Rule” [1.400.001]. [Prior reference: paragraphs .027-.028 of ET section 391 and new content].

Rationale for edit – Editorial

1.510.030.01 A *member’s* spouse may provide services for a contingent fee to an **attest entity 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– Category 1 & 2

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 an **attest entity** ~~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 entity** ~~client for whom~~ **with respect to which** the *member* performs a service listed in paragraph .01a of the “Contingent Fees Rule.”

Rationale for edits – Category 1 & 2

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 an **attest entity** ~~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 entity’s** ~~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 entity’s** ~~client’s~~ additions or withdrawals during the period.
- c. The fee arrangement is not renewed with the **attest entity** ~~client~~ more frequently than on a quarterly basis. [Prior reference: paragraphs .047-.048 of ET section 391]

Rationale for edits – Category 1 & 3

1.520.020.01 A commission is considered to be received when the performance of the related services is complete and the fee has been determined. For example, if in one year a *member* sells a life insurance policy to an **attest entity** ~~client~~, and the *member’s* commission payments are determined to be a fixed percentage of future years’ renewal premiums, the commission is deemed to be received in the year that the policy is sold. [Prior reference: paragraphs .367-.368 of ET section 591]

Rationale for edit – Category 1

1.520.030.01 A *member’s* spouse may receive a commission for referring products or services to or from an **attest entity** ~~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 – Category 1 & 3

1.520.040.02 For example, if the *member* or *member’s firm* performs ~~for a client~~ a service listed in paragraph .01 of the “Commissions and Referral Fees Rule” [1.520.001], the *member* may not recommend or refer to that **attest entity** ~~client~~ any product or services for a commission that will be paid through a distributor or an agent or receive a commission for the recommendation or referral. This prohibition applies during the period in which the *member* is engaged to perform any of the services listed in paragraph .01 of the rule and during the period covered by any historical *financial statements* in such services.

Rationale for edits – Category 1

1.520.040.03 In addition, if a *member* receives a commission for referring a third party’s product or service to a *client* **or to an attest entity** ~~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 – Category 1 & 2

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 an **attest entity 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 an **attest entity 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 – Category 1 & 2

1.520.050.02 In such instances, the *member* should disclose the commission arrangement to the **attest entity's client's** owners, officers, or employees or the employee benefit plan. The *member's* failure to disclose the commission would be in violation of the “Commissions and Referral Fees Rule” [1.520.001].

Rationale for edit – Category 1

1.520.060.01 If a *member* purchases a product, taking title to the product and assuming all the associated risks of ownership, any profit the *member* receives on reselling it to a *client* would not constitute a commission. [Prior reference: paragraphs .369-.370 of ET section 591]

Rationale for edit – Category 1

1.520.070.01 If, in providing *professional services to a client*, a *member* subcontracts the services of another person or entity, any mark-up of the cost of the subcontracted services would not constitute a commission.

Rationale for edit – Category 1

1.810.010.01 A *member* may own an interest in a separate business that performs for *clients* or **attest entities** accounting, tax, personal financial planning, or litigation support services or other services for which standards are promulgated by bodies designated by *Council*.

Rationale for edit – Category 1

1.810.010.02 If the *member*, either individually or collectively with the *member's firm* or others in the *firm*, *controls* the separate business, then the separate business, its owners (including the *member*), and its professional employees must comply with the code. For example, if one or more *members* individually or collectively *control* the separate business, the *member(s)* and others associated with the separate business are subject to the “Commissions and Referral Fees Rule” [1.520.001] and its *interpretations*. With respect to an **attest entity client**, the “Independence Rule” [1.200.001] and its *interpretations* would apply to the activities of the separate business, its owners, and its professional employees.

Rationale for edit – Category 4

1.810.010.03 When the *member*, individually or collectively with the *member's firm* or others in the *firm*, does not *control* the separate business, the provisions of the code would apply to the *member's* actions but not to the separate business, its other (nonmember) owners, and its professional employees. For example, the separate business could enter into a contingent fee arrangement with the *member's attest entity client* or accept commissions for the referral of

products or services to the *member's attest entity client*. [Prior reference: paragraph .03 of ET section 505]

Rationale for edit – Category 4

1.810.010.04 When the owners of the separate business are non-CPAs, to prevent any misunderstanding or misrepresentation, the CPA *member* should advise *clients*, **attest entities**, and other interested parties that the CPA *member* is an owner in two separate businesses: one made up of non-CPAs (except for the CPA *member*) and another that is a CPA *firm*. [Prior reference: paragraphs .275-.276 of ET section 591]

Rationale for edit – Category 1

1.810.020.01 Only *members* of a *firm* who are legally *partners* should use the designation *partner*. *Members* who are not parties to the *firm's* partnership agreement should not hold themselves out in any manner that might lead *clients*, **attest entities**, or the public to believe that they are *partners*. For example, using the designation “nonproprietary partner” to describe a high-ranking professional employee would be misleading and in violation of the “Form of Organization and Name Rule” [1.800.001] even if the professional employee was a *partner* in one of the predecessor *firms* that merged into the *firm*. [Prior reference: paragraphs .273-.274 of ET section 591]

Rationale for edit – Category 1

1.810.040.01 Unless there are laws, rules or regulations that are applicable to the *member* that conclude otherwise, two former *partners* may continue to jointly perform an *attest engagement* even if one of them is not a CPA. However, to be clear that a partnership no longer exists and to assure the *attest entity client* and others that both individuals performed the *attest engagement*, they should present their report on plain paper (that is, paper with no letterhead) that is signed in the following manner:

John Doe, Certified Public Accountant

Richard Roe, Accountant

[Prior reference: paragraphs .271–.272 of ET section 591]

Rationale for edit – Category 4

Text of Proposed New Paragraphs to Existing Interpretations (Additions appear in boldface italic)

1.275.005 Simultaneous Employment or Association With an Attest **Entity Client**

.01 In this interpretation, simultaneous employment or association with an *attest entity 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 entity client*, or in any capacity equivalent to that of a member of management of an *attest entity 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 entity 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 entity 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 **Entity 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 entity client* should consider their obligations as a *member in business* under part 2 of the code. [No prior reference: new content]

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

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

1.400.200 Records Requests (in part)

1.400.200.12 Refer to the Information Obtained From Nonclient Sources interpretation [1.400.240] of the “Acts Discreditable Rule” [1.400.001] for additional guidance regarding a disclosure of information obtained from a prospective client and a nonclient (including an attest entity that is not also a client).

1.400.240 ~~Use of Confidential~~ Information Obtained From Nonclient Sources (in part)

.02 If a member receives accounting or other records from a prospective client or a nonclient (including an attest entity that is not also a client) and does not return those

original records upon request, the member would be in violation of the “Acts Discreditable Rule” [1.400.001].

Text of Proposed New Interpretation

1.520.15 Application of the “Commissions and Referral Fees Rule” to Attest Entities

.01 In addition to applying the “Commissions and Referral Fees Rule” [1.520.001] to clients (that is, the entity that engages the member to perform any of the services specified in those rules), members should apply the rule to any person or entity with respect to which a member performs one of the attest services specified in the rule.

1.700.35 Disclosing Information from a Prospective Client or a Nonclient

.01 Refer to the *Information Obtained From Nonclient Sources* interpretation [1.400.240] of the “Acts Discreditable Rule” [1.400.001] for guidance regarding disclosure of information obtained from a prospective *client* and a nonclient (including an attest entity that is not also a client).

IT and Cloud Services Task Force

Task Force Members: Shelly VanDyne (Chair), Cathy Allen, Wendy Davis, Mike Schmitz, Katie Jaeb, Ray Roberts, Anna Dourkourekas and Jeff Seymour. Staff: Ellen Gorla

Task Force Objective

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

Reason For Agenda

To provide feedback on the Task Force's draft interpretation contained in **Agenda Item 2B**.

Summary of Issues

Based upon the feedback provided by the Committee in October, the Task Force revamped and streamlined the draft Hosting Services interpretation. The draft interpretation now contains an introduction paragraph that explains what hosting services are and then a paragraph that provides examples of hosting services and a final paragraph that provides examples of situations that would not be considered to be hosting services.

Hosting Services

The threshold question in terms of the existing Code prohibition on custody and/or control of assets, was whether the Task Force believes that an attest client's data and records should be considered attest client assets. The Task Force concluded that data and records should be considered an attest client's assets even though not a traditional asset like cash or property. So when an attest client engages a member to have custody and/or control of its data or records, the Task Force believes that the member has been engaged to have custody and/or control of the attest client's assets. The Task Force also believes the member is providing hosting services to the client when the attest client uses the records or data that the member has custody and control of/over to carry out its operations. Since the Task Force believes that data and records should be considered attest client assets, the Task Force also believe that providing hosting services creates threats that cannot be reduced to an acceptable level by the application of safeguards and as such would impair independence.

The Task Force did not reach a consensus on whether or not the member needed to be engaged to have both custody *and* control of the attest client's data or records or if threats would be the same if the member only had either custody *or* control of the data or records. The examples of hosting services included in paragraph .02 all seemed to imply that the member was engaged to have both custody and control so that convention was used throughout the draft interpretation. In considering this issue, Staff notes that:

- In 6 interpretations ([1.255.020.01](#), [1.295.030.02e](#), [1.295.115.04d](#), [1.295.120.03g](#), [1.295.130.03d](#), [1.295.155.03c](#)) when referring to a client's assets, the Code only mentions having custody of assets and is silent as to control.
- "Custody or Control" is used in two interpretations.
 - In paragraph .03 of the [Tax Services](#) interpretation when discussing preparation and transmittal of a return, the guidance concludes that the member does not have custody or control over an attest clients funds or assets when certain conditions exist and provides examples of when the member would not be considered to have custody or control over such funds or assets.

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- In paragraphs .03, .04 and .10 of the [Records Requests](#) interpretation the member is told that
 - Client-provided records in the member's custody or control should be returned;
 - How the member should respond to requests for member-prepared records or a member's work products that are in the member's custody or control; and
 - The fact that the statutes of the state in which the member practices grant the member a lien on certain records in his or her custody or control does not relieve the member of his or her obligation to comply with this interpretation
 - "Custody and Control" is used in paragraph .08 of the [Records Requests](#) interpretation when explaining that a member should honor a client's request for records in a specific format when the records are available in such format and are within the member's custody and control.

The Task Force believes it is important to emphasize that the attest client must engage the member to provide the hosting services so that members do not believe they are providing hosting services when the member temporarily has an attest client's data or records while the member is performing a professional service such as an audit or tax return.

Questions For Committee

1. Does the Committee agree that attest client's data and records should be considered assets of the attest client?
2. What convention should be used, custody and control or custody or control?
3. Does the committee have any other feedback on paragraph .01 of the draft interpretation?

Examples of Hosting Services

During the October meeting the Committee asked the Task Force to clarify the examples of hosting services included in the draft interpretation as some of the examples seemed duplicative. The Task Force believed the second two examples were drafted broadly enough that specific examples could be added.

Question For Committee

1. Does the committee have any feedback on paragraph .02 of the draft interpretation?

Examples of What is not Deemed to be Hosting Services

During the October meeting the Committee asked the Task Force to incorporate examples of situations that would not be considered hosting services as there was some concern that using portals to communicate with clients could be viewed as hosting services if information remains in the portal for some time. The Task Force does not believe that the fact that data or records exist in an electronic format in a portal, should constitute hosting services, unless of course the attest client has engaged the member to host its data or records. The Task Force believes that the explanation in paragraph .01 of what hosting services are helps to clarify this issue related to portal communication and incorporated several examples of situations where members would not be considered to be providing hosting services.

Question For the Committee

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|--|
| <ol style="list-style-type: none">1. Does the Committee believe the phrase “since the member would not have custody and control of data or records that the attest client uses to conduct its operations” is helpful to include or could it be eliminated because it is implied that the member does not have such custody or control?2. Does the Committee have any feedback on paragraph .03 of the draft interpretation? |
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Cloud Based Services

During the Committee’s May meeting, Staff was directed to draft a FAQ for cloud based bookkeeping services. After discussing Staff’s draft FAQ, the Task Force recommends that the Committee not proceed with issuing a FAQ at this time. Rather, the Task Force recommends that any guidance issued concerning cloud based bookkeeping services should be authoritative and not limited not limited to bookkeeping services as many types of nonattest services can be provided through a cloud based solution (e.g., data analytics, cyber security). The Task Force also recommends that the guidance should emphasize that such services should not run afoul of the hosting services guidance that the Committee eventually issues.

To accomplish this, the Task Force recommends that the [Scope and Applicability of Nonattest Services](#) interpretation state that a member could perform permitted services through a cloud based solution provided the member complies with all the requirements of the nonattest services subtopic, including hosting services interpretation discussed previously.

.08 Activities Provided Through a Cloud Based Solution. Threats to independence would not be considered significant solely because a member provides a permitted nonattest services (that is, a nonattest service that does not impair independence and complies with all the requirements for the nonattest services subtopic) through a cloud-based solution provided the member complies with the “Hosting Services” interpretation [1.295.xxx].

<h3>Questions For Committee</h3>

- | |
|---|
| <ol style="list-style-type: none">1. Do you believe the parenthetical sentence clearly explains what a permitted nonattest service is?2. Does the Committee agree that the reminder that the nonattest services should comply with the hosting services interpretation?3. Does the Committee have any feedback on this provision? |
|---|

Next Steps

In addition to finalizing the *Hosting Services* interpretation and the provision for activities provided through a cloud based solution, the Task Force still needs to discuss what is meant by “off-the-shelf accounting software” (i.e., how much personalization can be done without impacting independence) in the Information Systems Design, Implementation, or Integration interpretation and how the project management FAQs could possibly be broadened. The Task Force hopes that the latter two issues can be addressed non-authoritatively.

Action Needed

The Committee’s feedback is requested.

Effective Date

N/A

Communication Plan

N/A

Materials Presented

Agenda Item 2B Draft Hosting Services Interpretation

1.295.xxx - 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 and 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 cannot be reduced to an acceptable level by the application of safeguards, and independence would be impaired.
02. Examples of hosting services that would impair independence include:
 - 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) on the member's servers. For example, the firm hosts the attest client's financial system or website on firm's servers.
 - c. Keeping the attest client's data or records in the member's office for safekeeping. For example, the client's original lease agreements or other legal documents are stored in the member's office.
03. Following are examples of situations where a member will not be considered to be providing hosting services that would impair independence since the member would not have custody and control of data or records that the attest client uses to conduct its operations:
 - 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 the payroll data that supports a payroll tax return the member prepared or a copy of a bank reconciliation that supports attest procedures performed on the cash account.
 - 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.
 - c. Electronically exchanging data or records with a client provided the member has not been engaged to retain custody or control of the data or records on behalf of the client. For example, a member and an attest client may use a portal to exchange data and records related to permissible nonattest services the member has been engaged to provide.
 - d. Client licenses from the member the use of a software product where the client inputs its data and the software product provides the client with an output that the client is responsible for maintaining. The software product must perform an activity that if performed by the member, would not impair 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, Eric Holbrook, Jack Dailey, Randy Roberts, E. Gorla (Staff), Teresa Bordeaux (Staff), Laura Hyland (Staff), Sue Hicks (Staff)

Reason For Agenda

The Committee is asked to provide feedback on the revised draft interpretation contained in **Agenda Item 3A** for downstream entities in the state and local government environment.

Summary of Issues

The focus of the Task Force's discussions so far has been related to situations where the member is providing financial statement attest services to the primary government to determine which funds or component units members must also apply the independence rule and related interpretations. Since facts and circumstances can change at any time, it is envisioned that the evaluations called for in this interpretation are continual and will require the use of professional judgment. The introduction section contained in **Agenda Item 3B** is a work in process as it does not take into account upstream entities.

Making Reference to Another Auditor's Report

Under the extant interpretation members do not need to remain independent of an entity when the member explicitly states reliance on other auditors' reports (i.e., makes reference to another auditor's report).

After further discussion, the Task Force does not believe making reference to another auditor's report would be an effective safeguard anytime the primary government has more than minimal influence over the accounting or financial reporting process of a fund or component unit (see below for further discussion about minimal influence). When the primary government has only minimal influence, the Task Force believes making reference to another auditor's report ("making reference safeguard") could be an effective safeguard provided other factors exist.

The Task Force believes that the making reference safeguard is strongest when the primary government has only minimal influence over a fund's or component unit's accounting or financial reporting process and the fund or component unit is either immaterial to the primary government or will not be subject to financial statement attest procedures of the member. Accordingly, in these situations the Task Force proposes that members do not need to be independent of such funds or component units.

However, if the fund or component unit is material and its financial information will be subject to the member's financial statement attest procedures, the Task Force believes that even when the primary government has only minimal influence over a fund's or component unit's accounting or financial reporting process, the making reference safeguard may not be enough to reduce threats to an acceptable level. Specifically, the Task Force believes that when the member knows or has reason to believe a relationship or circumstance that would impair independence exists, then threats will be significant. The Task Force recommends that when such is the case, the member should be required to use the Conceptual Framework for Independence to determine whether additional

safeguards (beyond the making reference safeguard) can be implemented that will eliminate these significant threats or reduce them to an acceptable level.

The Task Force identified a couple of factors that members could consider when trying to determine whether a fund or component unit will be subject to financial statement attest procedures of the member.

Questions For the Committee

1. Are there any other factors that the Committee believes should be considered in determining which funds and component units members should remain independent of?
2. Can the Committee identify any other factors that members could consider when trying to determine whether a fund or component unit will be subject to financial statement attest procedures of the member?

Minimal Influence

While the Task Force believes there is a presumption that the primary government has more than minimal influence over its fund's and component unit's accounting or financial reporting process, it also agrees that it is very possible for this presumption to be rebutted depending upon the specific facts and circumstances. To assist members in assessing their unique facts and circumstances the Task Force proposes to include a list of factors that might help members rebut this presumption and conclude that the primary government has only minimal influence. The Task Force does believe it will likely need to develop some FAQs to provide further guidance on what is meant by "minimal influence" over a fund's or component unit's financial reporting or financial reporting process. Ms. Miller will provide the Committee with an example including of how a somewhat slight change in facts and circumstances can result in the level of influence appearing to change.

The Task Force did not reach a consensus regarding whether the member's evaluation of the primary government's level of influence over the accounting or financial reporting process should be documented or if the member should just be encouraged to document the evaluation. However, there would be a basis for concluding that documentation should be required since when a member applies safeguards to eliminate or reduce significant threats, the Conceptual Framework for Independence would require the member document the identified threats and safeguards applied.

Questions for the Committee

1. Does the Committee agree with the Task Force's belief that a primary government is presumed to have more than minimal influence over funds and component unit's accounting or financial reporting process but that this presumption could be rebutted?
2. Does the Committee believe the factors included in the interpretation are helpful and are there any other factors that should also be included?
3. Should the interpretation require that member's evaluation of the primary government's level of influence over the accounting or financial reporting process be documented or just encourage documentation?

Action Needed

The Committee feedback as noted is appreciated.

Materials Presented

Agenda Item 3B – Draft Interpretation
Agenda Item 3C - Government Reporting Crosswalk

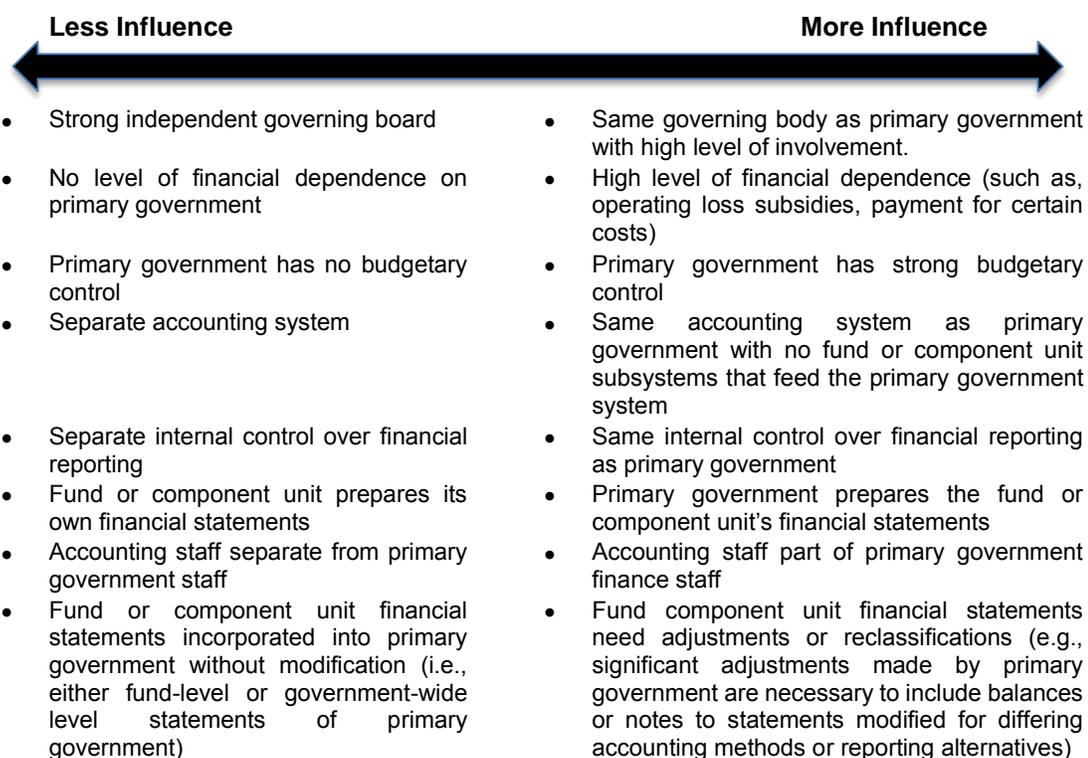
1.224.020 Entities Included in State and Local Government Financial Statements

- .01 This interpretation applies to financial statement attest engagements of state and local governmental entities whose basic financial statements include funds and component units that are required under the applicable framework, as defined in AU-C 200.14, (b) and (c), to be included in the reporting entity of a primary government (funds and component units).
- .02 For purposes of this interpretation, state and local governmental entities include general purpose governments such as states, counties, cities, towns and villages. State and local governmental entities also include special purpose governments, which perform only one activity or only a few activities. Examples of special purpose governments include, but are not limited to, school districts, public universities and community colleges, utilities, hospitals or other health care organizations, public retirement systems, public transportation systems, public authorities, tribes, and special districts.

Auditor of Primary Government

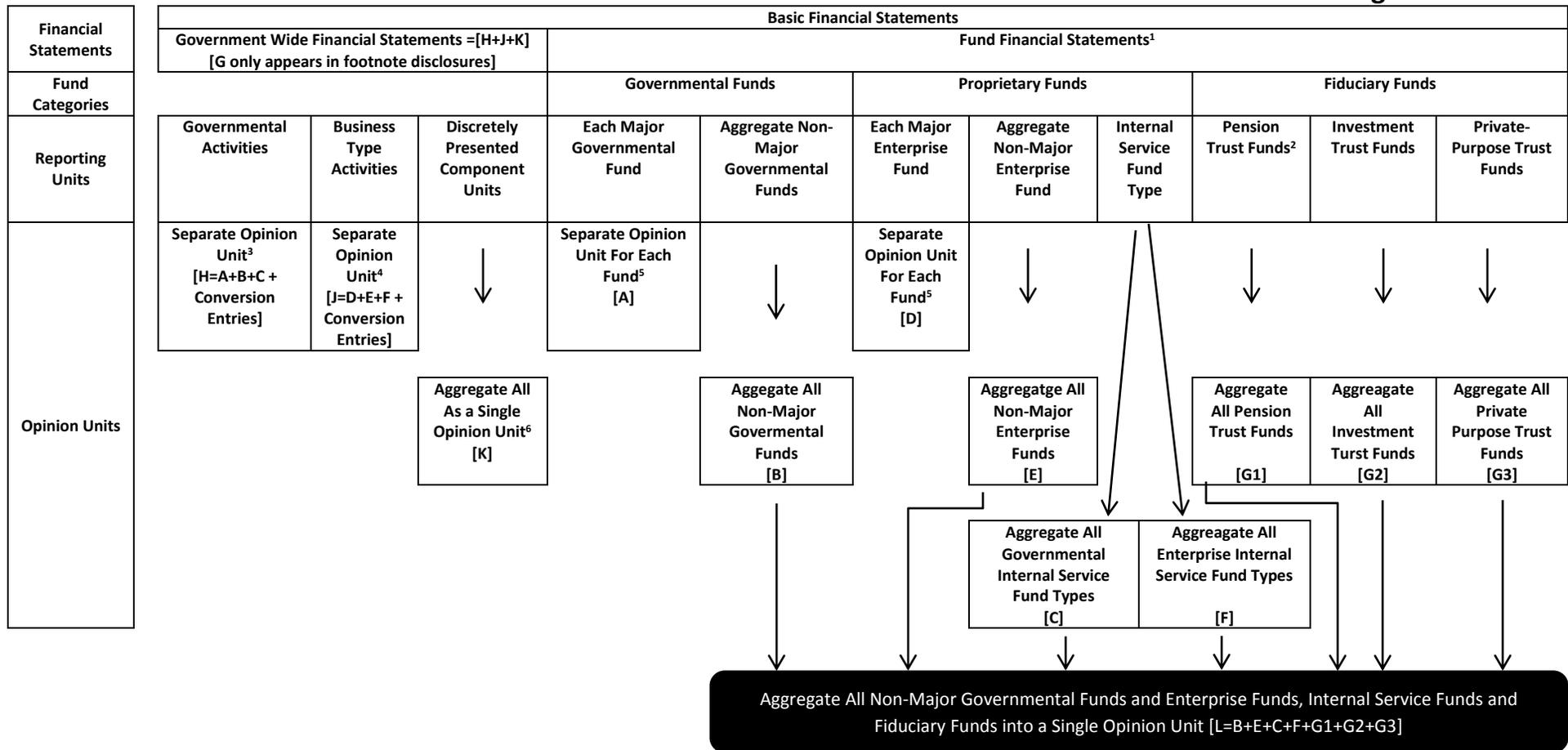
- .03 When performing a financial statement attest engagement for a primary government, covered members should apply the “[Independence Rule](#)” [1.200.001] and related interpretations applicable to the primary government to all entities included or required to be included in the reporting entity under the applicable framework. However, when the member makes reference to another auditor’s report and the primary government has only minimal influence over the accounting or financial reporting process of a fund or component unit, the following exceptions apply:
 - a. Members do not need to be independent of an immaterial fund or component unit of the primary government.
 - b. Members do not need to be independent of material funds or component units of 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 of the member.
 - c. When a material fund’s or component unit’s financial information will be subject to the member’s financial statement attest procedures, members may use the Conceptual Framework for Independence to evaluate any relationships or circumstances that the member knows or have reason to believe exist that impairs independence under the interpretations of the “Independence Rule” to determine if safeguards can be applied that will eliminate significant threats or reduce them to an acceptable level.
- .04 There is a rebuttable presumption that the primary government has more than minimal influence over the accounting or financial reporting process of a fund or component unit. However, the member can rebut that presumption by considering the factors such as the following that, in the member’s professional judgment, demonstrate the primary government has only minimal influence
 - a. Primary government does not have the ability to direct the behaviors or actions of the governing board of the fund or component unit.
 - b. Primary government does not have the ability to add or remove members of the governing board of the fund or component unit.
 - c. Primary government does not exert influence that results from:
 - i. the primary government’s issuance or full or partial payment of the fund’s or component unit’s debt,

- ii. the primary government's financing of some or all of the fund's or component unit's deficits, or
 - iii. the primary government's actions to use or take the fund's or component unit's financial resources
 - d. Primary government does not have budgetary control over the fund or component unit.
 - e. Fund or component unit does not have the same accounting systems as the primary government.
 - f. Fund or component unit does not have the same internal control over financial reporting systems.
 - g. Primary government does not prepare the financial statements for the fund or component unit.
 - h. Accounting or finance staff of the fund or component unit is not the same staff as the primary government.
- .05 The overall facts and circumstances should be considered when using the factors in paragraph .04 to evaluate whether a primary government has more than minimal influence over the accounting or financial reporting process of a fund or component unit. While some factors may indicate influence others may indicate little to no influence. Some factors may be weighted differently depending on the circumstances and the subject matter of any potential impairment. Thus, the consideration of these factors runs along a spectrum. The following illustrates one possible spectrum.



- .06 Members should consider factors such as the following when evaluating whether a fund or component unit's financial statements will be subject to the member's financial statement attest procedures:
- a. Are significant modifications made by the primary government to the fund or component unit's financial statements in order to be included into the primary

-
- government's basic financial statements (e.g., adjustments to add fund or component unit financial information into government-wide statements)?
- b. Are there modifications to the fund or component unit's financial statements made by the primary government to revise the fund or component unit's financial information for accounting methods or reporting alternatives?



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 it should be reported as a blended component unit.

Compliance With Standards

Staff:

Lisa Snyder, Director

Reason for Agenda Item

The purpose of this agenda item is to discuss the application of the *Compliance With Standards* rule of the AICPA *Code of Professional Conduct* as it relates to performance audits performed in accordance with the GAO's Yellow Book as well as certain other engagements.

Summary of Issues

On February 11th, the PEEC's Planning Subgroup (Messrs. Burke, Denham, Mintzer and Shapiro) attended a joint meeting with representatives from the Auditing Standards Board (ASB) and Peer Review Board (PRB) to discuss issues of joint interest and areas of possible collaboration. One of the matters discussed involved the application of the *Compliance With Standards* rule as it relates to performance audits performed in accordance with the GAO's Yellow Book and other services that would not be covered by AICPA professional standards. It was agreed that this matter warranted further consideration and interpretation by PEEC.

The *Compliance With Standards* rule states as follows:

1.310.001 Compliance With Standards Rule

.01 A *member* who performs auditing, review, compilation, management consulting, tax, or other *professional services* shall comply with standards promulgated by bodies designated by *Council*.

.02 See [Appendix A](#) "*Council Resolution Designating Bodies to Promulgate Technical Standards.*" [Prior reference: paragraph .01 of ET section 202]

Bodies designated by Council to promulgate technical standards as set forth in Appendix A of the Code are:

- i) Federal Accounting Standards Advisory Board (FASAB);
- ii) Financial Accounting Standards Board (FASB);
- iii) Governmental Accounting Standards Board (GASB);
- iv) Public Company Accounting Oversight Board (PCAOB);
- v) International Accounting Standards Board (IASB)
- vi) AICPA Accounting and Review Services Committee (ARSC);
- vii) AICPA Auditing Standards Board (ASB);
- viii) AICPA Management Consulting Services Executive Committee;
- ix) AICPA Tax Executive Committee;
- x) AICPA Forensic and Valuation Services Executive Committee; and
- xi) Personal Financial Planning Executive Committee

Committee members are asked to read the proposed Q&A: *Applicability of AICPA Standards to Performance Audits* drafted by ASB Staff in **Agenda Item 4B**. The Q&A concludes that "*In summary, because the auditing, attestation and consulting standards do not apply to the specific service of conducting a performance audit, a member is not required to follow the SASs, SSAEs nor the SSCS. This, however, does not prohibit an*

AICPA member from following those standards if a member wishes to do or if such member represents that he is she is following the audit, attestation or consulting standards in the conduct of the performance audit.”

At least one firm has questioned the appropriateness of this conclusion. Specifically, the question has been raised as to whether the *Compliance With Standards* rule would require a member to comply with AICPA professional standards if such standards could be applied to the engagement. For example, should a member be required to apply the SSCSs (i.e., consulting standards), in addition to the GAO’s performance audit standards contained in the Yellow Book, in order to comply with the rule. In addition, the issue was raised as to whether the *Compliance With Standards* rule would require that all professional services provided by a member must be performed in accordance with professional standards promulgated by bodies designated by Council (i.e., a member can *only* perform services that are covered by such professional standards).

Prior to the joint PEEC/ASB/PRB meeting, members of the PEEC’s Technical Standards Subcommittee (TNS), Mr. Denham (PEEC member), and Ms. Miller (KPMG and former TNS Chair) discussed this issue via a conference call. There was a general consensus that the *Compliance With Standards* rule was intended to apply only when professional standards exist that are specifically applicable to the type of engagement agreed to between the member and client. Accordingly, most committee members did not believe that a member should be required to “pigeonhole” a particular service to fit it within a professional standard if the professional standards did not specifically apply. There was agreement, however, that the AICPA Code would still apply regardless of the type of professional service, particularly the *General Standards* rule.

2.300.001 General Standards Rule

.01 A *member* shall comply with the following standards and with any *interpretations* thereof by bodies designated by *Council*.

a. Professional Competence. Undertake only those *professional services* that the *member* or the *member’s firm* can reasonably expect to be completed with professional competence.

b. Due Professional Care. Exercise due professional care in the performance of *professional services*.

c. Planning and Supervision. Adequately plan and supervise the performance of *professional services*.

d. Sufficient Relevant Data. Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any *professional services* performed.

.02 See appendix A, “*Council Resolution Designating Bodies to Promulgate Technical Standards.*” [Prior reference: paragraph .01 of ET section 201]

At least one firm believes that such an interpretation of the *Compliance With Standards* rule could have unintended consequences as it relates to other types of engagements. As noted above, the issue was raised as to whether the rule would require members to comply with (and therefore only select) professional standards (e.g., attest, consulting, etc.) that have been promulgated by bodies designated by Council when performing professional services for a client. There are an array of services being provided by members where the engagements can be structured in a particular way as agreed to between the member and client. If members were not required to structure such engagements in a manner that complied with AICPA professional standards, there is concern that this could result in various organizations, not recognized by Council, establishing their own “standards” that members could follow when performing certain

engagements for a client. Examples of such engagements provided by one firm include requests for assurance such as letters from underwriters, bankers etc. on tax returns, ability to pay debts etc. While AICPA has significant commentary on its website cautioning practitioners about the risks of issuing such letters, the firm questions whether these engagements would be permissible if the member is not engaged to do them under AICPA professional standards.

Many attendees at the joint PEEC/ASB/PRB meeting believed that the rule was intended to require compliance with standards promulgated by Council-designated bodies only in situations where such standards applied. Such individuals believed that in cases where a particular service was not covered by such standards, the public interest was protected since members would still be required to comply with the *General Standards* rule. It was agreed that since PEEC is responsible for interpreting the Code of Professional Conduct and therefore, the intent and application of the *Compliance With Standards* rule, the Committee should further consider this issue and determine how the rule should be interpreted.

Action Needed

The Committee is asked to discuss this matter and determine whether the *Compliance With Standards* rule would permit a member to perform professional services using standards promulgated by bodies that have not been designated by Council (e.g., GAO) in situations where AICPA professional standards applicable to the service do not exist. If the Committee believes that members would be permitted to perform engagements that are not covered by professional standards promulgated by Council-designated bodies, does the Committee believe the General Standards rule is sufficient to protect the public interest?

The Committee's consideration of this matter is appreciated.

Effective Date

N/A.

Communications Plan

N/A.

Materials Presented

Agenda Item 4B – Draft Q&A

DRAFT Q&A: Applicability of AICPA Standards to Performance Audits

Question – An AICPA member is asked to conduct a Performance Audit pursuant to Generally Accepted Government Auditing Standards (GAGAS or Yellow Book). GAGAS is promulgated by the United States Government Accountability Office (GAO). The Yellow Book contains separate standards for financial statement audits, attestation engagements and performance audits. The Yellow Book distinguishes a performance audit from a financial statement audit and attestation engagements. In promulgating its financial statement and attestation standards, the GAO incorporates by reference all or some of the AICPA's auditing and attestation standards. There are no AICPA standards incorporated into the GAO's performance audit standard.

Because Section 1.130.001 of the AICPA's Code of Professional Conduct states:

A member who performs auditing, review, compilation, management consulting, tax, or other professional services shall comply with standards promulgated by bodies designated by Council

and because GAO is not a body designated by Council, is an AICPA member required to follow the AICPA's auditing, attestation or consulting standards when conducting a performance audit pursuant to the Yellow Book?

Answer – An AICPA member is required to follow the AICPA's Code of Professional Conduct in performance of their professional responsibilities. Additionally, a member is required to follow those specific professional standards issued by the AICPA when such standards apply to the service being performed.

The Statements on Auditing Standards (SASs) apply when a member is engaged to audit or does audit financial statements of a non-issuer. Since a performance audit is not an audit of financial statements or other subject matter covered by the SASs, the SASs do not apply.

The Statements on Standard for Attestation Engagements (SSAEs) apply when a member is engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter. In an attestation examination, a member's conclusion should be expressed in the form of an opinion as to whether (a) the subject matter is based on (or in conformity with) the criteria in all material respects or (b) the assertion is presented (or fairly stated), in all material respects, based on the criteria. Although a performance audit could be viewed as a type of examination, the reporting objectives in a performance audit are different from those of an attestation examination since there is no requirement in a performance audit to form an opinion. Because of the differences in the reporting objectives and because in a performance audit there is no requirement for an assertion, GAO has distinguished a performance audit from an attestation engagement. Additionally, GAO has not incorporated the AICPA's attestation standards into its performance audit standard. Because of these differences, the AICPA's SSAEs would not apply unless a member, who was engaged to conduct a performance audit, was also engaged to conduct an AICPA attestation examination or the member issued a performance audit report that purports to be in accordance with the SSAEs.

The AICPA's Statement on Standards for Consulting Services (SSCS) applies when a member provides consulting services as defined within SSCS. Consulting services differ fundamentally from an audit, attestation engagement or performance audit. In a consulting service, a member develops findings, conclusions, and recommendations.

Although the reporting objectives of a consulting and performance audit may be similar, the nature and scope of a consulting service is determined solely by the agreement between the member and the client, without any regard to the member being independent or obtaining reasonable assurance, both characteristics of a performance audit. Therefore, although a member may wish to apply the SSCS in conducting a performance audit, there is no AICPA requirement to do so.

In summary, because the auditing, attestation and consulting standards do not apply to the specific service of conducting a performance audit, a member is not required to follow the SASs, SSAEs nor the SSCS. This, however, does not prohibit an AICPA member from following those standard if a member wishes to do or if such member represents that he is she is following the audit, attestation or consulting standards in the conduct of the performance audit.

Financial Statement Preparation Services: Members Employed by Non-CPA Entities

Staff:

Lisa Snyder, Director and April Sherman, Technical Manager

Reason for Agenda Item

The Committee is asked to consider if members employed by non-CPA entities that perform financial statement preparation services are considered to be in public practice and, therefore, are subject to the Statements on Standards for Accounting and Review Services (SSARS) No. 21.

Summary of Issues

Staff has received an inquiry concerning whether or not a member involved in the preparation of financial statements for clients of a non-CPA entity is considered to be in public practice. The owner of the entity is not a CPA or a member and the entity is not a registered/licensed CPA firm. The engagement letter for each client is signed by the owner. The member is employed by the entity as a manager. Non-CPA bookkeeping staff prepare the initial financial statements but the member reviews the financial statements (which includes editing, deleting, and adding journal entries, changing the format of the financial statements, and making any other edits necessary to arrive at complete and accurate financial statements). The entity provides no reports on the financial statements.

Definitions

SSARS 21 requires compliance by accountants in public practice, which was the main concern of the member's inquiry. (Please refer to SSARS 21, Section 70 at **Agenda Item 5B**. The SSARS rely on the definition of *public practice* found in the *AICPA Code of Professional Conduct* ("the Code"), so Staff reviewed the following definitions in Section .400 *Definitions* of the Code:

.42 Public practice. Consists of the performance of professional services for a client by a member or member's firm.

.40 Professional services. Include all services requiring accountancy or related skills that are performed by a member for a client, an employer, or on a volunteer basis. These services include, but are not limited to accounting, audit and other attest services, tax, bookkeeping, management consulting, financial management, corporate governance, personal financial planning, business valuation, litigation support, educational, and those services for which standards are promulgated by bodies designated by Council.

.07 Client. Any person or entity, other than the member's employer, that engages a member or member's firm to perform professional services and, if different, the person or entity with respect to which professional services are performed.

.18 Firm. A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council and that is engaged in public practice. A firm includes the individual partners thereof, except for purposes of applying the "[Independence Rule](#)" [1.200.001] and related interpretations. For purposes of applying the "Independence Rule," a firm includes a network firm when the engagement is either a financial statement audit or review engagement

and the audit or review report is not restricted, as set forth in the AICPA SASs and SSARSs (AICPA, *Professional Standards*).

Public Practice

Staff believes that the individual member is performing *professional services* for *clients* of the employing entity; therefore, it would appear that the member himself is in *public practice*. However, it is unclear as to whether or not the employing entity is in public practice based upon the definitions. A characteristic of being in public practice is the performance of professional services for a client by a member or member's *firm*. Whether or not the employing entity is to be considered a *firm* is dependent upon whether or not the entity is permitted by law or regulation, has characteristics that conform to resolutions of AICPA Council and engaged in public practice. Since the entity does not perform any attest or compilation services, resolutions of the Council would only require that it is "legally permissible under applicable law or regulation." [See "B" in *Appendix B* of the Code at **Agenda Item 5C**.]

Although the employing entity could be viewed as meeting the definition of the "member's firm" and in public practice based on the definitions, Staff does not believe it was the intent of the Committee to consider non-CPA firms that only perform bookkeeping services (i.e., no attest services) to be considered in public practice. However, Staff believes it is reasonable to conclude that the member himself would be considered to be in public practice with respect to clients of the employing entity. This conclusion would be consistent with the application of "C" in *Appendix B* of the Code which requires a member engaged in public practice in a firm that performs compilations of financial statements under SSARS (and no other attest services) to ensure that a CPA has ultimate responsibility for the compilation service and signs the report. This provision has been applied in the past to CPAs working for non-CPA entities such as American Express that offer compilation services to clients.

SSARS 21, Section 70, (see **Agenda Item 5B**) contains the requirements and guidance related to engagements to prepare financial statements and applies when an accountant in public practice is engaged to prepare financial statements but is not engaged to perform an audit, review or a compilation on those financial statements:

Scope of This Section

.01 This section applies when an accountant in public practice is engaged to prepare financial statements. This section does not apply when an accountant prepares financial statements

- and is engaged to perform an audit, review, or compilation of those financial statements,*
- solely for submission to taxing authorities,*
- for inclusion in written personal financial plans prepared by the accountant,*
- in conjunction with litigation services that involve pending or potential legal or regulatory proceedings, or*
- in conjunction with business valuation services. This section may also be applied, adapted as necessary in the circumstances, to the preparation of other historical or prospective financial information.¹ (Ref: par. .A1)*

.02 The determination about whether the accountant has been engaged to prepare financial statements or merely assist in preparing financial statements (which is a bookkeeping service that is not subject to this section) is determined based on services the client

requests the accountant to perform and requires the accountant to apply professional judgment. (Ref: par. A2).

A2 The appendix, "Preparation of Financial Statements Versus Assistance in Preparing Financial Statements," provides examples of services that the accountant may be engaged to perform and whether this section would apply."

The Committee is asked to consider whether the member would be considered "engaged to prepare financial statements" on behalf of the employing entity, in which case it would appear that the member would be subject to SSARS 21 and responsible for ensuring that all financial statements he reviewed complied with the standard (assuming the Committee agrees the member would be considered in public practice.) Since the employing entity is not a CPA firm and not in public practice, Staff believes the entity itself would not be required to comply with SSARS 21.

Staff would also recommend that the member should consult with his or her state board of accountancy as to whether the state would consider the member or his employer to be in public practice.

Action Needed

The Committee is asked to discuss this matter and provide feedback as to whether it believes:

1. A member employed by a non-CPA entity that provides professional services to clients is in public practice and the entity itself is not in public practice.
2. If the member is considered to be in public practice, whether the member is subject to SSARS 21, Section 70.

Materials Presented

Agenda Item 5B	SSARS 21 Section 70
Agenda Item 5C	Appendix B

AR-C Section 70

Preparation of Financial Statements

Source: SSARS No. 21

Effective for the preparation of financial statements for periods ending on or after December 15, 2015.

Introduction

Scope of This Section

.01 This section applies when an accountant in public practice is engaged to prepare financial statements. This section does not apply when an accountant prepares financial statements

- and is engaged to perform an audit, review, or compilation of those financial statements,
- solely for submission to taxing authorities,
- for inclusion in written personal financial plans prepared by the accountant,
- in conjunction with litigation services that involve pending or potential legal or regulatory proceedings, or
- in conjunction with business valuation services.

This section may also be applied, adapted as necessary in the circumstances, to the preparation of other historical or prospective financial information.¹ (Ref: par. .A1)

.02 The determination about whether the accountant has been engaged to prepare financial statements or merely assist in preparing financial statements (which is a bookkeeping service that is not subject to this section) is determined based on services the client requests the accountant to perform and requires the accountant to apply professional judgment. (Ref: par. .A2)

The Preparation Engagement

.03 An engagement to prepare financial statements is a nonattest service and does not require a determination about whether the accountant is independent of the entity. (Ref: par. .A3)

.04 In addition, an engagement to prepare financial statements does not require the accountant to verify the accuracy or completeness of the information provided by management or otherwise gather evidence to express an opinion or a conclusion on the financial statements or otherwise report on the financial statements.

¹ The Accounting and Review Services Committee plans to expose for public comment separate proposed Statements on Standards for Accounting and Review Services that would provide requirements and guidance to accountants with respect to compilation engagements on pro forma or prospective financial information.

Effective Date

.05 This section is effective for the preparation of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted.

Objective

.06 The objective of the accountant is to prepare financial statements pursuant to a specified financial reporting framework.

Definitions

.07 For purposes of Statements on Accounting and Review Standards (SSARs), the following terms have the meanings attributed as follows:

Applicable financial reporting framework. The financial reporting framework adopted by management and, when appropriate, those charged with governance, in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements or that is required by law or regulation.

Financial reporting framework. A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements (for example, accounting principles generally accepted in the United States of America [U.S. GAAP], International Financial Reporting Standards promulgated by the International Accounting Standards Board, or a special purpose framework).

Management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

Special purpose framework. A financial reporting framework other than GAAP that is one of the following bases of accounting:

- a. **Cash basis.** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. **Tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- c. **Regulatory basis.** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission). (Ref: par. .A4)
- d. **Contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the accountant.
- e. **Other basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

The cash-basis, tax-basis, regulatory-basis, and other-basis of accounting are commonly referred to as *other comprehensive bases of accounting* (OCBOA).

Those charged with governance. The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of an entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

Requirements

General Principles for Performing Engagements to Prepare Financial Statements

.08 In addition to complying with this section, an accountant is required to comply with section 60, *General Principles For Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*.

Acceptance and Continuance of Client Relationships and Engagements to Prepare Financial Statements

.09 If the accountant is not satisfied with any of the matters set out in paragraph .25 of section 60 as preconditions for accepting an engagement to prepare financial statements, the accountant should discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the proposed engagement.

Agreement on Engagement Terms

.10 The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement and should include the following: (Ref: par. .A5–.A9)

- a. The objective of the engagement
- b. The responsibilities of management set forth in paragraph .25c of section 60
- c. The agreement of management that each page of the financial statements will include a statement indicating that no assurance is provided on the financial statements or the accountant will be required to issue a disclaimer that makes clear that no assurance is provided on the financial statements. (Ref: par. .A11)
- d. The responsibilities of the accountant
- e. The limitations of the engagement to prepare financial statements
- f. Identification of the applicable financial reporting framework for the preparation of financial statements
- g. Whether the financial statements are to contain a known departure or departures from the applicable financial reporting framework (including inadequate disclosure) or omit substantially all

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disclosures required by the applicable financial reporting framework.

.11 The engagement letter or other suitable form of written agreement should be signed by

- a. the accountant or the accountant's firm and
- b. management or those charged with governance, as appropriate. (Ref: par. .A8)

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework

.12 The accountant should obtain an understanding of the financial reporting framework and the significant accounting policies intended to be used in the preparation of the financial statements. (Ref: par. .A10)

Preparing the Financial Statements

.13 The accountant should prepare the financial statements using the records, documents, explanations, and other information provided by management.

.14 The accountant should ensure that a statement is included on each page of the financial statements indicating, at a minimum, that "no assurance is provided" on the financial statements. If the accountant is unable to include a statement on each page of the financial statements, the accountant should (Ref: par. .A11)

- issue either a disclaimer that makes clear that no assurance is provided on the financial statements or (Ref: par. .A12)
- perform a compilation engagement in accordance with section 80, *Compilation Engagements*

.15 When preparing financial statements in accordance with a special purpose framework, the accountant should include a description of the financial reporting framework on the face of the financial statements or in a note to the financial statements. (Ref: par. .A13)

.16 If, during the preparation of financial statements, the accountant assists management with significant judgments regarding amounts or disclosures to be reflected in the financial statements, the accountant should discuss those judgments with management so management understands the significant judgments reflected in financial statements and accepts responsibility for those judgments. (Ref: par. .A14 and .A18)

.17 If the accountant becomes aware that the records, documents, explanations, or other information, including significant judgments, used in the preparation of the financial statements are incomplete, inaccurate, or otherwise unsatisfactory, the accountant should bring that to the attention of management and request additional or corrected information.

.18 When, after discussions with management, the accountant prepares financial statements that contain a known departure or departures from the applicable financial reporting framework (including inadequate disclosure), the accountant should disclose the material misstatement or misstatements in the financial statements. (Ref: par. .A15)

Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework

.19 When, after discussions with management, the accountant prepares financial statements that omit substantially all disclosures required by the applicable financial reporting framework, the accountant should disclose such omission in the financial statements. (Ref: par. .A16)

.20 The accountant should not prepare financial statements that omit substantially all disclosures required by the financial reporting framework if the accountant becomes aware that the omission of substantially all disclosures was undertaken with the intention of misleading users of such financial statements. (Ref: par. .A17)

Documentation in a Preparation Engagement

.21 The accountant should prepare documentation in connection with each preparation engagement in sufficient detail to provide a clear understanding of the work performed which, at a minimum, includes the following: (Ref: par. .A18)

- a. The engagement letter or other suitable form of written documentation with management, as described in paragraphs .10–.11
- b. A copy of the financial statements that the accountant prepared

.22 If, in rare circumstances, the accountant judges it necessary to depart from a relevant presumptively mandatory requirement, the accountant must document the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement.

Application and Other Explanatory Material

Scope of This Section (Ref: par. .01–.02)

.A1 Other historical or prospective financial information to which this section may be applied includes the following:

- Specified elements, accounts, or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes
- Supplementary information
- Required supplementary information
- Pro forma financial information
- Prospective financial information, including budgets, forecasts, or projections

.A2 The appendix, "Preparation of Financial Statements Versus Assistance in Preparing Financial Statements," provides examples of services that the accountant may be engaged to perform and whether this section would apply.

The Preparation Engagement (Ref: par. .03)

.A3 The "Nonattest Services" subtopic of the "Independence Rule" (ET sec. 1.295) addresses the accountant's considerations with respect to independence

when performing nonattest services for attest clients. For example, the accountant may prepare monthly or other interim financial statements and be engaged to perform an audit, review, or compilation engagement with respect to the annual financial statements. The accountant needs to be aware that the performance of the preparation services may impair independence unless the safeguards described in this subtopic are met.

Definitions (Ref: par. .07)

.A4 Certain regulators, including state and local government legislators, regulatory agencies, or departments, require financial statements to be prepared in accordance with a financial reporting framework that is based on GAAP but does not comply with all the requirements of GAAP. Such frameworks are regulatory-bases of accounting, as defined in paragraph .07. In some circumstances, however, the cash- or tax-basis of accounting may be permitted by a regulator. For purposes of this section, the cash- and tax-bases of accounting are not regulatory-bases of accounting.

Agreement on Engagement Terms (Ref: par. .10–.11)

.A5 Both management and the accountant have an interest in documenting the agreed-upon terms of the engagement to prepare financial statements before the commencement of the engagement to help avoid misunderstandings with respect to the engagement. For example, it reduces the risk that management may inappropriately rely on or may expect the accountant to protect management against certain risks or to perform certain functions, including those that are management's responsibility.

.A6 When a third party has contracted for an engagement to prepare the entity's financial statements, agreeing the terms of the engagement with management of the entity is necessary in order to establish that the preconditions for an engagement to prepare financial statements are present.

.A7 A contract is another suitable form of written communication. The understanding with management regarding the services to be performed for engagements to prepare financial statements is required by paragraph .10 to be in a documented form, and, accordingly, a verbal understanding is insufficient. An engagement letter is the most common, and usually the most convenient, method for documenting the understanding with management regarding the services to be performed for engagements to prepare financial statements.

.A8 The roles of management and those charged with governance in agreeing upon the terms of the engagement to prepare financial statements for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management, those charged with governance, or both. Nonetheless, when the agreement on the terms of engagement is only with those charged with governance in accordance with paragraph .25c of section 60, the accountant is required to obtain management's agreement that it acknowledges and understands its responsibilities.

.A9 An illustrative example of an engagement letter for an engagement to prepare financial statements is presented in the exhibit, "Illustrative Engagement Letter."

The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework (Ref: par. .12)

.A10 The requirement that the accountant obtain an understanding of the financial reporting framework adopted by management intended to be used in the preparation of the financial statements and the significant accounting policies adopted by management does not prevent the accountant from accepting an engagement to prepare financial statements for an entity in an industry in which the accountant has no previous experience. The accountant may obtain such understanding, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals who are knowledgeable about the industry.

Preparing the Financial Statements (Ref: par. .10, .14–.16, and .18)

.A11 The statement on each page of the financial statements, including related notes, is intended to avoid misunderstanding on the part of users with respect to the accountant's involvement with the financial statements. The statement is made at management's discretion, and the accountant or the accountant's firm name is not required to be included. The accountant is concerned that the indication is not misleading. Examples of a statement on each page of the financial statements include the following:

- No assurance is provided on these financial statements.
- These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them.

Other statements that convey that no assurance is provided on the financial statements would also be acceptable.

.A12 An example of a disclaimer that the accountant may issue is as follows:

The accompanying financial statements of XYZ Company as of and for the year ended December 31, 20XX, were not subjected to an audit, review, or compilation engagement by me (us) and, accordingly, I (we) do not express an opinion, a conclusion, nor provide any assurance on them.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date]

.A13 A description of the special purpose framework is usually placed next to or under the title of the financial statements (for example "statement of assets and liabilities—modified cash basis"). However, the description may be placed elsewhere in the financial statements.

.A14 In the preparation of financial statements, the accountant may provide assistance to management with significant judgments (for example, the accountant may advise management on alternative accounting policies that are significant to the financial statements or help management with significant judgments regarding material accounting estimates).

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.A15 The disclosure of the material misstatement or misstatements may be made on the face of the financial statements or in a note to the financial statements.

Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework (Ref: par. .19–.20)

.A16 The disclosure of the omission of substantially all disclosures required by the applicable financial reporting framework may be made on the face of the financial statements or in a selected note to the financial statements.

.A17 The accountant may prepare financial statements that include disclosures about only a few matters in the notes to the financial statements. Such disclosures may be labeled "Selected Information—Substantially All Disclosures Required by [*the applicable financial reporting framework*] Are Not Included."

Documentation in a Preparation Engagement (Ref: par. .16 and .21)

.A18 Documentation may include documentation regarding significant consultations or significant professional judgments made throughout the engagement.

.A19

Appendix—Preparation of Financial Statements Versus Assistance in Preparing Financial Statements (Ref: par. .A2)

The determination about whether the accountant has been engaged to prepare financial statements or merely assist in preparing financial statements (which is a bookkeeping service that is not subject to this section) is determined based on the services the client requests the accountant to perform and requires the accountant to apply professional judgment. The following table provides examples of services that the accountant may be engaged to perform and whether section 70 would apply. The table is not intended to be all inclusive, and professional judgment would still need to be applied.

<i>Examples of Services for Which This Section Applies</i>	<i>Examples of Accountant Services for Which This Section Does Not Apply</i>
Preparation of financial statements prior to audit or review by another accountant	Preparation of financial statements when the accountant is engaged to perform an audit, review, or compilation of such financial statements
Preparation of financial statements for an entity to be presented alongside the entity's tax return	Preparation of financial statements with a tax return solely for submission to taxing authorities
Preparation of personal financial statements for presentation alongside a financial plan	Personal financial statements that are prepared for inclusion in written personal financial plans prepared by the accountant
	Financial statements prepared in conjunction with litigation services that involve pending or potential legal or regulatory proceedings
	Financial statements prepared in conjunction with business valuation services
	Maintaining depreciation schedules
	Preparing or proposing certain adjustments, such as those applicable to deferred income taxes, depreciation, or leases
Preparation of single financial statements, such as a balance sheet or income statement or financial statements with substantially all disclosures omitted	Drafting financial statement notes
Using the information in a general ledger to prepare financial statements outside of an accounting software system	Entering general ledger transactions or processing payments (general bookkeeping) in an accounting software system

.A20

Exhibit—Illustrative Engagement Letter (Ref: par. .A9)

The following is an example of an engagement letter for an engagement to prepare financial statements prepared in accordance with accounting principles generally accepted in the United States of America. This engagement letter is intended as an illustration that may be used in conjunction with the considerations outlined in Statements on Standards for Accounting and Review Services. The engagement letter will vary according to individual requirements and circumstances and is drafted to refer to the preparation of financial statements for a single reporting period. The accountant may seek legal advice about whether a proposed letter is suitable.

To the appropriate representative of ABC Company:¹

You² have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended and the related notes to the financial statements.^{3, 4} We are pleased to confirm our acceptance and our understanding of this engagement to prepare the financial statements of ABC Company by means of this letter.

Our Responsibilities

The objective of our engagement is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you. We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARSs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion or provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

¹ The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement to prepare financial statements, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A8.

² Throughout this engagement letter, references to *you, we, us, management, and accountant* would be used or amended as appropriate in the circumstances.

³ If the accountant is to be engaged to prepare financial statements that omit the statement of cash flows and the related notes, the sentence may be revised to read, "You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income and changes in stockholders' equity." The following additional sentence may then be added: "These financial statements will not include a statement of cash flows and related notes to the financial statements."

⁴ The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

Management Responsibilities

The engagement to be performed is conducted on the basis that management acknowledges and understands that our role is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America. Management has the following overall responsibilities that are fundamental to our undertaking the engagement to prepare your financial statements in accordance with SSARSs:

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The prevention and detection of fraud
- c. To ensure that the entity complies with the laws and regulations applicable to its activities
- d. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement to prepare financial statements
- e. To provide us with:
 - i. Documentation, and other related information that is relevant to the preparation and presentation of the financial statements,
 - ii. Additional information that may be requested for the purpose of the preparation of the financial statements, and
 - iii. Unrestricted access to persons within ABC Company of whom we determine necessary to communicate.

The financial statements will not be accompanied by a report. However, you agree that the financial statements will clearly indicate that no assurance is provided on them.

[If the accountant expects to issue a disclaimer, instead of the preceding paragraph, the following may be added:

As part of our engagement, we will issue a disclaimer that will state that the financial statements were not subjected to an audit, review, or compilation engagement by us and, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them.]

Other Relevant Information

Our fees for these services. . . .

[The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):

You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us.]

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement

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to prepare the financial statements described herein, and our respective responsibilities.

Sincerely yours,

[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

[Signed]

[Name and Title]

[Date]

[Revised, February 2015, to include additional required engagement letter elements.]

Appendix B

Council Resolution Concerning the Form of Organization and Name Rule

[As adopted May 23, 1994; revised May 7, 1997, May 15, 2000, May 22, 2006 August 2011, and October 19, 2014.]

- A. RESOLVED: That with respect to a *member* engaged in *public practice* in a *firm* or organization which performs (1) any audit or other engagement performed in accordance with the Statements on Auditing Standards, (2) any review of a *financial statement* performed in accordance with the Statements on Standards for Accounting and Review Services, (3) any examination of prospective financial information performed in accordance with the Statements on Standards for Attestation Engagements, (4) any engagement to be performed in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB), or (5) any examination, review, or agreed upon procedures engagement to be performed in accordance with the SSAE, other than an examination described in subsection (A) (3), or which holds itself out as a *firm* of certified public accountants or uses the term “certified public accountant(s)” or the designation “CPA” in connection with its name, the characteristics of such a *firm* or organization under the “[Form of Organization and Name Rule](#)” (AICPA, *Professional Standards*, ET sec. 1.800.001) of the Code of Professional Conduct are as set forth below:
1. A majority of the ownership of the *member’s firm* in terms of financial interests and voting rights must belong to CPAs. Any non-CPA owner would have to be actively engaged as a member of the *firm* or its affiliates. Ownership by investors or commercial enterprises not actively engaged as members of the *firm* or its affiliates is against the public interest and continues to be prohibited.
 2. There must be a CPA who has ultimate responsibility for all the services described in A above, compilation services and other engagements governed by Statements on Auditing Standards or Statements on Standards for Accounting and Review Services, and non-CPA owners could not assume ultimate responsibility for any such services or engagements.
 3. Non-CPA owners would be permitted to use the title “principal,” “owner,” “officer,” “member” or “shareholder” or any other title permitted by state law, but not hold themselves out to be CPAs.
 4. A *member* shall not knowingly permit a person, whom the *member* has the authority or capacity to control, to carry out on his or her behalf, either with or without compensation, acts which, if carried out by the *member*, would place the *member* in violation of the rules. Further, a *member* may be held responsible for the acts of all persons associated with him or her in the *public practice* whom the *member* has the authority or capacity to control.
 5. Owners shall at all times own their equity in their own right and shall be the beneficial owners of the equity capital ascribed to them. Provision would have to be made for the ownership to be transferred, within a reasonable period of time, to the *firm* or to other qualified owners if the owner ceases to be actively engaged in the *firm* or its affiliates.
 6. Non-CPA owners would not be eligible for regular membership in the AICPA, unless they meet the requirements in BL section 2.2.1.
- B. RESOLVED: The characteristics of all other *firms* or organizations are deemed to be whatever is legally permissible under applicable law or regulation, except as otherwise provided in paragraph C below.
- C. RESOLVED: That with respect to a *member* engaged in *public practice* in a *firm* or organization which is not within the description of a *firm* or organization set forth in

paragraph A above, but who performs compilations of *financial statements* performed in accordance with the Statements on Standards for Accounting and Review Services, the characteristics of such a *firm* or organization under the “Form of Organization and Name Rule” of the Code are as set forth below.

1. There must be a CPA who has ultimate responsibility for any *financial statement* compilation services provided by the *firm* and by each business unit performing such compilation services and non-CPA owners could not assume ultimate responsibility for any such services.
2. Any compilation report must be signed individually by a CPA, and may not be signed in the name of the *firm* or organization.

Application of Council Resolution Concerning the Form of Organization and Name Rule to Certain Attestation Engagements

Staff:

Lisa Snyder, Director

Reason for Agenda Item

The Committee is asked to consider the application of the *Council Resolution Concerning the Form of Organization and Name Rule* (“Council Resolution”) in Appendix B of the AICPA Code with regard to certain types of attestation engagements that may be performed by non-CPAs within the firm.

Summary of Issues

The Council Resolution (see [Agenda Item 6B](#)) states, in part:

A. RESOLVED: That with respect to a *member* engaged in *public practice* in a *firm* or organization which performs (1) any audit or other engagement performed in accordance with the Statements on Auditing Standards, (2) any review of a *financial statement* performed in accordance with the Statements on Standards for Accounting and Review Services, (3) any examination of prospective financial information performed in accordance with the Statements on Standards for Attestation Engagements (SSAE), (4) any engagement to be performed in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB), or (5) any examination, review, or agreed upon procedures engagement to be performed in accordance with the SSAE, other than an examination described in subsection (A) (3), or which holds itself out as a *firm* of certified public accountants or uses the term “certified public accountant(s)” or the designation “CPA” in connection with its name, the characteristics of such a *firm* or organization under the “[Form of Organization and Name Rule](#)” (AICPA, *Professional Standards*, ET sec. 1.800.001) of the Code of Professional Conduct are as set forth below:

1. A majority of the ownership of the *member’s firm* in terms of financial interests and voting rights must belong to CPAs. Any non-CPA owner would have to be actively engaged as a member of the *firm* or its affiliates. Ownership by investors or commercial enterprises not actively engaged as members of the *firm* or its affiliates is against the public interest and continues to be prohibited.
2. **There must be a CPA who has ultimate responsibility for all the services described in A above, compilation services and other engagements governed by Statements on Auditing Standards or Statements on Standards for Accounting and Review Services, and non-CPA owners could not assume ultimate responsibility for any such services or engagements....(emphasis added)**

The Committee is asked to determine how to interpret the phrase, “there must be a CPA who has ultimate responsibility for all services described in A above.” CPA firms provide certain services such as Service Organization Control (SOC), sustainability (e.g., reporting on greenhouse gas emissions information) and cybersecurity engagements that require specialized knowledge often held by non-CPA owners within the firm rather than the traditional skillset of a traditional CPA. These engagements are typically performed under

the attestation standards (SSAES) which are covered under A(5) of the Council Resolution. The question has been raised as to whether a non-CPA owner of the firm can serve as the engagement partner for such an engagement and/or sign the report provided there is a CPA owner of the firm that “accepts responsibility” for the engagement. While Staff believes that the Council Resolution can be interpreted to permit a non-CPA owner serve as the engagement partner, there must still be a CPA owner within the firm who accepts responsibility for the engagement. There have been mixed views as to what actions the CPA must take in order to assume ultimate responsibility for the engagement as well as what level of “competency” the CPA must possess. For example, it has been suggested that in order to accept responsibility for the engagement, the CPA should review the work performed and have the “skills, knowledge and/or experience” similar to that required of a client under the *Nonattest Services* interpretations; however, the CPA would not be expected to be able to re-perform the engagement.

Action Needed

The Committee is asked to consider the following:

1. Would a non-CPA owner of the firm be able to serve as the engagement partner of an attestation engagement provided a CPA-owner of the firm assumes responsibility for the engagement? If yes, would the non-CPA owner be able to sign the report or must the CPA-owner who assumes responsibility for the engagement sign the firm’s report?
2. What actions would be required by the CPA-owner and what level of competency should he or she possess in order to assume responsibility for the engagement?

The Committee’s consideration of this matter is appreciated.

Effective Date

N/A.

Communications Plan

N/A.

Materials Presented

Agenda Item 6B - Council Resolution

Appendix B: Council Resolution Concerning the Form of Organization and Name Rule (in part)

A. RESOLVED: That with respect to a *member* engaged in *public practice* in a *firm* or organization which performs (1) any audit or other engagement performed in accordance with the Statements on Auditing Standards, (2) any review of a *financial statement* performed in accordance with the Statements on Standards for Accounting and Review Services, (3) any examination of prospective financial information performed in accordance with the Statements on Standards for Attestation Engagements, (4) any engagement to be performed in accordance with the standards of the Public Company Accounting Oversight Board (PCAOB), or (5) any examination, review, or agreed upon procedures engagement to be performed in accordance with the SSAE, other than an examination described in subsection (A) (3), or which holds itself out as a *firm* of certified public accountants or uses the term “certified public accountant(s)” or the designation “CPA” in connection with its name, the characteristics of such a *firm* or organization under the [“Form of Organization and Name Rule”](#) (AICPA, *Professional Standards*, ET sec. 1.800.001) of the Code of Professional Conduct are as set forth below:

1. A majority of the ownership of the *member’s firm* in terms of financial interests and voting rights must belong to CPAs. Any non-CPA owner would have to be actively engaged as a member of the *firm* or its affiliates. Ownership by investors or commercial enterprises not actively engaged as members of the *firm* or its affiliates is against the public interest and continues to be prohibited.

2. There must be a CPA who has ultimate responsibility for all the services described in A above, compilation services and other engagements governed by Statements on Auditing Standards or Statements on Standards for Accounting and Review Services, and non-CPA owners could not assume ultimate responsibility for any such services or engagements.

3. Non-CPA owners would be permitted to use the title “principal,” “owner,” “officer,” “member” or “shareholder” or any other title permitted by state law, but not hold themselves out to be CPAs.

4. A *member* shall not knowingly permit a person, whom the *member* has the authority or capacity to control, to carry out on his or her behalf, either with or without compensation, acts which, if carried out by the *member*, would place the *member* in violation of the rules. Further, a *member* may be held responsible for the acts of all persons associated with him or her in the *public practice* whom the *member* has the authority or capacity to control.

5. Owners shall at all times own their equity in their own right and shall be the beneficial owners of the equity capital ascribed to them. Provision would have to be made for the ownership to be transferred, within a reasonable period of time, to the *firm* or to other qualified owners if the owner ceases to be actively engaged in the *firm* or its affiliates.

6. Non-CPA owners would not be eligible for regular membership in the AICPA, unless they meet the requirements in BL section 2.2.1.

IFAC Convergence – Improving the Structure of the Code of Ethics for Professional Accountants – Phase I

IESBA Convergence Task Force:

Sam Burke, Rick David, Jana Dupree, Brian Lynch, and Larry Shapiro, Staff: Jason Evans. Observer: Lisa Snyder.

Task Force Objective:

To draft a comment letter on behalf of the PEEC in response to the IESBA exposure draft.

Reason for Agenda Item

The PEEC is asked to read the exposure draft entitled “Improving the Structure of the Code of Ethics for Professional Accountants – Phase I” (ED) as issued by the International Ethics Standards for Board for Professional Accountants (IESBA).

Intro

In December 2015, the IESBA released the ED with comments due on April 18, 2016. Numerous stakeholders suggested the restructuring to improve understandability and usability of the IESBA Code. Stakeholders expressed concerns in understanding the requirements of the IESBA Code along with long sentences and complex language contained in the IESBA Code.

In November 2014, the Board released a consultation paper in connection with the project seeking input as to the approach of the restructuring. The PEEC responded noting that in general, there was not a great need to clarify the IESBA Code and that the project may require too many resources of the IESBA staff.

Overview of the Restructuring

Highlights of the restructuring include:

- Increased prominence of the requirement to apply the conceptual framework and comply with the fundamental principles – each section contains a requirement to apply the Conceptual Framework and there is also a sentence in the header of each page;
- Increased prominence of the requirements of the IESBA Code, which are proposed to be distinguished as those paragraphs designated with an “R” – stakeholders noted difficulty in distinguishing requirements which may impede compliance and enforcement;
- Application material is placed under the applicable requirement and designated with an “A”;
- Increased clarity of a firm’s responsibility and that of a professional accountant; and
- Increased clarity of language – shorter sentences, simpler language.

Additional aspects of the restructuring include:

- A new Guide to the Code (substantially new material);
- Reorganizing the Code as appropriate, to enhance clarity and usability, positioning the Code to take advantage of forthcoming electronic features;
- Organization of the material into more self-contained sections and subsections;
 - Each Section having its own introduction which broadly describes the context, including the threats that may exist, and references the fundamental principles;

-
- Revised numbering to facilitate revisions;
 - Independence sections moved to the end of the Code and more sub-headings to facilitate navigation;
 - Definitions section enhanced and presented as a glossary, which also includes descriptions of terms used -example of a description is “audit” which includes reviews and audits in the independence section of the IESBA Code; and
 - A new title for the IESBA Code.

The proposed structure of the IESBA Code is as follows:

- Table of contents (Phase 1 ED)
- Guide to the IESBA Code (Phase 1 ED)
- Part A – Intro to the Code and fundamental principles (Phase 1 ED)
- Part B – Professional accountants in business (PAIB) (to be released in the Phase 2 ED)
- Part C – Professional accountants in public practice (PAPP) (Phase 1 ED)
- C1 – Independence for audits and reviews (partial Phase 1 with the remaining to be released in the Phase 2 ED)
- C2 – Independence for other assurance engagements (to be released in the Phase 2 ED)
- Glossary (Phase 1 ED)

Action Needed:

The PEEC is asked to read the exposure draft as found in **Agenda Item 7B** and provide feedback for inclusion in the Task Force’s comment letter.

Materials Presented

Agenda Item 7B – IESBA exposure draft: Improving the Structure of the Code of Ethics for Professional Accountants – Phase I

Exposure Draft

December 2015

Comments due: April 18, 2016

*International Ethics Standards Board for
Accountants®*

**Improving the Structure of the
Code of Ethics for
Professional Accountants—
Phase 1**

IESBA

International
Ethics Standards
Board for Accountants®



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

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

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

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

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REQUEST FOR COMMENTS

This Exposure Draft, *Improving the Structure of the Code of Ethics for Professional Accountants—Phase 1*, was developed and approved by the International Ethics Standards Board for Accountants® (IESBA®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. Comments are requested by **April 18, 2016**.

Respondents are asked to submit their comments electronically through the IESBA website, using the [“Submit a Comment”](#) link. Please submit comments in both PDF and Word files. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. Although IESBA prefers that comments are submitted via its website, comments can also be sent to Ken Siong, IESBA Technical Director at KenSiong@ethicsboard.org

This publication may be downloaded from the IESBA website: www.ethicsboard.org. The approved text is published in the English language.

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I. Introduction

1. It is in the public interest for the *Code of Ethics for Professional Accountants* (the Code) to be understandable and usable. In restructuring the Code, the IESBA is aiming to enhance the understandability and usability of the Code, thereby facilitating its adoption, effective implementation, consistent application, and enforcement.
2. This memorandum provides background to, and an explanation of, the proposed international ethics pronouncement *International Code of Ethics Standards for Professional Accountants*. The IESBA approved the exposure draft (ED) in December 2015.

II. Background

3. This ED sets out a substantial part of the proposed restructured Code. It responds to input from a variety of stakeholders who suggested restructuring to improve understandability and usability of the Code. Feedback from an IFAC Small and Medium Practices (SMP) Committee (SMPC) survey noted that the biggest barrier faced by SMPs in complying with the Code is fully understanding the requirements of the Code. Some users, especially those whose first language is not English, reported difficulty in understanding the Code because of its complexity of language and construction. Others have commented on difficulties in translating some parts of the Code, and understanding complex and long sentences. The IESBA has also received feedback from some regulators regarding the usability of the Code from the perspective of enforceability. These issues may be impacting adoption and implementation.
4. The IESBA has conducted extensive research and outreach in connection with this project. The findings indicate a broad-based appetite for change. There is widespread support from those providing input for restructuring the Code on a timely basis, with particular interest in raising the visibility of the Code's requirements, clarifying who is responsible for compliance with requirements in particular circumstances, and clarifying the language in the Code. In November 2014, the IESBA issued a [consultation paper](#) (CP) to seek input on possible approaches to restructuring the Code and related matters for consideration. These matters included: distinguishing requirements from application material; identification of a firm's or individual professional accountant's responsibility for compliance with requirements in particular circumstances; use of language; and reorganization of the Code. Respondents to the CP included regulators, audit oversight bodies, national standard setters, large and small accounting firms, professional accountancy organizations and individuals. The IESBA is grateful to all who commented on the CP. This memorandum develops the themes raised by CP respondents.
5. The project scope encompasses the entire Code. The IESBA has reviewed all proposed changes for consistency with the objectives of the restructuring. These are to improve the understandability and usability of the Code by restructuring it without changing its meaning, except in limited circumstances where determined necessary by the Board. The IESBA has made significant effort to avoid inadvertent changes in the meaning of the Code. It has also sought to avoid inadvertent reduction in requirements or other weakening of the Code.
6. During the restructuring work, the IESBA identified a number of matters that would involve potential changes outside the scope of the project. The IESBA has noted these matters for further consideration when it develops its next strategy and work plan.

Highlights of the Restructuring

7. The highlights of the restructuring include:
- Increased prominence of the requirement to apply the conceptual framework and comply with the fundamental principles.
 - Requirements distinguished – paragraphs identified with 'R'.
 - Application material generally positioned next to the relevant requirements – paragraphs identified with 'A'.
 - Increased clarity of responsibility – more clearly enabling identification, where relevant, of a firm's responsibilities and, together with firms' policies and procedures, the responsibilities of particular professional accountants.
 - Increased clarity of language – where possible: simpler and shorter sentences; simplifying complex grammatical structures; increased use of the active voice; avoiding legalistic and archaic terms.
8. Additional aspects of the restructuring are as follows:
- The addition of a *Guide to the Code*.
 - Reorganizing the Code as appropriate, to enhance clarity and usability, positioning the Code to take advantage of forthcoming electronic features.
 - Organization of the material into more self-contained sections and subsections:
 - Each Section having its own introduction which broadly describes the context, including the threats that may exist, and references the fundamental principles.
 - Revised numbering to facilitate revisions.
 - Independence sections moved to the end of the Code and more sub-headings to facilitate navigation.
 - Definitions section enhanced and presented as a glossary, which also includes descriptions of terms used.
 - A new title for the Code.
9. A [mapping table](#) is available to facilitate tracking of the changes from the extant Code to the proposed restructured Code. In addition, to assist review from the restructured Code back, the IESBA has added comments against each paragraph of this ED to explain its derivation, i.e., whether it is from a particular paragraph in the extant Code or new material.
10. The IESBA has placed most definitions and descriptions in the Glossary, including words that were included in the "Terms Used" Sections in the CP. Descriptions from the Glossary are included in the body of the text and they are marked with a footnote the first time that they occur in a Section. An example of a term that has been included in the Glossary in this way is the term "audit" where it is defined to include "review" for the purposes of the independence provisions applicable to audit and review engagements.¹ Certain important concepts have been left in the body of the materials rather than being set out in the Glossary, including the fundamental principles, the conceptual framework

¹ Set out in the ED, C1

and network firms. The terms for these concepts are included in the Glossary with a cross reference to where they first appear in the restructured Code.

11. This ED comprises the following parts of the proposed restructured Code under the first phase of the project:
 - Table of Contents
 - Guide to the Code (substantially new material)
 - Part A Introduction to the Code and Fundamental Principles (Extant Part A)
 - Part C Professional Accountants in Public Practice (Part of Extant Part B)
 - C1 Independence for Audit and Review Engagements (Extant Section 290² excluding the paragraphs concerning Long Association, Non-assurance Services, Reports that Include a Restriction on Use and Distribution)
 - Glossary
12. Proposed restructured provisions related to the following topics will be exposed as part of the second phase of the project at a future date:
 - Part B – Professional Accountants in Business³
 - Responding to Non-Compliance with Laws and Regulations
 - Parts of C1 referring to:
 - Long Association
 - Non-assurance Services
 - Reports that Include a Restriction on Use and Distribution
 - C2, Independence – Other Assurance Engagements⁴

III. Significant Matters

Clarifying the Importance of the Conceptual Framework

13. The IESBA is mindful of the importance of the conceptual framework approach. This approach enables professional accountants to address threats to compliance with the fundamental principles regardless of the nature of the particular circumstances, rather than simply focusing on complying with specific requirements. The IESBA has not only retained the conceptual framework approach but also clarified its importance. In addition to including a requirement to apply the conceptual framework at the beginning of each Section, the IESBA has included a sentence in the header to each page of the Code. This is intended to remind professional accountants of the need to apply the conceptual framework in all circumstances.

² Extant Section 290, *Independence – Audit and Review Engagements*

³ Provisions covered under the extant Part C, Phase I project

⁴ Extant Section 291

Refinements to the Code

Distinguishing Requirements from Application Material

14. Most respondents to the CP supported the suggestion in the CP to distinguish requirements from application material. This was on the basis that the current structure makes it difficult to identify requirements and may impede compliance and enforcement. However, many respondents who supported distinguishing requirements from application material raised concerns regarding the separation of requirements from application material. In response to these concerns, the IESBA has placed application material as close as possible to the relevant requirements.
15. The Requirements component (described in paragraph 7 of the Guide to the Code) identifies requirements that address the specific threats related to the individual section. The provisions set out in this component are denoted by the word "shall." Professional accountants are required to comply with each one of these provisions unless prohibited by law or regulation or an exception is permitted.

Application Material

16. The Application Material component (described in paragraphs 8 and 9 of the Guide) provides context to facilitate a proper understanding and application of the requirements in the Code. This component includes *inter alia*:
 - Guidance on what a requirement means or is intended to cover.
 - Material laying out matters for the professional accountant's consideration in applying the requirements.
 - Examples of procedures, including safeguards, that may be appropriate in the context of the engagement or assignment.
17. The word "shall" is not used in the Application Material component. Where it is necessary to refer in Application Material to a requirement that is already established in the Requirements component, wording other than the term "shall" is employed. The IESBA has avoided the use of the present tense in Application Material in relation to actions by the professional accountant. This is to avoid ambiguity as to whether or not there is an obligation on the professional accountant to take the particular actions. Statements referring to actions by professional accountants in Application Material have been drafted to make it clear that there is no intention to create additional requirements. Alternative language has been used to appropriately explain the IESBA's intentions. If there were any "shall" statements in the extant Code that were determined to be interpretations or examples of the application of a requirement, rather than requirements in their own right, they have been included in an appropriately redrafted form as part of Application Material.

Identification of a Firm's or Individual Professional Accountant's Responsibility

18. Most respondents supported reducing the Code's use of the passive voice and retaining the extant Code's reference to ISQC 1⁵ to clarify responsibility in the Code.⁶ The proposed revisions include reference to ISQC 1 and responsibility in paragraph 400.7.

⁵ International Standard on Quality Control 1, *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*

⁶ As set out in paragraph 290.12 of the extant Code

19. Some respondents, including a few regulatory respondents, encouraged the IESBA to work with the International Auditing and Assurance Standards Board (IAASB). This was to ensure that any requirements or guidance regarding responsibility included within the Code do not conflict with ISQC 1 or the International Standards on Auditing (ISAs). The IAASB is currently undertaking an initiative to seek stakeholders' input on the issues to be addressed in a potential revision of ISQC 1, including the issue of responsibility. Apart from the restructuring changes to the extant Code's responsibility paragraph,⁷ the IESBA is deferring further consideration of the matter of responsibility until the outcome of the IAASB's consultation on ISQC 1 is known.

Use of Language – Improving Readability and Usability for all Users

20. Some users, especially those whose first language is not English, have reported difficulty in understanding the Code. The proposals in this ED have been designed to enhance the readability and clarity of the Code through various means including, where possible:
- Using simpler and shorter sentences.
 - Simplifying complex grammatical structures.
 - Adding links from the Glossary to terms which, although defined, are described at greater length within the text of the Code, such as “threat.”
 - Using the active voice instead of the passive voice.
 - Avoiding repetition of definitions in the body of the text where these are already included in the Glossary.
 - Avoiding legalistic and archaic terms, nuances, and superfluous adjectives.

Navigability

Guide to the Code

21. In response to feedback on the CP, the IESBA has further developed the section *How to Use this Code* proposed in the CP, and renamed it *Guide to the Code*. It draws on the material in the extant Preface. The *Guide to the Code* provides an overview of the Code and covers the following topics:
- The structure of the Code.
 - The authority statements from the existing Code.
 - How to use the Code.
 - Interaction with other ethics standards at the national level.

Sections and Subsections

22. To assist users in navigating the Code, the IESBA has subdivided material into sections and subsections. Sections introduce topics and can have subsections that deal with specific aspects of the topic. For example, the fundamental principles are addressed generally in Section 110. Subsections then discuss the fundamental principles individually.

⁷ Extant paragraph 290.12, ED paragraph 400.7

Reordering Extant Parts B and C

23. Respondents to the CP were supportive of reversing the order of extant Parts B⁸ and C⁹ to allow the independence provisions to be presented at the end. A few respondents also supported the reordering on the basis that extant Part C, which focuses on the application of the conceptual framework to professional accountants in business, might also be relevant to other professional accountants. In the light of the comments received from respondents to the CP, the IESBA has determined to retain the proposed reordering of extant Parts B and C of the Code.

Tools

24. The preparation of tools to assist users of the Code will be considered after the Code has been restructured. Possible tools that have been noted for future consideration include:
- A matrix summarizing the various types of financial relationships for different categories of individual (such as audit team member, immediate family member, close family member, etc.), or entity (i.e., firm or network firm) that might hold such an interest. This matrix would be designed to help users identify more easily which provisions might apply to their particular situations.
 - A summary reference to documentation requirements and application material in the Code.

Electronic Code

25. The IESBA believes that the proposals in this ED will help position the Code for further enhancements to navigability. Development of further electronic features to assist navigability will be considered after the Code has been restructured, and may include filtering options and enhancements to the navigability of the current electronic Code. Terms in the Glossary will be electronically linked to the body of the Code.

IV. Other Matters

Specific References to Network Firms

26. The extant Code¹⁰ establishes a general rule for the meaning of “firm” where used in extant Section 290 as follows: “firm includes network firm, except where otherwise stated.” The proposed restructured Code distinguishes network firms from firms. In some instances, distinguishing network firms required clarification of the application of a materiality or significance test to network firms.

Title

27. Respondents to the CP suggested various possible titles for the restructured Code. They generally agreed that the labeling and presentation of the section containing the fundamental principles and conceptual framework as a “code” or “standards” should reinforce and not detract from the principles-based approach. There was clear support for labeling and presenting independence sections as standards. The IESBA is of the view that the Code would benefit from a new name that emphasizes both the principles-based foundation and the inclusion of specific requirements. With

⁸ Extant Part B, *Professional Accountants in Public Practice*

⁹ Extant Part C, *Professional Accountants in Business*

¹⁰ Paragraph 290.3

this in mind, the IESBA proposes that the restructured Code be titled *International Code of Ethics Standards for Professional Accountants*.

V. Project Timetable and Effective Date

28. The IESBA is mindful of the need for appropriate alignment of the timing of issuance of the proposed two Structure EDs (Phases 1 and 2) in relation to the timing of other projects currently in progress. The proposed timing of the sections to be exposed takes account of the expected approval dates for various sections of the Code which are currently under revision or development. For further information, see the [IESBA Update, Restructuring the Code of Ethics for Professional Accountants](#).

VI. Guide for Respondents

29. The IESBA welcomes comments on all matters addressed in this ED, but especially those identified in the Request for Specific Comments below. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in this ED, it will be helpful for the IESBA to be made aware of this view.
30. As explained in the Background section above, the objectives of the restructuring are to improve the understandability and usability of the Code by restructuring it without changing its meaning, except in limited circumstances where the IESBA considers this necessary. Respondents are asked to distinguish in their responses between comments on the application of the structure and drafting conventions and comments on any changes in meaning.

Request for Specific Comments

31. The IESBA welcomes views from respondents on the following matters.

Refinements to the Code

1. Do you agree with the proposals, or do you have any suggestions for further improvement to the material in the ED, particularly with regard to:
 - (a) Understandability, including the usefulness of the Guide to the Code?
 - (b) The clarity of the relationship between requirements and application material?
 - (c) The clarity of the principles basis of the Code supported by specific requirements?
 - (d) The clarity of the responsibility of individual accountants and firms for compliance with requirements of the Code in particular circumstances?
 - (e) The clarity of language?
 - (f) The navigability of the Code, including:
 - (i) Numbering and layout of the sections;
 - (ii) Suggestions for future electronic enhancements; and
 - (iii) Suggestions for future tools?

(g) The enforceability of the Code?

2. Do you believe the restructuring will enhance the adoption of the Code?
3. Do you believe that the restructuring has changed the meaning of the Code with respect to any particular provisions? If so, please explain why and suggest alternative wording.

Other Matters

4. Do you have any comments on the clarity and appropriateness of the term “audit” continuing to include “review” for the purposes of the independence standards?
5. Do you have any comments on the clarity and appropriateness of the restructured material in the way that it distinguishes firms and network firms?

Title

6. Is the proposed title for the restructured Code appropriate?

Request for General Comments

32. In addition to the request for specific comments above, the IESBA is also seeking comments on the matters set out below:
 - (a) *Small and Medium Practices (SMPs)* – The IESBA invites comments regarding the impact of the proposed changes for SMPs.
 - (b) *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the Code, the IESBA invites respondents from these nations to comment on the proposals, and in particular, on any foreseeable difficulties in applying them in their environment.
 - (c) *Translations*—Recognizing that many respondents may intend to translate the final pronouncement for adoption in their environments, the IESBA welcomes comment on potential translation issues respondents may note in reviewing the proposals.

PROPOSED RESTRUCTURED CODE (PHASE 1)

This ED sets out proposed revisions to the Code developed by the IESBA in the course of its Structure of the Code project. Comment boxes next to the paragraphs identify their source in the extant Code or indicate whether they are new material.

The December 2015 [ED, Proposed Revisions Pertaining to Safeguards in the Code—Phase 1](#) sets out proposed revisions to the Code developed by the IESBA in the course of its Safeguards project. The Safeguards proposals are included in this ED for reference only, and are shaded in gray. Other paragraphs dealing with safeguards, which may be subject to revision as the Safeguards project continues, are shaded in gray and italicized.

Certain sections of the extant Code have been excluded from this ED. They will be addressed in the second phase of the Structure of the Code project.

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900	[Reserved for Independence – Other Assurance Engagements]
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PREFACE

The IESBA develops and issues, under its own standard setting authority, the *International Code of Ethics Standards for Professional Accountants* (the Code), including international independence standards. The Code is for use by professional accountants around the world. The Code is established by IESBA for international application following due process.

The International Federation of Accountants (IFAC) establishes separate requirements for its member bodies with respect to the Code.

Comment [IESBA1]: Preface

GUIDE TO THE CODE

Purpose of the Code

1. The Code sets out fundamental principles of ethics and standards for professional accountants, reflecting the profession's recognition of its public interest responsibilities. The fundamental principles are: integrity; objectivity; professional competence and due care; confidentiality; and professional behavior. The standards are established by the application of the fundamental principles to specific circumstances.
2. The Code provides a conceptual framework that professional accountants are to apply in order to identify, evaluate and address threats to compliance with the fundamental principles.
3. In the case of audits, reviews and other assurance engagements, the Code sets out international independence standards established by the application of the fundamental principle of objectivity to these engagements.

Comment [IESBA2]: 100.1, 100.2

Comment [IESBA4]: 100.6

Comment [IESBA5]: New paragraph

How the Code is Structured

4. The Code contains this Guide, the following three Parts and a Glossary:
 - Part A – *Introduction to the Code and Fundamental Principles*, which includes the fundamental principles and the conceptual framework, and is applicable to all professional accountants.
 - Part B – *Professional Accountants in Business*, which is applicable to professional accountants in business, which include professional accountants employed, engaged or contracted in an executive or non-executive capacity in, for example:
 - o Commerce, industry or service.
 - o The public sector.
 - o Education.
 - o The not-for-profit sector.
 - o Regulatory or professional bodies.
 Professional accountants in public practice might also find Part B relevant to their particular circumstances.
 - Part C – *Professional Accountants in Public Practice*, which is applicable to professional accountants in a firm that provides professional services and the firms in which they practice. Part C includes requirements for all accountants in public practice. It also includes the international independence standards:
 - o C1 – *Independence – Audit and Review Engagements*, applicable to professional accountants in public practice who perform audits and reviews.
 - o C2 – *Independence – Other Assurance Engagements*, applicable to professional accountants in public practice who provide assurance services other than audits and reviews.

Comment [IESBA6]: 100.2

Comment [IESBA7]: 100.3

Comment [IESBA8]: 100.3

Comment [IESBA9]: 100.3

Comment [IESBA10]: New paragraph

Comment [IESBA11]: New paragraph

Each part of the Code contains sections which introduce topics. Sections might have subsections dealing with specific aspects of the topic.

Comment [IESBA12]: New paragraph

The *Glossary* applies to the entire Code and contains defined terms (together with additional explanations where appropriate) and terms which have a specific meaning in certain parts of the Code. For example, as noted in the Glossary, in C1 “audit” is used to refer to both audit and review engagements.

Comment [IESBA13]: New paragraph

5. The content within each of the sections of the Code is, where appropriate, structured as follows:

Comment [IESBA14]: New paragraph

- Introduction – sets out the subject matter addressed within the Section, and introduces the requirements and application material in the context of the conceptual framework.
- Requirements – establish general and specific obligations with respect to the subject matter addressed, including any specific prohibitions.
- Application material – provides guidance to assist in complying with the requirements.

How to Use the Code

6. The Code requires professional accountants to comply with the fundamental principles of professional ethics.

Comment [IESBA15]: New paragraph

Requirements

7. The word “shall” in the Code imposes an obligation on the professional accountant or firm to comply with the specific provision in which “shall” has been used. “Shall” is used to indicate a requirement and requirements are designated with an “R”.

Comment [IESBA16]: 100.4

Application Material

8. In addition to requirements, the Code contains application material that provides context relevant to a proper understanding of the Code. In particular, the application material is intended to help the professional accountant to understand how to apply the conceptual framework to a particular set of circumstances or a specific requirement. While such application material does not of itself impose a requirement, consideration of the material is necessary to the proper application of the requirements of the Code, including application of the conceptual framework. The entire text of Part A and the relevant Section is required to understand and properly apply that Section. Application material is designated with an “A”.

Comment [IESBA17]: New paragraph

9. Where application material includes lists of examples, these lists are not intended to be read as exhaustive lists of all possibilities or circumstances that might arise.

Comment [IESBA18]: New paragraph

Exceptional Circumstances

10. A professional accountant might encounter circumstances in which the result of applying a specific requirement of the Code would be disproportionate or not be in the public interest. In those circumstances, the accountant is encouraged to consult with a professional body or a regulator.

Comment [IESBA19]: 100.11

11. A professional accountant might face a situation where compliance with one fundamental principle conflicts with one or more other fundamental principles. In those situations, the accountant is encouraged to consult. Appropriate parties for consultation might include one or more of the following:

Comment [IESBA20]: 100.19 to .21

- Others within the firm or employing organization.

- Those charged with governance.
- A professional body.
- A regulator.
- Legal counsel.

The accountant is usually able to obtain guidance on ethical issues without breaching the fundamental principle of confidentiality. However, such guidance does not relieve the accountant from the responsibility to apply professional judgment to resolve the conflict or, if necessary, disassociate from the matter creating the conflict.

Comment [IESBA21]: 100.23,100.24.

12. A professional accountant is encouraged to document the substance of the issue, the details of any discussions, the decisions made and the rationale for those decisions.

Comment [IESBA22]: 100.22

Additional Non-Authoritative Guidance

13. Non-authoritative guidance is available on the IESBA website (www.ethicsboard.org) to help users understand aspects of the Code and comply with it.

Comment [IESBA23]: New paragraph

Appendix

Comment [IESBA24]: New material

PARTS OF THE CODE

GUIDE TO THE CODE (ALL PROFESSIONAL ACCOUNTANTS)

PART A (ALL PROFESSIONAL ACCOUNTANTS)
INTRODUCTION TO THE CODE AND FUNDAMENTAL PRINCIPLES

PART B
PROFESSIONAL ACCOUNTANTS IN BUSINESS

PART C
PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

INTERNATIONAL INDEPENDENCE STANDARDS
C1 – INDEPENDENCE – AUDIT AND REVIEW ENGAGEMENTS
C2 – INDEPENDENCE – OTHER ASSURANCE ENGAGEMENTS

GLOSSARY

PART A INTRODUCTION TO THE CODE AND FUNDAMENTAL PRINCIPLES

Section 100

Compliance with the Code

Introduction to the Code

100.1 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. A professional accountant’s¹¹ responsibility is not exclusively to satisfy the needs of an individual client or employer. Therefore, the Code contains requirements and application material for accountants regarding matters that are integral to acting in the public interest.

Comment [IESBA25]: 100.1

100.2 The fundamental principles of professional ethics set out in the Code establish the standard of behavior expected of a professional accountant. The conceptual framework establishes an approach which accountants are required to apply to assist them in achieving compliance with those fundamental principles.

Comment [IESBA26]: New paragraph

R100.3 A professional accountant, acting in the public interest, shall comply with the Code. There might be circumstances when laws or regulations preclude an accountant from complying with certain parts of the Code. In such circumstances, those laws and regulations prevail, and the accountant shall comply with all other parts of the Code.

Comment [IESBA27]: 100.1

100.3 A1 The fundamental principle of professional behavior requires a professional accountant to comply with relevant laws and regulations. Some jurisdictions might have requirements and guidance that differ from or go beyond those set out in the Code. Accountants in those jurisdictions need to be aware of those differences and comply with the more stringent requirements and guidance unless prohibited by law or regulation.

Comment [IESBA28]: Preface

R100.4 A professional accountant who identifies a breach of the Code shall evaluate the significance of the breach and its impact on the accountant’s ability to comply with the fundamental principles. The accountant shall also:

Comment [IESBA29]: 100.10

- (a) Take whatever actions might be available, as soon as possible, to satisfactorily address the consequences of the breach; and
- (b) Determine whether to report the breach to, for example, those who might have been affected by it, a professional body or a regulator.

100.4 A1 Subsections 404 and 902¹² address a breach of an independence requirement.

Comment [IESBA30]: 100.10

¹¹ In Part A, “professional accountant” includes “professional accountants in business” and “professional accountants in public practice,” which also includes their firms.

¹² Subsection 902 is under development.

Section 110

The Fundamental Principles

Introduction

- 110.1 There are five fundamental principles of ethics for professional accountants:
- (a) Integrity – to be straightforward and honest in all professional and business relationships.
 - (b) Objectivity – to make professional or business judgments without bias, conflict of interest or undue influence of others.
 - (c) Professional Competence and Due Care – to:
 - (i) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service, based on current developments in practice, legislation and techniques; and
 - (ii) Act diligently and in accordance with applicable technical and professional standards.
 - (d) Confidentiality – to respect the confidentiality of information acquired as a result of professional and business relationships.
 - (e) Professional Behavior – to comply with relevant laws and regulations and avoid any action that the professional accountant knows or should know might discredit the profession.
- 110.2 Subsections 111 to 115 set out requirements and application material related to each of these fundamental principles.

Comment [IESBA31]: 100.5

Comment [IESBA32]: New paragraph

Subsection 111 – Integrity

- R111.1 A professional accountant shall comply with the fundamental principle of integrity which requires an accountant to be straightforward and honest in all professional and business relationships.
- 111.1 A1 Integrity implies fair dealing and truthfulness.
- R111.2 A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the accountant believes that the information:
- (a) Contains a materially false or misleading statement;
 - (b) Contains statements or information provided recklessly; or
 - (c) Omits or obscures required information where such omission or obscurity would be misleading.
- R111.3 When a professional accountant becomes aware of having been associated with information described in R111.2, the accountant shall take steps to be disassociated from that information.

Comment [IESBA33]: 110.1

Comment [IESBA34]: 110.1

Comment [IESBA35]: 110.2

Comment [IESBA36]: 110.2

111.3 A1 The professional accountant is not in breach of R111.3 if a modified report is provided in respect of the information described in R111.2.

Comment [IESBA37]: 110.3

Subsection 112 – Objectivity

R112.1 A professional accountant shall comply with the fundamental principle of objectivity which requires an accountant to make professional or business judgments without bias, conflict of interest or undue influence of others.

Comment [IESBA38]: 120.1

R112.2 A professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant’s professional judgment regarding that activity.

Comment [IESBA39]: 120.2

112.2 A1 The existence of threats to objectivity when undertaking any professional activity will depend upon the circumstances and nature of the activity. For example, a familiarity threat to objectivity might be created by a family or close personal or business relationship.

Comment [IESBA40]: 120.2, 280.1, 280.3

112.2 A2 Examples of safeguards include:

Comment [IESBA41]: 280.4

- Supervisory procedures.
- Discussing the issue:
 - With higher levels of management within the firm; or
 - With those charged with governance of the client;
- Withdrawing from the activity or the engagement team.
- Ending the financial or business relationship causing the threat.

112.3 A1 Independence is a measure of objectivity both in mind and appearance which is applied in relation to audit, review and other assurance engagements. It enables the professional accountant in public practice to express, and be seen to express, an objective conclusion when performing such engagements.

Comment [IESBA42]: 280.2

112.3 A2 C1 and C2 set out independence requirements and application material for professional accountants in public practice.

Comment [IESBA43]: 280.2

Subsection 113 – Professional Competence and Due Care

- R113.1 A professional accountant shall comply with the fundamental principle of professional competence and due care which requires an accountant to:
 - (a) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service, based on current developments in practice, legislation and techniques; and
 - (b) Act diligently and in accordance with applicable technical and professional standards.
- 113.1 A1 Serving clients and employers with professional competence requires the exercise of sound judgment in applying professional knowledge and skill when undertaking professional activities. Comment [IESBA44]: 130.1
- 113.1 A2 Maintaining professional competence requires a continuing awareness and an understanding of relevant technical, professional and business developments. Continuing professional development enables a professional accountant to develop and maintain the capabilities to perform competently within the professional environment. Comment [IESBA45]: 130.2
- 113.1 A3 Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis. Comment [IESBA46]: 130.3
- R113.2 In complying with the fundamental principle of professional competence and due care, a professional accountant shall take reasonable steps to ensure that those working in a professional capacity under the accountant's authority have appropriate training and supervision. Comment [IESBA47]: 130.4
- R113.3 Where appropriate, a professional accountant shall make clients, employers, or other users of the accountant's professional services or activities, aware of the limitations inherent in the services or activities. Comment [IESBA48]: 130.5
- Comment [IESBA49]: 130.6

Subsection 114 – Confidentiality

- R114.1 A professional accountant shall comply with the fundamental principle of confidentiality which requires an accountant to respect the confidentiality of information acquired as a result of professional and business relationships. An accountant shall:
 - (a) Be alert to the possibility of inadvertent disclosure, including in a social environment, and particularly to a close business associate or a close or immediate family member; Comment [IESBA50]: 140.1
 - (b) Maintain confidentiality of information within the firm or employing organization; Comment [IESBA51]: 140.2
 - (c) Maintain confidentiality of information disclosed by a prospective client or employer; Comment [IESBA52]: 140.4
 - (d) Not disclose confidential information acquired as a result of professional and business relationships to third parties without proper and specific authority, unless there is a legal or professional duty or right to disclose; Comment [IESBA53]: 140.3
 - (e) Not use confidential information acquired as a result of professional and business relationships for the personal advantage of the accountant or for the advantage of a third party; Comment [IESBA54]: 140.1(a)
 - Comment [IESBA55]: 140.1(b)

(f) Not use or disclose any confidential information, either acquired or received as a result of a professional or business relationship, after the business or personal relationship has ended; and

Comment [IESBA56]: 140.6

(g) Take reasonable steps to ensure that personnel under the accountant's control, and individuals from whom advice and assistance is obtained, respect the accountant's duty of confidentiality.

Comment [IESBA57]: 140.5

114.1 A1 The requirement to comply with the principle of confidentiality continues even after the end of the relationship between a professional accountant and a client or employer. When changing employment or acquiring a new client, the accountant is entitled to use prior experience but may not use or disclose any confidential information acquired or received as a result of a professional or business relationship.

Comment [IESBA58]: 140.6

114.1 A2 The following are circumstances where professional accountants might be required to disclose confidential information or when such disclosure might be appropriate:

Comment [IESBA59]: 140.7

(a) Disclosure is required by law, for example:

- Production of documents or other provision of evidence in the course of legal proceedings; or
- Disclosure to the appropriate public authorities of infringements of the law that come to light;

(b) Disclosure is permitted by law and is authorized by the client or the employer; 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 professional body;
- (ii) To respond to an inquiry or investigation by a professional or regulatory body;
- (iii) To protect the professional interests of an accountant in legal proceedings; or
- (iv) To comply with technical standards and ethics requirements.

114.1 A3 In deciding whether to disclose confidential information in such circumstances, factors to consider include:

Comment [IESBA60]: 140.8

- Whether the interests of all parties, including third parties whose interests might be affected, could be harmed if the client or employer consents to the disclosure of information by the professional accountant.
- Whether all the relevant information is known and substantiated, to the extent practicable. Factors affecting the decision to disclose include:
 - Unsubstantiated facts.
 - Incomplete information.
 - Unsubstantiated conclusions.
- The proposed type of communication, and to whom it is addressed.

- Whether the parties to whom the communication is addressed are appropriate recipients.

Subsection 115 – Professional Behavior

R115.1 A professional accountant shall comply with the fundamental principle of professional behavior which requires an accountant to comply with relevant laws and regulations and avoid any action that the accountant knows or should know might discredit the profession.

Comment [IESBA61]: 150.1

115.1 A1 Actions that might discredit the profession include actions that a reasonable and informed third party would be likely to conclude adversely affect the good reputation of the profession.

Comment [IESBA62]: 150.1

R115.2 When marketing or promoting themselves and their work, professional accountants shall not bring the profession into disrepute. Accountants shall be honest and truthful and shall not make:

Comment [IESBA63]: 150.2, 250.2

- (a) Exaggerated claims for the services they are able to offer, their qualifications, or their experience; or
- (b) Disparaging references or unsubstantiated comparisons to the work of others.

115.2 A1 If a professional accountant is in doubt about whether a form of advertising or marketing is appropriate, the accountant is encouraged to consult with the relevant professional body.

Comment [IESBA64]: 250.2

Section 120**The Conceptual Framework****Introduction**

- 120.1 The circumstances in which professional accountants operate might create specific threats to compliance with the fundamental principles. The conceptual framework assists the accountant in complying with the fundamental principles and meeting the responsibility to act in the public interest. It accommodates the many variations in facts and circumstances that create threats to compliance with the fundamental principles and deters an accountant from concluding that a situation is permitted if it is not specifically prohibited by this Code.
- 120.2 The conceptual framework specifies an approach for the professional accountant to:
- (a) Identify threats to compliance with the fundamental principles;
 - (b) Evaluate the threats identified; and
 - (c) Address the threats by eliminating or reducing them to an acceptable level.

Requirements and Application Material

- R120.3** The professional accountant shall apply the conceptual framework which involves identifying, evaluating and addressing threats to compliance with the fundamental principles.
- R120.4** When applying the conceptual framework, the professional accountant shall exercise professional judgment, remain alert to changing circumstances, and take into account whether a reasonable and informed third party would likely conclude that the accountant has complied with the fundamental principles.

Reasonable and Informed Third Party

- 120.4 A1 The concept of a reasonable and informed third party is a test which involves an evaluation by a hypothetical person. Such a person possesses skills, knowledge and experience to objectively evaluate the appropriateness of the professional accountant's judgments and conclusions. This evaluation entails weighing all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time that the evaluation is made to determine whether the accountant complies with the fundamental principles.

Identifying Threats

- R120.5** The professional accountant shall identify threats to compliance with the fundamental principles. An understanding of the facts and circumstances, including professional activities, interests and relationships, that might compromise compliance with the fundamental principles is a prerequisite to the accountant's identification of threats to such compliance.
- 120.5 A1 Threats might be created by a broad range of facts and circumstances. It is impossible to define every situation that creates threats. In addition, the nature of engagements and work assignments might differ and, consequently, different types of threats might be created.

120.5 A2 Threats to compliance with the fundamental principles fall into one or more of the following categories:

- (a) Self-interest threat – the threat that a financial or other interest will inappropriately influence the professional accountant’s judgment or behavior;
- (b) Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made, or activity or service performed by the accountant, or by another individual within the accountant’s firm or employing organization, on which the accountant will rely when forming a judgment as part of performing a current activity or providing a current service;
- (c) Advocacy threat – the threat that a professional accountant will promote a client’s or employer’s position to the point that the accountant’s objectivity is compromised;
- (d) Familiarity threat – the threat that due to a long or close relationship with a client or employer, a professional accountant will be too sympathetic to their interests or too accepting of their work; and
- (e) Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.

120.5 A3 A circumstance might create more than one threat, and a threat might affect compliance with more than one fundamental principle.

120.5 A4 Certain conditions, policies and procedures established by the profession, legislation, regulation, the firm or the employing organization can affect the likelihood of the professional accountant’s identification of threats to compliance with the fundamental principles. Examples of such conditions, policies and procedures include:

- Corporate governance requirements.
- Educational, training and experience requirements for the profession.
- Effective complaint systems.
- An explicitly stated duty to report breaches of ethical requirements.
- Professional or regulatory monitoring and disciplinary procedures.

Evaluating Threats

R120.6 When the professional accountant identifies a threat, the accountant shall evaluate whether such a threat is at an acceptable level.

120.6 A1 An acceptable level is a level at which a reasonable and informed third party would likely conclude that the professional accountant complies with the fundamental principles.

120.6 A2 The existence of qualitative as well as quantitative factors is relevant to the professional accountant’s evaluation of threats, as is the combined effect of multiple threats, if applicable.

120.6 A3 The existence of conditions, policies and procedures discussed in paragraph 120.5 A4 above might impact the professional accountant's evaluation of threats to compliance with the fundamental principles.

Addressing Threats

R120.7 If the professional accountant determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, the accountant shall address the threats by eliminating or reducing them to an acceptable level. The accountant shall do so by:

- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (b) Applying safeguards, where available and capable of being applied; or
- (c) Declining or discontinuing the specific professional activity or service involved.

120.7 A1 There are some situations where the threat created would be so significant that no safeguards could reduce the threat to an acceptable level. International Independence Standards C1 and C2 of the Code provide examples of such situations.

Safeguards

120.7 A2 Safeguards are actions, individually or in combination, that the professional accountant takes that effectively eliminate threats to compliance with the fundamental principles or reduce them to an acceptable level.

Re-evaluating Threats

R120.8 If the professional accountant becomes aware of new information or changes in facts and circumstances that might impact whether a threat has been eliminated or reduced to an acceptable level, the accountant shall re-evaluate and address that threat accordingly.

120.8 A1 Remaining alert throughout the professional activity or service assists the professional accountant in determining whether new information has emerged or changes in facts and circumstances have occurred that:

- (a) Impact the level of a threat; or
- (b) Affect the professional accountant's conclusions about whether safeguards applied continue to be appropriate to address identified threats.

120.8 A2 If the professional accountant identifies a new threat, the application of the conceptual framework requires that the accountant evaluate and address this new threat as set out in paragraphs R120.5–R120.8 above.

Overall Assessment

R120.9 The professional accountant shall review judgments made and overall conclusions reached to determine that threats to compliance with the fundamental principles are eliminated or

reduced to an acceptable level, and that no further action is needed. The reasonable and informed third party test described in paragraph 120.4 A1 is relevant to this assessment.

PART C PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

Section 300

Application of the Conceptual Framework for Professional Accountants in Public Practice

Introduction

300.1 This Part of the Code describes considerations for professional accountants in public practice¹³ in the application of the conceptual framework set out in Section 120. This Part does not describe all of the facts and circumstances, including professional services, interests and relationships, that could be encountered by accountants that create or might create threats to compliance with the fundamental principles. Therefore, accountants are encouraged to be alert for such facts and circumstances.

Comment [IESBA65]: 200.1

Requirements and Application Material

R300.2 A professional accountant shall comply with each of the fundamental principles and apply the conceptual framework set out in Section 120 to eliminate threats to compliance with those fundamental principles or to reduce them to an acceptable level.

Identifying Threats

300.2 A1 Compliance with the fundamental principles might be threatened by a broad range of facts and circumstances. The following are categories of threats, and examples of facts and circumstances that might create those threats for a professional accountant when undertaking a professional activity or providing a professional service:

(a) Self-interest Threats

- A professional accountant having a direct financial interest in a client.
- A firm having undue dependence on total fees from a client or the possibility of losing a significant client.
- A professional accountant having a significant close business relationship with a client.

(b) Self-review Threats

- A professional accountant issuing an assurance report on the effectiveness of the operation of financial systems after designing or implementing the systems.
- A professional accountant having prepared the original data used to generate records that are the subject matter of the assurance engagement.
- A professional accountant being, or having recently been, a director or officer of the client, or having recently been employed by the client in a position to exert significant influence over the subject matter of the engagement.

¹³ The term "professional accountant" refers to professional accountants in public practice and their firms.

(c) Advocacy Threats

- The professional accountant promoting shares in a client.
- A professional accountant acting as an advocate on behalf of an audit client in litigation or disputes with third parties.

(d) Familiarity Threats

- A member of the engagement team having a close or immediate family member who is a director or officer of the client, or is an employee of the client who is in a position to exert significant influence over the subject matter of the engagement.
- A director or officer of the client, or an employee in a position to exert significant influence over the subject matter of the engagement, having recently served as the engagement partner.
- Senior personnel having a long association with the assurance client.

(e) Intimidation Threats

- A firm being threatened with dismissal from a client engagement.
- A professional accountant feeling pressured to agree with the judgment of a client employee because the employee has more expertise on the matter in question.
- A professional accountant being informed by a partner of the firm that a planned promotion will not occur unless the accountant agrees with an audit client's inappropriate accounting treatment.

The categories of threats are also discussed in Section 120.

Evaluating Threats

300.2 A2 Conditions that might impact the evaluation of whether a threat is at an acceptable level include the nature of:

- (a) The client and its operating environment;
- (b) The professional service being provided; and
- (c) The firm and its operating environment.

The Client and its Operating Environment

300.2 A3 The level of a threat might be impacted by the following types of client or professional service that is provided:

- (a) An audit client and whether the audit client is a public interest entity;
- (b) An assurance client that is not an audit client; or
- (c) A non-assurance client.

For example, providing a service to an audit client might be perceived to result in a higher level of threat to the fundamental principle of objectivity. Such a threat might be further increased when the audit client is a public interest entity with a large number and wide range of stakeholders.

300.2 A4 A professional accountant's evaluation of the level of the threat might also be impacted by a client's operating environment. For example:

- The client requires appropriate persons other than management to ratify or approve the appointment of a firm to perform an engagement.
- The client has competent employees with experience and seniority to make managerial decisions.
- The client has implemented internal procedures that facilitate objective choices in tendering non-assurance engagements.
- The client has a corporate governance structure that provides appropriate oversight and communications regarding the firm's services.

The Professional Service Being Provided

300.2 A5 The level of a threat is impacted by the nature and scope of the professional service. Examples of professional services, the threats that might arise as a result, and how a professional accountant may address those threats are discussed in International Independence Standards C1 and C2.

The Firm and its Operating Environment

300.2 A6 A professional accountant's evaluation of the level of a threat might be impacted by the work environment within a firm and its operating environment. For example:

- Leadership of the firm that promotes compliance with the fundamental principles and establishes the expectation that professional accountants will act in the public interest.
- Methods and processes for establishing and monitoring compliance with the fundamental principles by all personnel.
- Compensation, performance appraisal and disciplinary policies and procedures that promote compliance with the fundamental principles.
- Management of the reliance on revenue received from a single client.
- The engagement partner having authority for compliance with the fundamental principles, including decisions about the permissibility of services to an audit client.
- Educational, training and experience requirements.
- Processes to facilitate and address internal and external complaints.

Addressing Threats

300.2 A7 If the professional accountant determines that the identified threats to compliance are not at an acceptable level, Section 120 requires that the accountant address those threats by:

- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (b) Applying safeguards, where available and capable of being applied; or
- (c) Declining or discontinuing the specific professional activity or service involved.

300.2 A8 There are some situations where the threat created would be so significant that no safeguards could reduce the threat to an acceptable level, and the threats may not be addressed by applying the requirements in Section 120. International Independence Standards C1 and C2 provide examples of such situations.

Examples of Safeguards

300.2 A9 Safeguards vary depending on the facts and circumstances. The following are examples of actions that in certain circumstances might be safeguards in addressing threats:

- Having a professional accountant who was not involved with the non-assurance service provided to an audit client review the non-assurance work performed, or otherwise advise as necessary might address a self-review threat.
- Having a professional accountant who was not a member of the team review the work performed or otherwise advise as necessary might address self-review threats.
- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client might address self-review and familiarity threats.
- Consulting those charged with governance or an independent third party, including a committee of independent directors, a professional regulatory body or another professional accountant might address advocacy or intimidation threats.
- Involving another firm to perform or re-perform part of the engagement might address self-interest, self-review, advocacy or familiarity threats.
- Rotating assurance team personnel might address self-interest and familiarity threats.

Re-evaluating Threats

300.2 A10 New information or changes in facts and circumstances might:

- (a) Impact the level of a threat; or
- (b) Affect the professional accountant's conclusions about whether safeguards applied continue to be appropriate to address identified threats.

300.2 A11 Examples of new information or changes in facts and circumstances include:

- When the scope of a professional service is expanded.

- When the client becomes a listed entity or acquires another business unit.
- When the firm merges with another firm.
- Where the engagement partner's immediate family member is recently employed by the client.

In those situations described above, actions already implemented as safeguards might no longer be effective in eliminating those threats or reducing them to an acceptable level.

Overall Assessment

300.2 A12 When applying the conceptual framework, Section 120 requires that the professional accountant reviews judgments made and overall conclusions reached to determine that threats to compliance with the fundamental principles are eliminated, or reduced to an acceptable level and that no further action is needed. The reasonable and informed third party test described in Section 120 is relevant to this assessment.

Those Charged with Governance

R300.3 When communicating with those charged with governance in accordance with the Code, the professional accountant shall determine the appropriate individual(s) within the entity's governance structure with whom to communicate. If the accountant communicates with a subgroup of those charged with governance, the accountant shall determine whether communication with all of those charged with governance is also necessary.

Comment [IESBA66]: 100.25

300.3 A1 In determining with whom to communicate, the professional accountant might consider:

Comment [IESBA67]: 100.25

- (a) The nature and importance of the circumstances; and
- (b) The matter to be communicated.

300.3 A2 If a professional accountant communicates with a subgroup of those charged with governance, for example, an audit committee or an individual, communication with all of those charged with governance might also be necessary to ensure they are adequately informed.

Comment [IESBA68]: 100.25

Section 310

Conflicts of Interest

Introduction

310.1 Section 310 sets out requirements and application material when applying the conceptual framework to conflicts of interest.

Comment [IESBA69]: New paragraph

310.2 Professional accountants might face circumstances that create a conflict of interest. A conflict of interest creates a threat to objectivity and might create threats to the other fundamental principles.

Comment [IESBA70]: 220.1

310.3 Such threats might be created when:

Comment [IESBA71]: 220.1

- (a) The professional accountant provides a professional service related to a particular matter for two or more clients whose interests with respect to that matter are in conflict; or
- (b) The interests of the accountant with respect to a particular matter and the interests of the client for whom the accountant provides a professional service related to that matter are in conflict.

310.4 Examples of circumstances that might create a conflict of interest include:

Comment [IESBA72]: 220.2

- Providing a transaction advisory service to a client seeking to acquire an audit client, where the firm has obtained confidential information during the course of the audit that might be relevant to the transaction.
- Providing advice to two clients at the same time where the clients are competing to acquire the same company and the advice might be relevant to the parties' competitive positions.
- Providing services to a seller and a buyer in relation to the same transaction.
- Preparing valuations of assets for two parties who are in an adversarial position with respect to the assets.
- Representing two clients in the same matter who are in a legal dispute with each other, such as during divorce proceedings, or the dissolution of a partnership.
- In relation to a license agreement, providing an assurance report for a licensor on the royalties due while advising the licensee on the amounts payable.
- Advising a client to invest in a business in which, for example, the spouse of the professional accountant has a financial interest.
- Providing strategic advice to a client on its competitive position while having a joint venture or similar interest with a major competitor of the client.
- Advising a client on:
 - Acquiring a business which the firm is also interested in acquiring.
 - Buying a product or service while having a royalty or commission agreement with

a potential seller of that product or service.

310.5 When a professional accountant provides an audit, review or other assurance service, compliance with the fundamental principle of objectivity also requires independence in accordance with C1 and C2, as appropriate.

Comment [IESBA73]: 220.1

Requirements and Application Material

R310.6 A professional accountant shall apply the conceptual framework set out in Section 120 and shall not allow a conflict of interest to compromise professional or business judgment.

Comment [IESBA74]: 220.1

Conflict Identification

R310.7 Before accepting a new client relationship, engagement, or business relationship, a professional accountant shall take reasonable steps to identify circumstances that might create a conflict of interest, including identifying:

Comment [IESBA75]: 220.6, 220.3

- (a) The nature of the relevant interests and relationships between the parties involved; and
- (b) The service and its implication for relevant parties.

310.7 A1 Professional accountants are assisted by having an effective conflict identification process in place. Such a process includes addressing matters identified by external parties, for example clients or potential clients. A conflict identification process assists an accountant to identify interests and relationships that might create an actual or potential conflict of interest, both before determining whether to accept an engagement and throughout the engagement. The earlier an actual or potential conflict of interest is identified, the greater the likelihood of the accountant being able to apply safeguards to eliminate the threat.

Comment [IESBA76]: 220.7

The process to identify actual or potential conflicts of interest will depend on factors such as:

- The nature of the professional services provided.
- The size of the firm.
- The size and nature of the client base.
- The structure of the firm, for example, the number and geographic location of offices.

310.7 A2 More information on client acceptance is set out in Section 320, *Professional Appointment*.

Comment [IESBA77]: New paragraph

R310.8 A professional accountant shall remain alert to changes in the circumstances that might create a conflict of interest during an engagement.

Comment [IESBA78]: 220.6

310.8 A1 The nature of the services and the interests and relationships might change during the engagement. This is often true in a situation that might become adversarial, although there is no dispute when the engagement begins.

Comment [IESBA79]: 220.6

Network Firms

R310.9 If the firm is a member of a network, the professional accountant shall consider conflicts of interest that the accountant has reason to believe might exist or arise due to interests and relationships of a network firm.

Comment [IESBA80]: 220.8

310.9 A1 Reasonable steps to identify interests and relationships involving a network firm will depend on factors such as:

Comment [IESBA81]: 220.8

- The nature of the professional services provided.
- The clients served by the network.
- The geographic locations of all relevant parties.

Applying the Conceptual Framework to Conflicts of Interest

310.10 A1 In applying the conceptual framework when evaluating a threat created by a conflict of interest, factors to consider include the significance of:

Comment [IESBA82]: 220.3, 220.9

- (a) The interests or relationships; and
- (b) The threats created by performing the professional services.

310.10 A2 In general, the more direct the connection between the professional service and the matter on which the parties' interests conflict, the more significant the threat to objectivity and compliance with the other fundamental principles will be.

Comment [IESBA83]: 220.9

310.10 A3 Examples of safeguards include:

Comment [IESBA84]: 220.10

- *Implementing measures to prevent unauthorized disclosure of confidential information, when performing professional services related to a particular matter for two or more clients whose interests with respect to that matter are in conflict. This could include:*
 - *Using separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality.*
 - *Creating separate practice areas for specialty functions within the firm, which might act as a barrier to the passing of confidential client information between practice areas.*
 - *Establishing policies and procedures to limit access to client files.*
 - *Using confidentiality agreements signed by personnel and partners of the firm.*
 - *Separating confidential information physically and electronically.*
- *Reviewing regularly the application of safeguards by a senior individual not involved with the client engagement or engagements.*
- *Having a professional accountant who is not involved in providing the service or otherwise affected by the conflict, review the work performed to assess whether the key judgments and conclusions are appropriate.*
- *Consulting third parties, such as a professional body, legal counsel or another*

professional accountant.

Disclosure and Consent

R310.11 A professional accountant shall exercise professional judgment to determine whether the nature and significance of a conflict of interest is such that specific disclosure and explicit consent is necessary.

Comment [IESBA85]: 220.11

310.11 A1 When determining whether specific disclosure and explicit consent are necessary, the conceptual framework requires the professional accountant to exercise professional judgment and consider all the circumstances that create a conflict of interest. Factors to consider include: the parties that might be affected; the nature of the issues that might arise; and the potential for the particular matter to develop in an unexpected manner.

Comment [IESBA86]: 220.11

310.11 A2 It is generally necessary:

Comment [IESBA87]: 220.11

- (a) To disclose the nature of the conflict of interest and any related safeguards to clients affected by the conflict; and
- (b) When safeguards are required to reduce the threat to an acceptable level, to obtain the consent of the affected clients to perform the professional services.

310.11 A3 Disclosure and consent might take different forms, for example:

Comment [IESBA88]: 220.11

- General disclosure to clients of circumstances where, as is common commercial practice, the professional accountant does not provide professional services exclusively to any one client (for example, in a particular professional service and market sector) in order for the client to provide general consent accordingly. For example, an accountant might make general disclosure in the standard terms and conditions for the engagement.
- Specific disclosure to affected clients of the circumstances of the particular conflict in sufficient detail to enable the client to make an informed decision about the matter and to provide explicit consent accordingly. Such disclosure might include a detailed presentation of the circumstances and a comprehensive explanation of any planned safeguards and the risks involved.
- Consent might be implied by clients' conduct in circumstances where the professional accountant has sufficient evidence to conclude that clients know the circumstances at the outset and have accepted the conflict of interest if they do not raise an objection to the existence of the conflict.

310.11 A4 If disclosure or consent is not in writing, the professional accountant is encouraged to document:

Comment [IESBA89]: 220.13

- (a) The nature of the circumstances giving rise to the conflict of interest;
- (b) The safeguards applied to reduce the threats to an acceptable level; and
- (c) The consent obtained.

R310.12 If a professional accountant has determined that explicit consent is necessary in accordance with paragraph R310.11 and the client has refused, the accountant shall either:

Comment [IESBA90]: 220.12

- (a) Decline to perform or discontinue professional services that would result in the conflict of interest; or
- (b) End relevant relationships, or dispose of relevant interests to eliminate the threat or reduce it to an acceptable level, so that consent can be obtained, after applying any additional safeguards if necessary.

Confidentiality

R310.13 A professional accountant shall remain alert to the fundamental principle of confidentiality including when making disclosures or sharing information within the firm or network and seeking guidance of third parties.

Comment [IESBA91]: 220.4

R310.14 When making specific disclosure for the purpose of obtaining explicit consent would result in a breach of confidentiality, the firm shall only accept or continue an engagement if:

Comment [IESBA92]: 220.14

- (a) The firm does not act in an advocacy role for one client in an adversarial position against another client in the same matter;
- (b) Specific measures are in place to prevent disclosure of confidential information between the engagement teams serving the two clients; and
- (c) The firm is satisfied that a reasonable and informed third party would be likely to conclude that it is appropriate for the firm to accept or continue the engagement because a restriction on the firm's ability to provide the professional service would produce a disproportionate adverse outcome for the clients or other relevant third parties.

310.14 A1 For example, a breach of confidentiality might arise when seeking consent to perform:

Comment [IESBA93]: 220.14

- A transaction-related service for a client in a hostile takeover of another client of the firm.
- A forensic investigation for a client regarding a suspected fraud, where the firm has confidential information from its work for another client who might be involved in the fraud.

R310.15 In the circumstances set out in R310.14, the professional accountant shall document:

Comment [IESBA94]: 220.14

- (a) The nature of the circumstances, including the role that the accountant is to undertake;
- (b) The specific measures in place to prevent disclosure of information between the engagement teams serving the two clients; and
- (c) Why it is appropriate to accept the engagement.

Section 320

Professional Appointment

Introduction

320.1 Section 320 sets out requirements and application material on applying the conceptual framework to changes in professional appointments, including new appointments and new or recurring engagements for existing clients.

Comment [IESBA95]: New paragraph

320.2 Accepting a new client or a new or recurring engagement might create threats to compliance with the fundamental principles.

Comment [IESBA96]: 210.1, 210.2

Requirements and Application Material

R320.3 A professional accountant shall apply the conceptual framework set out in Section 120 to a professional appointment.

Comment [IESBA97]: 210.1

Client Acceptance and Continuance

320.3 A1 In some circumstances, acceptance of a new client relationship might create threats to integrity or professional behavior. This might arise, for example, where the client, its owners or management are involved in illegal activities, dishonesty or questionable financial reporting practices.

Comment [IESBA98]: 210.1, 210.2

320.3 A2 *Examples of safeguards include:*

Comment [IESBA99]: 210.3

- *Obtaining knowledge and understanding of the client, its owners, managers and those charged with governance and business activities.*
- *Obtaining the client's commitment to improve corporate governance practices or internal controls.*

320.3 A3 A professional accountant is encouraged to conduct periodic reviews of acceptance decisions for recurring client engagements.

Comment [IESBA100]: 210.5

Engagement Acceptance

320.3 A4 A self-interest threat to professional competence and due care is created if the engagement team does not possess, or acquire, the competencies to perform the professional services.

Comment [IESBA101]: 210.6

320.3 A5 *Examples of safeguards include:*

Comment [IESBA102]: 210.7

- *Acquiring an appropriate understanding of:*
 - *The nature of the client's business;*
 - *The complexity of its operations;*
 - *The 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 engagement personnel with the necessary competencies.
- 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 engagements are accepted only when they can be performed competently.
- Using experts where necessary.

Changes in Professional Appointment

R320.4 A professional accountant shall determine whether there are any reasons, professional or otherwise, for not accepting an engagement when the accountant:

- (a) Is asked by a potential client to replace another accountant;
- (b) Considers tendering for an engagement held by another accountant; or
- (c) Considers undertaking work that is complementary or additional to that of another accountant.

Comment [IESBA103]: 210.9

Comment [IESBA104]: 210.9

Comment [IESBA105]: 210.12

320.4 A1 There might be reasons, professional or otherwise, for not accepting an engagement. Such reasons might include 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 might be a threat to professional competence and due care if a professional accountant accepts the engagement before knowing all the relevant facts.

Comment [IESBA106]: 210.9

320.4 A2 If a professional accountant is asked to undertake work that is complementary or additional to the work of an existing accountant, threats to professional competence and due care might result, for example, from incomplete information.

Comment [IESBA107]: 210.12

320.4 A3 *Examples of safeguards include:*

Comment [IESBA108]: 210.11

- Stating in tenders that, before accepting the engagement, contact with the existing accountant will be requested. This contact gives the proposed professional accountant the opportunity to inquire whether there are any reasons why the appointment should not be accepted.
- Asking the existing accountant to provide any known information that, in the existing accountant's opinion, the proposed professional accountant needs to be aware of before deciding whether to accept the engagement.
- Obtaining information from other sources such as through inquiries of third parties or background investigations of senior management or those charged with governance of the client.

Comment [IESBA109]: 210.11

320.4 A4 Depending on the nature of the engagement, direct communication with the existing accountant might be needed to establish the circumstances regarding a proposed change in appointment. Such communication might assist a professional accountant to decide whether it would be appropriate to accept the engagement. For example, the apparent reason for the

Comment [IESBA110]: 210.10

change in appointment might not fully reflect the facts. It might indicate disagreements with the existing accountant that might influence the decision to accept the appointment.

320.4 A5 A professional accountant will usually need the client's permission, preferably in writing, to initiate discussions with the existing accountant.

Comment [IESBA111]: 210.14

R320.5 If unable to communicate with the existing accountant, the proposed professional accountant shall take other reasonable steps to obtain information about any possible threats to compliance with the fundamental principles.

Comment [IESBA112]: 210.14

R320.6 When an existing professional accountant is asked to respond to a communication from a proposed accountant, the existing accountant shall:

Comment [IESBA113]: 210.14

- (a) Comply with relevant law and regulation governing the request; and
- (b) Provide any information honestly and unambiguously.

320.6 A1 An existing professional accountant is bound by confidentiality. Whether this 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:

Comment [IESBA114]: 210.13

- (a) Whether the accountant has permission from the client for the discussion; or
- (b) The legal and ethical requirements relating to such communications and disclosure, which might vary by jurisdiction.

320.6 A2 Circumstances where a professional accountant might be required to disclose confidential information, or when disclosure might be appropriate, are set out in paragraph 114.1 A2 of the Code.

Comment [IESBA115]: 210.13

Using the Work of an Expert

R320.7 When a professional accountant intends to use the work of an expert, the accountant shall determine whether the use is warranted.

Comment [IESBA116]: 210.8

320.7 A1 Factors to consider when a professional accountant intends to use the work of an expert include: reputation; expertise; resources available; and professional and ethical standards. This information might be gained from prior association with the expert or from consulting others.

Comment [IESBA117]: 210.8

Section 321

Second Opinions

Introduction

321.1 Section 321 sets out requirements and application material on applying the conceptual framework to providing a second opinion.

Comment [IESBA118]: New paragraph

321.2 A professional accountant might be asked to provide a second opinion on the application of accounting, auditing, reporting or other standards or principles to specific circumstances or transactions by or on behalf of a company or an entity that is not an existing client.

Comment [IESBA119]: 230.1

321.3 Providing a second opinion to an entity that is not an existing client might create threats to compliance with the fundamental principles. For example, there might be a threat to professional competence and due care if the second opinion is not based on the same facts that the existing accountant had, or is based on inadequate evidence.

Comment [IESBA120]: 230.1

Requirements and Application Material

R321.4 A professional accountant shall apply the conceptual framework set out in Section 120 when providing a second opinion.

Comment [IESBA121]: 230.2

R321.5 If an entity seeking a second opinion from a professional accountant will not permit the accountant to communicate with the existing accountant, the accountant shall determine whether, taking all the circumstances into account, the accountant may provide the second opinion sought and remain in compliance with the fundamental principles.

Comment [IESBA122]: 230.3

321.5 A1 The existence and significance of any threat created by providing a second opinion depends on the circumstances of the request and all the other available facts and assumptions relevant to the expression of a professional judgment.

321.5 A2 Examples of safeguards include:

Comment [IESBA123]: 230.2

- Seeking client permission to contact the existing accountant.
- Describing the limitations surrounding any opinion in communications with the client.
- Providing the existing accountant with a copy of the opinion.

Section 330

Fees and Other Types of Remuneration

Introduction

330.1 Section 330 sets out requirements and application material on applying the conceptual framework to fees and other types of remuneration.

Comment [IESBA124]: New paragraph

330.2 The level and nature of fee and other remuneration arrangements might create threats to compliance with the fundamental principles.

Comment [IESBA125]: New paragraph

Requirements and Application Material

R330.3 A professional accountant shall apply the conceptual framework set out in Section 120 to fees and other types of remuneration.

Comment [IESBA126]: 240.1, 240.2

Level of Fees

330.3 A1 The level of fees quoted might impact a professional accountant's ability to perform professional services in accordance with professional standards.

Comment [IESBA127]: 240.1, 240.2

330.3 A2 A professional accountant may quote whatever fee is considered appropriate. Quoting a fee lower than another accountant is not in itself unethical. However, fee quotations create a threat to professional competence and due care if the fee quoted is so low that it might be difficult to perform the engagement in accordance with applicable technical and professional standards for that price.

Comment [IESBA128]: 240.01

330.3 A3 *Examples of safeguards include:*

Comment [IESBA129]: 240.2

- *Making the client aware of the terms of the engagement and, in particular, the basis on which fees are charged and which professional services the quoted fee covers.*
- *Assigning appropriate time and qualified personnel to the task.*

Contingent Fees

330.3 A4 Contingent fees are widely used for certain types of non-assurance services. However, contingent fees might create threats to compliance with the fundamental principles, particularly a self-interest threat to objectivity, in certain circumstances. The existence and significance of such threats will depend on factors including:

Comment [IESBA130]: 240.3

- The nature of the engagement.
- The range of possible fee amounts.
- The basis for determining the fee.
- Whether an independent third party is to review the outcome or result of the transaction.

330.3 A5 *Examples of safeguards include:*

Comment [IESBA131]: 240.4

- *An advance written agreement with the client on the basis of remuneration.*

- *Disclosure to intended users of the work performed by the professional accountant and the basis of remuneration.*
- *Quality control policies and procedures.*
- *Review by an independent third party of the work performed by the accountant.*

330.3 A6 **Contingent fees** for services provided to audit clients and other assurance clients are set out in C1 and C2 of the Code.

Comment [IESBA132]: New paragraph

Referral Fees or Commissions

330.3 A7 **A self-interest** threat to objectivity and professional competence and due care is created if a professional accountant receives a referral fee or commission relating to a client. For example, such referral fees or commissions include:

Comment [IESBA133]: 240.5

- A fee received for referring a continuing client to another accountant or other expert where the existing accountant does not provide the specific professional service required by the client.
- A commission received from a third party (for example, a software vendor) in connection with the sale of goods or services to a client.

330.3 A8 **A self-interest** threat to objectivity and professional competence and due care is also created if a professional accountant pays a referral fee to obtain a client. For example, such a referral fee includes a fee that is paid when the client continues as a client of another accountant but requires specialist services not offered by the existing accountant.

Comment [IESBA134]: 240.6

330.3 A9 **Examples of safeguards** include:

Comment [IESBA135]: 240.7

- *Disclosing to the client any arrangements to pay a referral fee to another accountant for the work referred.*
- *Disclosing to the client any arrangements to receive a referral fee for referring the client to another accountant.*
- *Obtaining advance agreement from the client for commission arrangements in connection with the sale by a third party of goods or services to the client.*

330.3 A10 **A professional** accountant may purchase all or part of another firm on the basis that payments will be made to individuals formerly owning the firm or to their heirs or estates. Such payments are not referral fees or commissions for the purpose of paragraphs 330.3 A7 and 330.3 A8.

Comment [IESBA136]: 240.8

Section 340

Gifts and Hospitality

Introduction

340.1 Section 340 sets out requirements and application material on applying the conceptual framework to offers of gifts and hospitality.

Comment [IESBA137]: New paragraph

340.2 An offer of gifts or hospitality from a client to a professional accountant, or an immediate or close family member of an accountant, might create a self-interest or familiarity threat to objectivity if the offer is accepted, or an intimidation threat to objectivity if the acceptance of the offer might be made public.

Comment [IESBA138]: 260.1

Requirement and Application Material

R340.3 A professional accountant shall apply the conceptual framework set out in Section 120 to the acceptance of offers of gifts and hospitality.

Comment [IESBA139]: 260.3

340.3 A1 The existence and significance of a threat created by an offer of a gift or hospitality from a client will depend on the nature, value and intent of the offer. In some circumstances, a reasonable and informed third party would consider some gifts or hospitality to be trivial and inconsequential. In such circumstances, the professional accountant may conclude that the offer is made in the normal course of business without intent to influence decision making or to obtain information, and conclude that any threat to compliance with the fundamental principles is at an acceptable level.

Comment [IESBA140]: 260.2

Section 350

Custody of Client Assets

Introduction

350.1 Section 350 sets out requirements and application material on applying the conceptual framework to assuming custody of client money or other assets.

Comment [IESBA141]: New paragraph

350.2 Holding client assets creates threats to compliance with the fundamental principles, for example, a self-interest threat to professional behavior and objectivity.

Comment [IESBA142]: 270.2

Requirements and Application Material

R350.3 A professional accountant shall apply the conceptual framework set out in Section 120 when assuming custody of client money or other assets.

Comment [IESBA143]: New paragraph

350.3 A1 A professional accountant might also be bound by law that establishes who may take custody of client money or other assets and under what conditions such custody may be taken.

Comment [IESBA144]: 270.2

R350.4 A professional accountant shall not assume custody of client money or other assets unless permitted to do so by law.

Comment [IESBA145]: 270.1

R350.5 As part of client and engagement acceptance procedures related to assuming custody of client money or assets, the professional accountant shall:

Comment [IESBA146]: 270.3

- (a) Make inquiries about the source of the assets; and
- (b) Consider related legal and regulatory obligations.

350.5 A1 Inquiries about the source of client assets might reveal, for example, that the assets were derived from illegal activities, such as money laundering. In such circumstances, a threat to compliance with the fundamental principles would be created and the professional accountant may consider seeking legal advice.

Comment [IESBA147]: 270.3

R350.6 A professional accountant entrusted with money or other assets belonging to others shall:

Comment [IESBA148]: 270.2

- (a) Keep the assets separately from personal or firm assets;
- (b) Use the assets only for the purpose for which they are intended;
- (c) Be ready at all times to account for the assets and any income, dividends, or gains generated, to any individuals entitled to that accounting; and
- (d) Comply with the laws and regulations relevant to holding and accounting for the assets.

C1 – INDEPENDENCE – AUDIT AND REVIEW ENGAGEMENTS

Section 400

Application of Conceptual Framework to Independence for Audits and Reviews

Introduction

400.1 Independence is a measure of objectivity, both in mind and appearance, which is applied to audit engagements.¹⁴ It enables a firm to express, and be seen to express, an objective conclusion when performing such engagements. It is in the public interest and required by the Code that members of audit teams,¹⁵ firms and network firms be independent of audit clients.¹⁶ C1 sets out requirements and application material on maintaining independence when performing audit engagements. (See also paragraph 400.7 regarding references to “firm.”)

Comment [IESBA149]: 290.1

Comment [IESBA150]: 290.4

Comment [IESBA151]: 290.1

400.2 Independence comprises:

Comment [IESBA152]: 290.6

- (a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, and exercise objectivity and professional skepticism.
- (b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm’s, or a member of the audit or assurance team’s, integrity, objectivity or professional skepticism has been compromised.

400.3 C1 describes facts and circumstances, including professional activities, interests and relationships, that create or might create threats to independence. It describes the potential threats, and safeguards that might be appropriate to address any threats by eliminating them or reducing them to an acceptable level. It identifies situations where no safeguards could reduce the threats to an acceptable level but does not describe all situations that might create a threat.

Comment [IESBA153]: 290.5, 290.8, 290.9, 290.100

400.4 The conceptual framework requires a firm to evaluate the implications of similar, but different, facts and circumstances and determine whether the threat can be addressed by applying safeguards, including the safeguards in 300.2 A10 to eliminate the threats to independence or reduce them to an acceptable level.

Comment [IESBA154]: 290.8, 290.9, 290.100

400.5 Independence requirements for assurance engagements that are not audit or review engagements are set out in C2.

Comment [IESBA155]: 290.1 last sentence

¹⁴ In C1, “audit engagement” includes “review engagement.”

¹⁵ In C1, “audit team” includes “review team.”

¹⁶ In C1, “audit client” includes “review client” and related entities of the audit client – see Glossary for more detail.

Public Interest Entities

400.6 C1 sets out requirements and application material that reflect the extent of public interest in certain entities which are defined to be public interest entities. Firms and member bodies are encouraged to determine whether to treat additional entities, or certain categories of entities, as public interest entities because they have a large number and wide range of stakeholders. Factors to be considered include:

Comment [IESBA156]: 290.25, 290.26

- The nature of the business, such as the holding of assets in a fiduciary capacity for a large number of stakeholders. Examples might include financial institutions, such as banks and insurance companies, and pension funds.
- Size.
- Number of employees.

Responsibility

400.7 Firms are required by International Standards on Quality Control (ISQCs) to establish policies and procedures designed to provide them with reasonable assurance that independence is maintained when required by relevant ethical requirements. International Standards on Auditing (ISAs) establish responsibilities for engagement partners and engagement teams. Certain responsibilities within a firm depend on its size, structure and organization. Many of the provisions of C1 do not prescribe the specific responsibility of individuals within the firm for actions related to independence. Although firms and professional accountants within those firms each have responsibilities for compliance, for ease of reference, many of the provisions of C1 refer to “firm,” even if the main responsibility rests with an individual within the firm.

Comment [IESBA157]: 290.12

Reports that Include a Restriction on Use and Distribution

400.8 An audit report¹⁷ might include a restriction on use and distribution. If it does, the independence requirements in C1 may be modified as provided in Section 800,¹⁸ if the conditions set out in those paragraphs are met. These modifications are not permitted for an audit of financial statements which is required by law or regulation.

Comment [IESBA158]: 290.2

Requirements and Application Material

R400.9 A firm performing an audit engagement shall be independent of the audit client and shall apply the conceptual framework set out in Section 120 when identifying, evaluating and addressing threats to independence in relation to an audit engagement.

Comment [IESBA159]: 280.2

R400.10 In applying the conceptual framework, a firm shall:

- (a) When evaluating the significance of threats to independence, take qualitative as well as quantitative factors into account;

Comment [IESBA160]: 290.11

¹⁷ In C1, “audit report” includes “review report.”

¹⁸ Section 800 is under development.

- (b) *If a determination has been made that the threats are not at an acceptable level, and the decision to be made is whether to accept an engagement or include a particular individual on the audit team, determine whether safeguards are available to eliminate the threats or reduce them to an acceptable level;*
- (c) *If the decision is whether to continue an audit engagement, determine whether:*
 - (i) *Any existing safeguards will continue to be effective to eliminate the threats or reduce them to an acceptable level;*
 - (ii) *Other safeguards will need to be applied; or*
 - (iii) *The engagement needs to be ended; and*
- (d) *Whenever new information about a threat to independence comes to the attention of the firm during an audit engagement, evaluate the significance of that threat in accordance with the conceptual framework.*

Comment [IESBA161]: 290.10

Comment [IESBA162]: 290.10

Comment [IESBA163]: 290.10

R400.11 As defined, an audit client that is a listed entity includes all of its related entities. For all other entities, references to an audit client in C1 include related entities over which the client has direct or indirect control. When the audit team knows, or has reason to believe, that a relationship or circumstance involving any other related entity of the client is relevant to the evaluation of the firm's independence from the client, the audit team shall include that related entity when identifying and evaluating threats to independence and applying appropriate safeguards.

Comment [IESBA164]: 290.27

Engagement Period

R400.12 Independence as required by C1 shall be maintained during both:

- (a) The engagement period; and
- (b) The period covered by the financial statements.

Comment [IESBA165]: 290.30

R400.13 If an entity becomes an audit client during or after the period covered by the financial statements on which the firm will express an opinion, the firm shall determine whether any threats to independence are created by:

- (a) Financial or business relationships with the audit client during or after the period covered by the financial statements but before accepting the audit engagement; or
- (b) Previous services provided to the audit client by the firm or network firm.

Comment [IESBA166]: 290.31

R400.14 If a non-assurance service was provided to the audit client during, or after the period covered by the financial statements, but before the audit team begins to perform audit services, and the service would not be permitted during the engagement period, the firm shall evaluate any threat to independence created by the service. If a threat is not at an acceptable level, the firm shall only accept the audit engagement if safeguards are applied to eliminate any threats or reduce them to an acceptable level.

Comment [IESBA167]: 290.32

400.14 A1 *Examples of safeguards include:*

- *Not including individuals who provided the non-assurance service as members of the audit team.*
- *Having a professional accountant review the audit and non-assurance work as appropriate.*
- *Engaging another firm to evaluate the results of the non-assurance service.*
- *Having another firm re-perform the non-assurance service to the extent necessary to enable the other firm to take responsibility for the service.*

Comment [IESBA168]: 290.32

Communication with those Charged with Governance

R400.15 A firm shall comply with paragraph R300.3 when communicating with those charged with governance.

Comment [IESBA169]: New paragraph

400.15 A1 Even when not required by the Code, applicable professional standards, law or regulation, regular communication is encouraged between the firm and those charged with governance of the client regarding relationships and other matters that might, in the firm's opinion, reasonably bear on independence. Such communication enables those charged with governance to:

Comment [IESBA170]: 290.28

- (a) Consider the firm's judgments in identifying and evaluating threats to the fundamental principles;
- (b) Consider the appropriateness of safeguards applied to eliminate them or reduce them to an acceptable level; and
- (c) Take appropriate action.

Such an approach can be particularly helpful with respect to intimidation and familiarity threats.

Subsection 401 – Network Firms

Introduction

401.1 To enhance their ability to provide professional services, firms frequently form larger structures with other firms and entities. Whether these larger structures create a network depends on the particular facts and circumstances and does not depend on whether the firms and entities are legally separate and distinct. A larger structure is a network if it is aimed at co-operation and, for example, the firms share: a common brand name; a common system of quality control; or significant professional resources. Alternatively, a larger structure might be aimed only at facilitating the referral of work, which in itself does not meet the criteria necessary to constitute a network.

Comment [IESBA171]: 290.14

Requirements and Application Material

R401.2 A network firm shall be independent of the audit clients of the other firms within the network where C1 specifically requires such independence.

Comment [IESBA172]: 290.13

- R401.3** When associated with a larger structure of other firms and entities, a firm shall:
- (a) Use professional judgment to determine whether a network is created by such a larger structure;
 - (b) Consider whether a reasonable and informed third party would be likely to conclude that the other firms and entities in the larger structure are associated in such a way that a network exists; and
 - (c) Apply such judgment consistently throughout such a larger structure.
- 401.3 A1 The independence requirements in C1 that apply to a network firm apply to any entity that meets the definition of a network firm. It is not necessary for the entity also to meet the definition of a firm. For example, a consulting practice or professional law practice might be a network firm but not a firm.
- 401.3 A2 Where the larger structure is aimed at co-operation and it is clearly aimed at profit or cost sharing among the entities within the structure, it is a network. However, the sharing of immaterial costs does not in itself create a network. In addition, if the sharing of costs is limited only to those costs related to the development of audit methodologies, manuals or training courses, this would not in itself create a network. Further, an association between a firm and an otherwise unrelated entity jointly to provide a service or develop a product does not in itself create a network.
- 401.3 A3 Where the larger structure is aimed at co-operation and the entities within the structure share common ownership, control or management, it is a network. This could be achieved by contract or other means.
- 401.3 A4 Where the larger structure is aimed at co-operation and the entities within the structure share common quality control policies and procedures, it is a network. For this purpose, common quality control policies and procedures are those designed, implemented and monitored across the larger structure.
- 401.3 A5 Where the larger structure is aimed at co-operation and the entities within the structure share a common business strategy, it is a network. Sharing a common business strategy involves an agreement by the entities to achieve common strategic objectives. An entity is not a network firm merely because it co-operates with another entity solely to respond jointly to a request for a proposal for the provision of a professional service.
- 401.3 A6 Where the larger structure is aimed at co-operation and the entities within the structure share the use of a common brand name, it is a network. A common brand name includes common initials or a common name. A firm is using a common brand name if it includes, for example, the common brand name as part of, or along with, its firm name when a partner of the firm signs an audit report.
- 401.3 A7 Even if a firm does not belong to a network and does not use a common brand name as part of its firm name, it might appear to belong to a network if its stationery or promotional materials refer to being a member of an association of firms. Accordingly, if care is not taken in how a firm describes such membership, a perception might be created that the firm belongs to a network.

Comment [IESBA173]: 290.15

Comment [IESBA174]: 290.13

Comment [IESBA175]: 290.16

Comment [IESBA176]: 290.17

Comment [IESBA177]: 290.18

Comment [IESBA178]: 290.19

Comment [IESBA179]: 290.20

Comment [IESBA180]: 290.21

401.3 A8 Where the larger structure is aimed at co-operation and the entities within the structure share a significant part of professional resources, it is a network. Professional resources include:

Comment [IESBA181]: 290.23

- Common systems that enable firms to exchange information such as client data, billing and time records.
- Partners and other personnel.
- Technical departments that consult on technical or industry specific issues, transactions or events for assurance engagements.
- Audit methodology or audit manuals.
- Training courses and facilities.

401.3 A9 Whether the shared professional resources are significant depends on the circumstances. For example:

Comment [IESBA182]: 290.24

- Where the shared resources are limited to common audit methodology or audit manuals, with no exchange of personnel or client or market information, it is unlikely that the shared resources would be significant. The same applies to a common training endeavor.
- Where the shared resources involve the exchange of personnel or information, such as where personnel are drawn from a shared pool, or a common technical department is created within the larger structure to provide participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared resources are significant.

R401.4 If a firm or a network sells a component of its practice, the sales agreement sometimes provides that, for a limited period of time, the sold component might continue to use all or part of the name of the firm or the network, even though it is no longer connected to the firm or the network. In such circumstances, while the two entities might be practicing under a common name, the facts are such that they do not belong to a larger structure aimed at cooperation and are therefore not network firms. Those entities shall determine how to disclose that they are not network firms when presenting themselves to outside parties.

Comment [IESBA183]: 290.22

Subsection 402 – General Documentation of Independence for Audit and Review Engagements

Introduction

402.1 Documentation provides evidence of the firm's judgments when forming conclusions regarding compliance with independence requirements.

Comment [IESBA184]: New paragraph

Requirements and Application Material

R402.2 A firm shall document conclusions regarding compliance with independence requirements, and the substance of any relevant discussions that support those conclusions. Accordingly:

Comment [IESBA185]: 290.29

- (a) When safeguards are required to reduce a threat to an acceptable level, the firm shall document the nature of the threat and the safeguards in place or applied that reduce the threat to an acceptable level; and
- (b) When a threat required significant analysis to determine whether safeguards were necessary and the firm concluded that they were not because the threat was already at an acceptable level, the firm shall document the nature of the threat and the rationale for the conclusion.

402.2 A1 A lack of documentation does not determine whether a firm considered a particular matter or whether the firm is independent as required by C1.

Comment [IESBA186]: 290.29

Subsection 403 – Mergers and Acquisitions

Introduction

403.1 An entity might become a related entity of an audit client because of a merger or acquisition. A threat to independence, and therefore, the ability of a firm to continue an audit engagement might be created by previous or current interests or relationships between a firm or network firm and such a related entity.

Comment [IESBA187]: 290.33

403.2 It might not be reasonable to end an interest or relationship by the effective date of the merger or acquisition. This might be because the firm provides a non-assurance service to the related entity, which the entity is not able to transition in an orderly manner to another provider by that date.

Comment [IESBA188]: 290.34

Requirements and Application Material

R403.3 (a) In the circumstances set out in paragraph 403.1, the firm shall identify and evaluate previous and current interests and relationships with the related entity that, taking into account available safeguards, could affect its independence and therefore its ability to continue the audit engagement after the effective date of the merger or acquisition.

Comment [IESBA189]: 290.33

(b) In the circumstances set out in paragraph 403.1, the firm shall take steps to end any interests or relationships that are not permitted by the Code by the effective date of the merger or acquisition.

Comment [IESBA190]: 290.34

(c) As an exception to R403.3(b), if the interest or relationship cannot reasonably be ended by the effective date, the firm shall:

Comment [IESBA191]: 290.34

- (i) Evaluate the threat that is created by the interest or relationship; and
- (ii) Discuss with those charged with governance the reasons why the interest or relationship cannot reasonably be ended by the effective date and the evaluation of the significance of the threat.

403.3 A1 The more significant the threat, the more likely the firm's objectivity will be compromised and it will be unable to continue as auditor. The significance of the threat to objectivity might depend upon factors such as:

Comment [IESBA192]: 290.34

- The nature and significance of the interest or relationship.

- The nature and significance of the related entity relationship (for example, whether the related entity is a subsidiary or parent).
- The length of time until the interest or relationship can reasonably be ended.

R403.4

If those charged with governance request the firm to continue as the auditor, the firm shall do so only if:

Comment [IESBA193]: 290.35

- (a) The interest or relationship will be ended as soon as reasonably possible but no later than six months after the effective date of the merger or acquisition;
- (b) Any individual who has such an interest or relationship, including one that has arisen through performing a non-assurance service that would not be permitted by C1, will not be a member of the engagement team for the audit or the individual responsible for the engagement quality control review; and
- (c) Transitional measures will be applied, as necessary, and discussed with those charged with governance.

403.4 A1

Examples of transitional measures include:

Comment [IESBA194]: 290.35(c)

- Having a professional accountant review the audit or non-assurance work as appropriate.
- Having a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, perform a review that is equivalent to an engagement quality control review.
- Engaging another firm to evaluate the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable the other firm to take responsibility for the service.

R403.5

The firm might have completed a significant amount of work on the audit prior to the effective date of the merger or acquisition and might be able to complete the remaining audit procedures within a short period of time. In such circumstances, if those charged with governance request the firm to complete the audit while continuing with an interest or relationship identified in paragraph 403.1, the firm shall only do so if it:

Comment [IESBA195]: 290.36

- (a) Has evaluated the significance of the threat created by such interest or relationship and discussed the evaluation with those charged with governance;
- (b) Complies with the requirements of paragraph R403.4(a) to (c); and
- (c) Ceases to be the auditor no later than the date that the audit report is issued.

R403.6

When addressing previous and current interests and relationships set out in paragraph 403.1, the firm shall determine whether, even if all the requirements of paragraphs R403.3 to R403.5 could be met, the interests and relationships create threats that would remain so significant that objectivity would be compromised. If so, the firm shall cease to be the auditor.

Comment [IESBA196]: 290.37

R403.7 The firm shall document:

Comment [IESBA197]: 290.38

- (a) Any interests or relationships set out in paragraph 403.1 that will not be ended by the effective date of the merger or acquisition and the reasons why they will not be ended;
- (b) The transitional measures applied;
- (c) The results of the discussion with those charged with governance; and
- (d) The reasons why the previous and current interests and relationships do not create threats that would remain so significant that objectivity would be compromised.

Subsection 404 – Breach of an Independence Provision

Introduction

404.1 A breach of a provision of C1 might occur despite the firm having policies and procedures designed to provide it with reasonable assurance that independence is maintained. It might be necessary to end the audit engagement because of the breach.

Comment [IESBA198]: 290.39

Requirements and Application Material

When a Firm Identifies a Breach

R404.2 If a firm concludes that a breach of an independence provision of C1 has occurred, the firm shall:

- (a) End, suspend or eliminate the interest or relationship that created the breach and address the consequences of the breach;
- (b) Consider whether any legal or regulatory requirements apply to the breach and, if so:
 - (i) Comply with those requirements; and
 - (ii) Consider reporting the breach to a professional body or regulator if such reporting is common practice or expected in the relevant jurisdiction;
- (c) Promptly communicate the breach in accordance with its policies and procedures to:
 - (i) The engagement partner;
 - (ii) Those with responsibility for the policies and procedures relating to independence;
 - (iii) Other relevant personnel in the firm and, where appropriate, the network; and
 - (iv) Those subject to the independence requirements who need to take appropriate action;
- (d) Evaluate the significance of the breach and its impact on the firm's objectivity and ability to issue an audit report; and
- (e) Depending on the significance of the breach, determine whether:
 - (i) To end the audit engagement; or

Comment [IESBA199]: 290.40

Comment [IESBA200]: 290.41

Comment [IESBA201]: 290.42

Comment [IESBA202]: 290.42

Comment [IESBA203]: 290.43

- (ii) Whether it might be possible to take action that satisfactorily addresses the consequences of the breach, and whether such action can be taken and is appropriate in the circumstances.

In making this determination, the firm shall exercise professional judgment and take into account whether a reasonable and informed third party would be likely to conclude that the firm's objectivity would be compromised and therefore the firm is unable to issue an audit report.

Comment [IESBA204]: 290.43

404.2 A1 When a breach of the independence requirements set out in C1 is identified, the significance and impact of the breach on the firm's objectivity and ability to issue an audit report will depend on factors such as:

Comment [IESBA205]: 290.42

- The nature and duration of the breach.
- The number and nature of any previous breaches with respect to the current audit engagement.
- Whether an audit team member had knowledge of the interest or relationship that created the breach.
- Whether the individual who created the breach is an audit team member or another individual for whom there are independence requirements.
- If the breach relates to an audit team member, the role of that individual.
- If the breach was created by providing a professional service, the impact of that service, if any, on the accounting records or the amounts recorded in the financial statements on which the firm will express an opinion.
- The extent of the self-interest, advocacy, intimidation or other threats created by the breach.

404.2 A2 Depending upon the significance of the breach, examples of actions that the firm might consider to satisfactorily address the breach include:

Comment [IESBA206]: 290.44

- Removing the relevant individual from the audit team.
- Using different individuals to conduct an additional review of the affected audit work or to re-perform that work to the extent necessary.
- Recommending that the audit client engage another firm to review or re-perform the affected audit work to the extent necessary.
- If the breach relates to a non-assurance service that affects the accounting records or an amount recorded in the financial statements:
 - Engaging another firm to evaluate the results of the non-assurance service.
 - Having another firm re-perform the non-assurance service to the extent necessary to enable the other firm to take responsibility for the service.

R404.3 If the firm determines that it cannot take action to satisfactorily address the consequences of the breach, the firm shall inform those charged with governance as soon as possible and

Comment [IESBA207]: 290.45

take the steps necessary to end the audit engagement in compliance with any applicable legal or regulatory requirements. Where ending the engagement is not permitted by law or regulation, the firm shall comply with any reporting or disclosure requirements.

R404.4 If the firm determines that it can take action to satisfactorily address the consequences of the breach, the firm shall discuss with those charged with governance:

Comment [IESBA208]: 290.46

- (a) The significance of the breach, including its nature and duration;
- (b) How the breach occurred and how it was identified;
- (c) The action proposed or taken and why the action will satisfactorily address the consequences of the breach and enable the firm to issue an audit report;
- (d) The conclusion that, in the firm's professional judgment, objectivity has not been compromised and the rationale for that conclusion; and
- (e) Any steps proposed or taken by the firm to reduce or avoid the risk of further breaches occurring.

Such discussion shall take place as soon as possible unless an alternative timing is specified by those charged with governance for reporting less significant breaches.

Communication with Those Charged with Governance – Breaches of an Independence Provision

R404.5 The firm shall communicate in writing to those charged with governance:

Comment [IESBA209]: 290.47

- (a) All matters discussed in accordance with paragraphs R404.2 to R404.4 and obtain the concurrence of those charged with governance that action can be, or has been, taken to satisfactorily address the consequences of the breach; and
- (b) A description of the firm's policies and procedures relevant to the breach designed to provide it with reasonable assurance that independence is maintained and any steps that the firm has taken, or proposes to take, to reduce or avoid the risk of further breaches occurring.

R404.6 If those charged with governance do not concur that the action proposed by the firm in accordance with R404.2(e)(ii) satisfactorily addresses the consequences of the breach, the firm shall take the steps necessary to end the audit engagement in accordance with the provisions set out in paragraph R404.3.

Comment [IESBA210]: 290.47

Breaches Before the Previous Audit Report Was Issued

R404.7 If the breach occurred prior to the issuance of the previous audit report, the firm shall comply with the provisions of C1 in evaluating the significance of the breach and its impact on the firm's objectivity and its ability to issue an audit report in the current period.

Comment [IESBA211]: 290.48

R404.8 The firm shall also consider the impact of the breach, if any, on the firm's objectivity in relation to any previously issued audit reports, and the possibility of withdrawing such audit reports, and discuss the matter with those charged with governance.

Comment [IESBA212]: 290.48

Documentation – Breaches of an Independence Provision

R404.9 In applying the provisions of R404.1 to R404.8, the firm shall document:

- (a) The breach;
- (b) The action taken;
- (c) Key decisions made;
- (d) All the matters discussed with those charged with governance; and
- (e) Any discussions with a professional body or regulator.

R404.10 If the firm continues with the audit engagement, it shall also document the conclusion that, in the firm's professional judgment, objectivity has not been compromised and why the action taken satisfactorily addressed the consequences of the breach so that the firm could issue an audit report.

Comment [IESBA213]: 290.49

Comment [IESBA214]: 290.49

Section 410

Fees

Introduction

410.1 The level and nature of fees or other types of remuneration might create threats to independence. For example, such threats might be created by:

Comment [IESBA215]: New paragraph

- The amount of fees from an audit client relative to the total fees of the firm or an individual partner or office of the firm.
- Fees from an audit client that remain unpaid for a long time.
- Charging contingent fees to an audit client.

Comment [IESBA216]: 290.217, 290.218

Comment [IESBA217]: 290.220

Comment [IESBA218]: 290.221

Section 410 sets out requirements and application material on applying the conceptual framework to fees or other remuneration.

Requirements and Application Material

R410.2 A firm shall apply the conceptual framework set out in Section 120 to fees or other remuneration.

Comment [IESBA219]: New paragraph

Fees – Relative Size

410.3 A1 When the total fees generated from an audit client by the firm expressing the audit opinion represent a large proportion of the total fees of that firm, the dependence on that client and concern about losing the client creates a self-interest or intimidation threat. The significance of the threat will depend on factors such as:

Comment [IESBA220]: 290.217

- The operating structure of the firm.
- Whether the firm is well established or new.
- The significance of the client qualitatively and/or quantitatively to the firm.

410.3 A2 Examples of safeguards include:

Comment [IESBA221]: 290.217

- Reducing dependence on the client.
- External quality control reviews.
- Consulting a third party, such as a professional or regulatory body or a professional accountant, on key audit judgments.

410.3 A3 A self-interest or intimidation threat is also created when the fees generated by the firm from an audit client represent a large proportion of the revenue of one partner or one office of the firm.

Comment [IESBA222]: 290.218

The significance of the threat will depend upon factors such as:

- The significance of the client qualitatively and/or quantitatively to the partner or office.
- The extent to which the remuneration of the partner, or the partners in the office, is dependent upon the fees generated from the client.

410.3 A4 *Examples of safeguards include:*

- *Reducing dependence on the audit client.*
- *Having a professional accountant review the work or advise as necessary.*
- *Regular independent internal or external quality reviews of the engagement.*

Comment [IESBA223]: 290.218

Audit Clients that are Public Interest Entities

R410.4 Where an audit client is a public interest entity and, for two consecutive years, the total fees from the client and its related entities (subject to the considerations in paragraph R400.11) represent more than 15% of the total fees received by the firm expressing the opinion on the financial statements of the client, the firm shall:

Comment [IESBA224]: 290.219

- (a) Disclose to those charged with governance of the audit client the fact that the total of such fees represents more than 15% of the total fees received by the firm; and
- (b) Discuss which of the safeguards below it will apply to reduce the threat to an acceptable level, and apply the selected safeguard:
 - (i) Prior to the audit opinion being issued on the second year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, performs an engagement quality control review of that engagement; or a professional body performs a review of that engagement that is equivalent to an engagement quality control review ("a pre-issuance review"); or
 - (ii) After the audit opinion on the second year's financial statements has been issued, and before the audit opinion being issued on the third year's financial statements, a professional accountant, who is not a member of the firm expressing the opinion on the financial statements, or a professional body performs a review of the second year's audit that is equivalent to an engagement quality control review ("a post-issuance review").

R410.5 When the total fees described in R410.4 significantly exceed 15%, the firm shall:

Comment [IESBA225]: 290.219

- (a) Determine whether the significance of the threat is such that a post-issuance review would not reduce the threat to an acceptable level; and
- (b) In such circumstances, have a pre-issuance review performed.

R410.6 If the fees described in R410.4 continue to exceed 15%, the firm shall each year:

Comment [IESBA226]: 290.219

- (a) Disclose to and discuss with those charged with governance the matters set out in paragraph R410.4; and
- (b) Comply with the provisions set out in paragraphs R410.4(b) and R410.5.

Fees – Overdue

R410.7 When a significant part of fees due from an audit client remains unpaid for a long time, the firm shall determine:

Comment [IESBA227]: 290.220

- (a) Whether the overdue fees might be equivalent to a loan to the client; and
- (b) Whether it is appropriate for the firm to be re-appointed or continue the audit engagement because of the significance of the overdue fees.

410.7 A1 A self-interest threat might be created if a significant part of fees is not paid before the audit report for the following year is issued. It is generally appropriate for the firm to require payment of such fees before such audit report is issued. The provisions of Section 511 with respect to loans and guarantees might also be relevant to situations where such unpaid fees exist.

Comment [IESBA228]: 290.220

410.7 A2 An example of a safeguard is having an additional professional accountant, who did not take part in the audit engagement, provide advice or review the work performed.

Comment [IESBA229]: 290.220

Contingent Fees

R410.8 A firm shall not charge directly or indirectly, for example through an intermediary, a contingent fee for an audit engagement.

Comment [IESBA230]: 290.22

R410.9 A firm or network firm shall not charge directly or indirectly, for example through an intermediary, a contingent fee for a non-assurance service provided to an audit client, if:

Comment [IESBA231]: 290.223

- (a) The fee is charged by the firm expressing the opinion on the financial statements and the fee is material or expected to be material to that firm;
- (b) The fee is charged by a network firm that participates in a significant part of the audit and the fee is material or expected to be material to that firm; or
- (c) The outcome of the non-assurance service, and therefore the amount of the fee, is dependent on a future or contemporary judgment related to the audit of a material amount in the financial statements.

410.9 A1 Contingent fees are fees calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed. For the purposes of this section, a fee is not regarded as being contingent if established by a court or other public authority.

Comment [IESBA232]: 290.221

410.9 A2 Paragraphs R410.8 and R410.9 preclude a firm or a network firm from entering into certain contingent fee arrangements with an audit client. Even if such contingent fee arrangements are not precluded when providing a non-assurance service to an audit client, threats might still be created. The existence and significance of any threats will depend on factors such as:

Comment [IESBA233]: 290.224

- The range of possible fee amounts.
- Whether an appropriate authority determines the outcome on which the contingent fee depends.
- The nature of the service.
- The effect of the event or transaction on the financial statements.

410.9 A3 *Examples of safeguards include:*

- *Having a professional accountant review the relevant audit work or advise as necessary.*
- *Using professionals who are not members of the audit team to perform the non-assurance service.*

Comment [IESBA234]: 290.224

Section 411

Compensation and Evaluation Policies

Introduction

411.1 Evaluating or compensating an audit team member for selling non-assurance services to that audit client might create a self-interest threat. Section 411 sets out requirements and application material on applying the conceptual framework to compensation and evaluation policies.

Comment [IESBA235]: 290.225

Requirements and Application Material

R411.2 A firm shall apply the conceptual framework set out in Section 120 to compensation and evaluation policies.

Comment [IESBA236]: 290.225

411.2 A1 When an audit team member for a particular audit client is evaluated on or compensated for selling non-assurance services to that audit client, the significance of the threat will depend on:

Comment [IESBA237]: 290.225

- (a) What proportion of the compensation or evaluation is based on the sale of such services;
- (b) The role of the individual on the audit team; and
- (c) Whether the sale of such non-assurance services influences promotion decisions.

411.2 A2 Examples of safeguards include:

Comment [IESBA238]: 290.225

- *Revising the compensation plan or evaluation process for that individual.*
- *Removing such members from the audit team.*
- *Having a professional accountant review the work of the audit team member.*

R411.3 A key audit partner shall not be evaluated or compensated based on that partner's success in selling non-assurance services to the partner's audit client. This requirement does not preclude normal profit-sharing arrangements between partners of a firm.

Comment [IESBA239]: 290.226

Section 420

Gifts and Hospitality

Introduction

420.1 Accepting gifts or hospitality from an audit client might create self-interest and familiarity threats. Section 420 sets out requirements on applying the conceptual framework to evaluating gifts and hospitality.

Comment [IESBA240]: 290.227

Requirements

R420.2 A firm shall apply the conceptual framework set out in Section 120 to accepting gifts or hospitality from an audit client.

Comment [IESBA241]: New paragraph

R420.3 A firm or an audit team member shall not accept gifts or hospitality from an audit client, unless the value is trivial and inconsequential.

Comment [IESBA242]: 290.227

Section 430

Actual or Threatened Litigation

Introduction

430.1 When litigation occurs, or appears likely, between an audit client and the firm, a network firm or an audit team member, self-interest and intimidation threats are created. Section 430 sets out requirements and application material on applying the conceptual framework to such actual or threatened litigation.

Comment [IESBA243]: 290.228

Requirements and Application Material

R430.2 A firm shall apply the conceptual framework set out in Section 120 if there is actual or threatened litigation between the audit client and:

Comment [IESBA244]: New paragraph.

- (a) The firm;
- (b) A network firm; or
- (c) An audit team member.

430.2 A1 The relationship between client management and the audit team members must be characterized by complete candor and full disclosure regarding all aspects of a client's operations. The adversarial positions which could result from actual or threatened litigation might affect management's willingness to make complete disclosures and create self-interest and intimidation threats. The significance of the threats created by actual or threatened litigation might depend on factors such as:

Comment [IESBA245]: 290.228

- The materiality of the litigation.
- Whether the litigation relates to a prior audit engagement.

430.2 A2 Examples of safeguards include:

Comment [IESBA246]: 290.228

- If the litigation involves an audit team member, removing that individual from the audit team.
- Having a professional review the work performed.

Section 510

Financial Interests

Introduction

510.1 Holding a financial interest in an audit client might create a self-interest threat. The existence and significance of any threat depends on:

- (a) The role of the individual holding the financial interest;
- (b) Whether the financial interest is direct or indirect; and
- (c) The materiality of the financial interest.

Comment [IESBA247]: 290.102

Section 510 sets out requirements and application material on applying the conceptual framework to financial interests.

510.2 Financial interests might be held directly or indirectly through an intermediary (for example, a collective investment vehicle, estate or trust). When a beneficial owner has control over the intermediary or the ability to influence investment decisions, the Code defines that financial interest to be direct. Conversely, when a beneficial owner has no control over the intermediary or the ability to influence investment decisions, the Code defines that financial interest to be indirect.

Comment [IESBA248]: 290.103

510.3 Section 510 contains references to the “materiality” of a financial interest. For the purpose of determining whether such an interest is material to an individual, the combined net worth of the individual and the individual’s immediate family members may be taken into account.

Comment [IESBA249]: 290.101

Requirements and Application Material

R510.4 A firm shall apply the conceptual framework set out in Section 120 to financial interests.

Comment [IESBA250]: New paragraph

Financial Interests Held by the Firm, Network, Audit Team Members, and Other Partners and Employees of the Firm

R510.5 A direct financial interest or a material indirect financial interest in the audit client shall not be held by:

- (a) The firm or a network firm;
- (b) An audit team member, or any of that individual’s immediate family;
- (c) Any other partner in the office in which an engagement partner practices in connection with the audit engagement, or any of that other partner’s immediate family;
- (d) Any other partner or managerial employee who provides non-audit services to the audit client, except for any whose involvement is minimal, or any of their immediate family.

Comment [IESBA251]: 290.104

Comment [IESBA252]: 290.104

Comment [IESBA253]: 290.108

Comment [IESBA254]: 290.110

510.5 A1 The office in which the engagement partner practices in connection with an audit engagement is not necessarily the office to which that partner is assigned. When the engagement partner is located in a different office from that of the other members of the audit team, professional

Comment [IESBA255]: 290.109

judgment is needed to determine the office in which the partner practices in connection with the engagement.

R510.6 As an exception to paragraph R510.5, an immediate family member identified in subparagraphs 510.5(c) or (d) may hold a direct or material indirect financial interest in an audit client, provided that:

Comment [IESBA256]: 290.111

- (a) The family member received the financial interest because of employment rights (for example, through pension or share option plans);
- (b) The family member disposes of or forfeits the financial interest as soon as practicable when the family member has or obtains the right to do so, or in the case of a stock option, when the family member obtains the right to exercise the option; and
- (c) When necessary, the firm applies safeguards to eliminate any threat to independence or reduce it to an acceptable level.

R510.7 When an entity has a controlling interest in an audit client and the audit client is material to the entity, neither the firm, nor a network firm, nor an audit team member, nor that individual's immediate family member shall hold a direct or material indirect financial interest in that entity.

Comment [IESBA257]: 290.106

Financial Interests Held as Trustee

R510.8 Paragraph R510.5 also applies to a financial interest in an audit client held as trustee as it does to other financial interests, unless:

Comment [IESBA258]: 290.114

- (a) None of the following is a beneficiary of the trust: the trustee, that individual's immediate family member, the firm or a network firm;
- (b) The interest in the audit client held by the trust is not material to the trust;
- (c) The trust is not able to exercise significant influence over the audit client; and
- (d) None of the following can significantly influence any investment decision involving a financial interest in the audit client: the trustee, that individual's immediate family member, the firm or a network firm.

Financial Interests in Common with the Audit Client

R510.9 (a) A firm, or a network firm, or an audit team member, or that individual's immediate family member shall not hold a financial interest in an entity when an audit client also has a financial interest in that entity, unless:

Comment [IESBA259]: 290.112

- (i) The financial interests are immaterial to the firm, the network firm, the audit team member, that individual's immediate family member and the audit client, as the case may be; or
- (ii) The audit client cannot exercise significant influence over the entity.

(b) Before an individual can become an audit team member, the individual or that individual's immediate family member shall either:

Comment [IESBA260]: 290.112

- (i) Dispose of the interest; or

- (ii) Dispose of enough of the interest so that the remaining interest is no longer material.

Unintended Acquisition of Interests

R510.10 If a firm, a network firm or a partner or employee of the firm or a network firm, or that individual's immediate family member, receives a direct financial interest or a material indirect financial interest in an audit client by way of an inheritance, gift, as a result of a merger or in similar circumstances and the interest would not otherwise be permitted to be held under this section then:

Comment [IESBA261]: 290.116

- (a) If the interest is received by the firm or a network firm, or an audit team member or a member of that individual's immediate family, the financial interest shall be disposed of immediately, or enough of an indirect financial interest shall be disposed of so that the remaining interest is no longer material; or
- (b) (i) If the interest is received by an individual who is not an audit team member, or by that individual's immediate family member, the financial interest shall be disposed of as soon as possible, or enough of an indirect financial interest shall be disposed of so that the remaining interest is no longer material; and
- (ii) Pending the disposal of the financial interest, the firm shall determine whether safeguards are necessary.

Financial Interests – Other circumstances

R510.11 In the following circumstances related to financial interests, the firm shall apply the conceptual framework set out in Section 120:

- (a) If an audit team member knows that a close family member has a direct or material indirect financial interest in the audit client. (Ref: Para. 510.11 A1).
- (b) If the retirement benefit plan of a firm or a network firm holds a direct or material indirect financial interest in an audit client.
- (c) If an audit team member, or that individual's immediate family member, or the firm or a network firm, has a financial interest in an entity and a director or officer or controlling owner of the audit client is also known to have a financial interest in the same entity. (Ref: Para. 510.11 A3).
- (d) If an audit team member knows that a financial interest in the audit client is held by other individuals, such as:
 - (i) Partners and professional employees of the firm or network firm, in addition to those who are specifically not permitted to hold such financial interests by paragraph R510.5, or their immediate family members; or
 - (ii) Individuals with a close personal relationship with an audit team member. (Ref: Para. 510.11 A5).

Comment [IESBA262]: 290.105

Comment [IESBA263]: 290.107

Comment [IESBA264]: 290.113

Comment [IESBA265]: 290.115

510.11 A1 A self-interest threat might be created if an audit team member has a close family member who the audit team member knows has a direct or material indirect financial interest in the audit client. The significance of any threat created depends on factors such as:

- The nature of the relationship between the audit team member and the close family member.
- The materiality of the financial interest to the close family member.

Comment [IESBA266]: 290.105

510.11 A2 Examples of safeguards include:

- *The close family member disposing, as soon as practicable, of all of the financial interest or disposing of enough of an indirect financial interest so that the remaining interest is no longer material.*
- *Having a professional accountant review the work of the audit team member.*
- *Removing the individual from the audit team.*

Comment [IESBA267]: 290.105

510.11 A3 Self-interest, familiarity, or intimidation threats might be created if an audit team member, or that individual's immediate family member, or the firm or a network firm has a financial interest in an entity when a director or officer or controlling owner of the audit client is also known to have a financial interest in that entity. The existence and significance of any threat depends upon factors such as:

- The role of the individual on the audit team.
- Whether ownership of the entity is closely or widely held.
- Whether the interest allows the investor to control or significantly influence the entity.
- The materiality of the financial interest.

Comment [IESBA268]: 290.113

510.11 A4 Examples of safeguards include:

- *Removing the audit team member with the financial interest from the audit team.*
- *Having a professional accountant review the work of the audit team member.*

Comment [IESBA269]: 290.113

510.11 A5 Whether the interests set out in paragraph R510.11(d) create a self-interest threat depends on factors such as:

- The firm's organizational, operating and reporting structure.
- The nature of the relationship between the individual and the audit team member.

Comment [IESBA270]: 290.115

510.11 A6 Examples of safeguards include:

- *Removing the audit team member with the personal relationship from the audit team.*
- *Excluding the audit team member from any significant decision-making concerning the audit engagement.*
- *Having a professional accountant review the work of the audit team member.*

Comment [IESBA271]: 290.115

Section 511

Loans and Guarantees

Introduction

511.1 A loan or a guarantee of a loan between an audit client and a firm, a network firm, a member of the audit team, or that individual's immediate family member might create self-interest or other threats. Section 511 sets out requirements and application material on applying the conceptual framework to loans and guarantees.

Comment [IESBA272]: New paragraph

511.2 Section 511 contains references to the "materiality" of a loan or guarantee. For the purpose of determining whether such an interest is material to an individual, the combined net worth of the individual and the individual's immediate family members may be taken into account.

Comment [IESBA273]: 290.101

Requirements and Application Material

R511.3 A firm shall apply the conceptual framework set out in Section 120 to loans and guarantees.

Comment [IESBA274]: New paragraph

Loans and Guarantees with a Bank or Similar Institution

R511.4 A firm, a network firm, an audit team member, or that individual's immediate family member shall not accept a loan, or a guarantee of a loan, from an audit client that is a bank or a similar institution unless the loan or guarantee is made under normal lending procedures, terms and conditions.

Comment [IESBA275]: 290.117

511.4 A1 If a loan to a firm or network firm from an audit client that is a bank or similar institution is made under normal lending procedures, terms and conditions and it is material to the audit client or firm receiving the loan, it might be possible to apply safeguards to reduce the self-interest threat to an acceptable level.

Comment [IESBA276]: 290.118

511.4 A2 An example of such a safeguard is having the work reviewed by a professional accountant from a network firm that is neither involved with the audit nor received the loan.

Comment [IESBA277]: 290.118

511.4 A3 A loan, or a guarantee of a loan, from an audit client that is a bank or a similar institution to an audit team member, or that individual's immediate family member, does not create a threat to independence if the loan or guarantee is made under normal lending procedures, terms and conditions. Examples of such loans include: home mortgages; bank overdrafts; car loans; and credit card balances.

Comment [IESBA278]: 290.119

Loans and Guarantees with a Client that is Not a Bank or Similar Institution

R511.5 A firm, a network firm, an audit team member, or that individual's immediate family member shall not accept a loan from, or have a borrowing guaranteed by, an audit client that is not a bank or similar institution, unless the loan or guarantee is immaterial to:

Comment [IESBA279]: 290.120

- (a) The firm, the network firm, or the audit team member and the immediate family member receiving the loan, as the case may be; and
- (b) The client.

R511.6 A firm, a network firm, an audit team member, or that individual's immediate family member shall not make or guarantee a loan to an audit client unless the loan or guarantee is immaterial to:

Comment [IESBA280]: 290.121

- (a) The firm, the network firm or the audit team member and the immediate family member making the loan or guarantee, as the case may be; and
- (b) The client.

Deposits or Brokerage Accounts

R511.7 A firm, a network firm, an audit team member, or that individual's immediate family member shall not have deposits or a brokerage account with an audit client that is a bank, broker or similar institution, unless the deposit or account is held under normal commercial terms.

Comment [IESBA281]: 290.122

Section 520

Business Relationships

Introduction

520.1 A close business relationship between an audit client and a firm, a network firm, an audit team member, or that individual's immediate family member might create self-interest or intimidation threats. Section 520 sets out requirements and application material on applying the conceptual framework to these business relationships.

Comment [IESBA282]: 290.123

520.2 Section 520 contains references to the "materiality" or "significance" of a business relationship. For the purpose of determining whether such an interest is material or significant to an individual, the combined net worth of the individual and the individual's immediate family members may be taken into account.

Comment [IESBA283]: 290.101

Requirements and Application Material

R520.3 A firm shall apply the conceptual framework set out in Section 120 to business relationships.

Comment [IESBA284]: New paragraph

Firm or Audit Team Member Relationships

R520.4 The firm, a network firm or an audit team member shall not have a close business relationship with an audit client or its management unless the financial interest is immaterial and the business relationship is insignificant to the firm, the network firm or the audit team member, as the case may be, and the client or its management.

Comment [IESBA285]: 290.123

520.4 A1 Examples of a close business relationship arising from a commercial relationship or common financial interest include:

Comment [IESBA286]: 290.123

- Having a financial interest in a joint venture with either the client or a controlling owner, director, officer or other individual who performs senior managerial activities for that client.
- Arrangements to combine one or more services or products of the firm or a network firm with one or more services or products of the client and to market the package with reference to both parties.
- Distribution or marketing arrangements under which the firm or the network firm distributes or markets the client's products or services, or the client distributes or markets the firm's or the network firm's products or services.

Common Interests in Closely-Held Entities

R520.5 The firm, a network firm, an audit team member, or that individual's immediate family member shall not have a business relationship involving the holding of an interest in a closely-held entity when an audit client or a director or officer of the client, or any group thereof, also holds an interest in that entity, unless:

Comment [IESBA287]: 290.124

- (a) The business relationship is insignificant to the firm, the network firm, or the audit team member and the immediate family member, as the case may be, and the client;

- (b) The financial interest is immaterial to the investor or group of investors; and
- (c) The financial interest does not give the investor, or group of investors, the ability to control the closely-held entity.

Buying Goods or Services

520.6 A1 The purchase of goods and services from an audit client by a firm, a network firm, an audit team member, or that individual's immediate family member does not usually create a threat to independence if the transaction is in the normal course of business and at arm's length. However, such transactions might be of such a nature and magnitude that they create a self-interest threat.

Comment [IESBA288]: 290.125

520.6 A2 Examples of safeguards include:

- *Eliminating or reducing the magnitude of the transaction.*
- *Removing the individual from the audit team.*

Comment [IESBA289]: 290.125

Section 521

Family and Personal Relationships

Introduction

521.1 A family or personal relationship between an audit team member and a director or officer or other employees of the audit client (depending on their role) might create self-interest, familiarity or intimidation threats. Section 521 sets out requirements and application material on applying the conceptual framework to these family or personal relationships.

Comment [IESBA290]: 290.126

Requirements and Application Material

R521.2 A firm shall apply the conceptual framework set out in Section 120 to family and personal relationships.

Comment [IESBA291]: New paragraph

521.2 A1 The existence and significance of any threats created by family and personal relationships will depend on a number of factors, including the individual's responsibilities on the audit team, the role of the family member or other individual within the client and the closeness of the relationship.

Comment [IESBA292]: 290.126

Immediate Family of Audit Team Member

R521.3 An individual shall not participate as an audit team member when that individual's immediate family member:

Comment [IESBA293]: 290.127

- (a) Is a director or officer of the audit client;
- (b) Is an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion; or
- (c) Was in any such position during any period covered by the engagement or the financial statements.

521.3 A1 Threats to independence are created when an immediate family member of an audit team member is an employee in a position to exert significant influence over the client's financial position, financial performance or cash flows.

Comment [IESBA294]: 290.128

The significance of the threats will depend on factors such as:

- The position held by the immediate family member.
- The role of the professional on the audit team.

521.3 A2 Examples of safeguards include:

Comment [IESBA295]: 290.128

- Removing the individual from the audit team.
- Structuring the responsibilities of the audit team so that the professional does not deal with matters that are within the responsibility of the immediate family member.

Close Family of Audit Team Member

521.4 A1 Threats to independence are created when a close family member of an audit team member is:

Comment [IESBA296]: 290.129

- (a) A director or officer of the audit client; or
- (b) An employee in a position to exert significant influence over the preparation of:
 - (i) The client's accounting records; or
 - (ii) The financial statements on which the firm will express an opinion.

The significance of the threats will depend on factors such as:

- The nature of the relationship between the audit team member and the close family member.
- The position held by the close family member.
- The role of the professional on the audit team.

521.4 A2 Examples of safeguards include:

Comment [IESBA297]: 290.129

- Removing the individual from the audit team.
- Structuring the responsibilities of the audit team so that the professional does not deal with matters that are within the responsibility of the close family member.

Other Close Relationships of Audit Team Member

R521.5 An audit team member shall consult in accordance with firm policies and procedures if the audit team member has a close relationship with an individual who is not an immediate or close family member, but who is:

Comment [IESBA298]: 290.130

- (a) A director or officer; or
- (b) An employee in a position to exert significant influence over the preparation of:
 - (i) The client's accounting records; or
 - (ii) The financial statements on which the firm will express an opinion.

521.5 A1 The significance of the threats created by a relationship set out in paragraph R521.5 will depend on factors such as:

Comment [IESBA299]: 290.130

- The nature of the relationship between the individual and the audit team member.
- The position the individual holds with the client.
- The role of the professional on the audit team.

521.5 A2 Examples of safeguards include:

Comment [IESBA300]: 290.130

- Removing the professional from the audit team.

- *Structuring the responsibilities of the audit team so that the professional does not deal with matters that are within the responsibility of the individual with whom the professional has a close relationship.*

R521.6 Partners and employees of the firm shall consult in accordance with firm policies and procedures if they are aware of a personal or family relationship between:

Comment [IESBA301]: 290.131

- (a) A partner or employee of the firm who is not an audit team member; and
- (b) A director or officer of the audit client or an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

521.6 A1 The existence and significance of any threat will depend on factors such as:

Comment [IESBA302]: 290.131

- The nature of the relationship between the partner or employee of the firm and the director or officer or employee of the client;
- The interaction of the partner or employee of the firm with the audit team.
- The position of the partner or employee within the firm.
- The position the individual holds with the client.

521.6 A2 Examples of safeguards include:

Comment [IESBA303]: 290.131

- *Structuring the partner's or employee's responsibilities to reduce any potential influence over the audit engagement.*
- *Having a professional accountant review the relevant audit work performed.*

Section 522

Recent Service with an Audit Client

Introduction

522.1 Self-interest, self-review or familiarity threats might be created if an audit team member has recently served as a director or officer, or employee of the audit client. For example, an audit team member might have to evaluate elements of the financial statements when that individual prepared the relevant accounting records while with the client. Section 522 sets out requirements and application material on applying the conceptual framework in circumstances where audit team members have served with an audit client.

Comment [IESBA304]: 290.141

Requirements and Application Material

R522.2 A firm shall apply the conceptual framework set out in Section 120 when an audit team member has served recently with an audit client.

Comment [IESBA305]: New paragraph

R522.3 The audit team shall not include an individual who, during the period covered by the audit report:

Comment [IESBA306]: 290.142

- (a) Had served as a director or officer of the audit client; or
- (b) Was an employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

522.3 A1 Self-interest, self-review or familiarity threats might be created if, before the period covered by the audit report, an audit team member:

Comment [IESBA307]: 290.143

- (a) Had served as a director or officer of the audit client; or
- (b) Was an employee in a position to exert significant influence over the preparation of the client's accounting records or financial statements on which the firm will express an opinion.

For example, a threat would be created if a decision made or work performed by the individual in the prior period, while employed by the client, is to be evaluated in the current period as part of the current audit engagement.

522.3 A2 The existence and significance of any threats will depend on factors such as:

Comment [IESBA308]: 290.143

- The position the individual held with the client.
- The length of time since the individual left the client.
- The role of the professional on the audit team.

522.3 A3 An example of a safeguard is conducting a review of the work performed by the individual as an audit team member.

Comment [IESBA309]: 290.143

Section 523

Serving as a Director or Officer of an Audit Client¹⁹

Introduction

523.1 Self-review and self-interest threats are created if a partner or employee of the firm or a network firm serves as a director or officer of an audit client. Section 523 sets out requirements on applying the conceptual framework in these circumstances.

Comment [IESBA310]: 290.144

523.2 The position of Company Secretary has different implications in different jurisdictions. Duties might range from: administrative duties, such as personnel management and the maintenance of company records and registers; to duties as diverse as ensuring that the company complies with regulations or providing advice on corporate governance matters. Generally, this position is seen to imply a close association with the entity. (See also Section 600 and Subsections 601 and 602 in relation to providing non-assurance services to an audit client).

Comment [IESBA311]: 290.145

Requirements

R523.3 A partner or employee of the firm or a network firm shall not serve as a director or officer of an audit client of the firm.

Comment [IESBA312]: 290.144

R523.4 A partner or employee of the firm or a network firm shall not serve as Company Secretary for an audit client of the firm, unless:

Comment [IESBA313]: 290.146

- (a) This practice is specifically permitted under local law, professional rules or practice;
- (b) Management makes all relevant decisions; and
- (c) The duties and activities performed are limited to those of a routine and administrative nature, such as preparing minutes and maintaining statutory returns.

A firm shall apply the conceptual framework set out in Section 120 if a partner or employee of the firm or a network firm performs those duties and activities for an audit client.

¹⁹

This draft reflects the amended provisions related to non-assurance services taking effect April 2016

Section 524

Employment with an Audit Client

Introduction

524.1 An employment relationship between a former partner or employee of a firm and an audit client might create familiarity or intimidation threats. In particular, such threats might be created if any of the following individuals have been an audit team member or partner of the firm:

Comment [IESBA314]: 290.132

- A director or officer of the audit client.
- An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

Section 524 sets out requirements and application material on applying the conceptual framework to these employment relationships.

Requirements and Application Material

R524.2 A firm shall apply the conceptual framework set out in Section 120 to employment with an audit client.

Comment [IESBA315]: New paragraph

R524.3 The firm shall ensure that no significant connection remains between the firm and:

Comment [IESBA316]: 290.133

- A former partner who joins an audit client of the firm; or
- A former audit team member who joins the audit client, if either has joined the audit client as:
 - (a) A director or officer; or
 - (b) An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

524.3 A1 A significant connection remains between the firm and the individual, unless:

Comment [IESBA317]: 290.133

- (a) The individual is not entitled to any benefits or payments from the firm that are not made in accordance with fixed pre-determined arrangements;
- (b) Any amount owed to the individual is not material to the firm; and
- (c) The individual does not continue to participate or appear to participate in the firm's business or professional activities.

524.3 A2 If one of those individuals joins the audit client in such a position and no significant connection remains between the firm and the individual, the existence and significance of any familiarity or intimidation threats created will depend on factors such as:

Comment [IESBA318]: 290.134

- The position the individual has taken at the client.
- Any involvement the individual will have with the audit team.

- The length of time since the individual was an audit team member or partner of the firm.
- The former position of the individual within the audit team or firm. An example includes whether the individual was responsible for maintaining regular contact with the client's management or those charged with governance.

524.3 A3 *Examples of safeguards include:*

- *Modifying the audit plan.*
- *Assigning individuals to the audit team who have sufficient experience in relation to the individual who has joined the client.*
- *Having a professional accountant review the work of the former audit team member.*

Comment [IESBA319]: 290.134

524.3 A4 The requirement to apply the conceptual framework also applies if, prior to an entity becoming a client of the firm, a former partner of the firm has joined the entity as:

Comment [IESBA320]: 290.135

- A director or officer; or
- An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion.

R524.4 A firm shall:

Comment [IESBA321]: 290.136

- Have policies and procedures that require audit team members to notify the firm when entering employment negotiations with an audit client; and
- On receiving such notification, apply the conceptual framework.

524.4 A1 A self-interest threat is created when an audit team member participates in the audit engagement while knowing that the audit team member will, or might, join the client at some time in the future.

Comment [IESBA322]: 290.136

524.4 A2 *Examples of safeguards include:*

- *Removing the individual from the audit team.*
- *Reviewing any significant judgments made by that individual while on the team.*

Comment [IESBA323]: 290.136

Audit Clients that are Public Interest Entities

Key Audit Partners

R524.5 If an individual who was a key audit partner joins an audit client of the firm that is a public interest entity as:

Comment [IESBA324]: 290.137

- A director or officer; or
- An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion,

independence is compromised, unless subsequent to the partner ceasing to be a key audit partner:

- (a) The public interest entity has issued audited financial statements covering a period of not less than twelve months; and
- (b) The partner was not an audit team member with respect to the audit of those financial statements.

Chief Executive of the Firm

R524.6 If an individual who was the Chief Executive, or equivalent, of the firm joins an audit client that is a public interest entity as:

Comment [IESBA325]: 290.138

- (a) A director or officer; or
- (b) An employee in a position to exert significant influence over the preparation of the client's accounting records or the financial statements on which the firm will express an opinion,

independence is compromised, unless twelve months have passed since the individual was the Chief Executive or equivalent of the firm.

Business Combinations

524.7 A1 Independence is not compromised if the circumstances set out in paragraphs R524.5 and R524.6 arise as a result of a business combination and:

Comment [IESBA326]: 290.139

- (a) The position was not taken in contemplation of the business combination;
- (b) Any benefits or payments due to the former partner from the firm have been settled in full, unless made in accordance with fixed pre-determined arrangements and any amount owed to the partner is not material to the firm;
- (c) The former partner does not continue to participate or appear to participate in the firm's business or professional activities; and
- (d) The firm discusses the position held with the audit client by the former partner with those charged with governance.

Section 525

Temporary Personnel Assignments

Introduction

525.1 The loan of personnel by a firm or a network firm to an audit client might create a self-review threat. Section 525 sets out requirements and application material on applying the conceptual framework to loans of firm personnel to an audit client.

Comment [IESBA327]: 290.140

Requirements and Application Material

R525.2 A firm shall apply the conceptual framework set out in Section 120 to temporary personnel assignments.

Comment [IESBA328]: New paragraph

525.2 A1 *Examples of safeguards that might be available to address a threat created by the loan of personnel by a firm or a network firm to an audit client include:*

Comment [IESBA329]: 290.140

- *Conducting an additional review of the work performed by the loaned personnel.*
- *Not including the loaned personnel as an audit team member.*
- *Not giving the loaned personnel audit responsibility for any function or activity that the personnel performed during the loaned personnel assignment.*

R525.3 A firm or network firm shall not loan personnel to an audit client unless:

Comment [IESBA330]: 290.140

- (a) Such assistance is provided only for a short period of time; and
- (b) The personnel are not involved in:
 - (i) Providing non-assurance services that would not be permitted under C1; or
 - (ii) Assuming management responsibilities.

In all circumstances, the audit client is responsible for directing and supervising the activities of the loaned personnel.

GLOSSARY²⁰

In the *International Code of Ethics Standards for Professional Accountants*, the singular shall be construed as including the plural as well as the reverse, and the following expressions have the following meanings assigned to them.

Acceptable level ²¹	A level at which a reasonable and informed third party would likely conclude that the professional accountant complies with the fundamental principles.
	<i>This term is described in Section 120.6 A1</i>
Advertising	The communication to the public of information as to the services or skills provided by professional accountants in public practice with a view to procuring professional business.
Assurance client	The responsible party that is the person (or persons) who: <ul style="list-style-type: none"> (a) In a direct reporting engagement, is responsible for the subject matter; or (b) In an assertion-based engagement, is responsible for the subject matter information and may be responsible for the subject matter.
Assurance engagement	An engagement in which a professional accountant in public practice expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. <p><i>(For guidance on assurance engagements, see the <i>International Framework for Assurance Engagements</i> issued by the International Auditing and Assurance Standards Board. The <i>International Framework for Assurance Engagements</i> describes the elements and objectives of an assurance engagement and identifies engagements to which <i>International Standards on Auditing</i> (ISAs), <i>International Standards on Review Engagements</i> (ISREs) and <i>International Standards on Assurance Engagements</i> (ISAEs) apply.)</i></p>
Assurance team	<ul style="list-style-type: none"> (a) All members of the engagement team for the assurance engagement; (b) All others within a firm who can directly influence the outcome of the assurance engagement, including: <ul style="list-style-type: none"> (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the assurance engagement partner in connection with the performance of the assurance engagement;

²⁰ In this Glossary; defined terms are shown in regular font; italics are used for terms which have a specific meaning in certain Parts of the Code or for additional explanations of defined terms; references are also provided to terms described in the Code.

²¹ This definition has been shaded in gray as it is included in the Safeguards ED.

- (ii) Those who provide consultation regarding technical or industry specific issues, transactions or events for the assurance engagement; and
- (iii) Those who provide quality control for the assurance engagement, including those who perform the engagement quality control review for the assurance engagement.

Audit *In C1, the term “audit” includes “review engagement.”*

Comment [IESBA331]: 290.3

Audit client An entity in respect of which a firm conducts an audit engagement. When the client is a listed entity, audit client will always include its related entities. When the audit client is not a listed entity, audit client includes those related entities over which the client has direct or indirect control. (See also R400.11.)

In C1, “audit client” includes “review client.”

Comment [IESBA332]: 290.3

Audit engagement A reasonable assurance engagement in which a professional accountant in public practice expresses an opinion whether financial statements are prepared, in all material respects, (or give a true and fair view or are presented fairly, in all material respects,) in accordance with an applicable financial reporting framework, such as an engagement conducted in accordance with International Standards on Auditing. This includes a Statutory Audit, which is an audit required by legislation or other regulation.

In C1, “audit engagement” includes “review engagement.”

Comment [IESBA333]: 290.3

Audit report *In C1, “audit report” includes “review report.”*

Comment [IESBA334]: 290.3

- Audit team
- (a) All members of the engagement team for the audit engagement;
 - (b) All others within a firm who can directly influence the outcome of the audit engagement, including:
 - (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the engagement partner in connection with the performance of the audit engagement, including those at all successively senior levels above the engagement partner through to the individual who is the firm’s Senior or Managing Partner (Chief Executive or equivalent);
 - (ii) Those who provide consultation regarding technical or industry-specific issues, transactions or events for the engagement; and
 - (iii) Those who provide quality control for the engagement, including those who perform the engagement quality control review for the engagement; and
 - (c) All those within a network firm who can directly influence the outcome of the audit engagement.

In C1, "audit team" includes "review team."

Comment [IESBA335]: 290.3

Close family	A parent, child or sibling who is not an immediate family member.
Conceptual Framework	<i>This term is described in Section 120.</i>
Contingent fee	A fee calculated on a predetermined basis relating to the outcome of a transaction or the result of the services performed by the firm. A fee that is established by a court or other public authority is not a contingent fee.
Direct financial interest	<p>A financial interest:</p> <ul style="list-style-type: none"> (a) Owned directly by and under the control of an individual or entity (including those managed on a discretionary basis by others); or (b) Beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has control, or the ability to influence investment decisions.
Director or officer	Those charged with the governance of an entity, or acting in an equivalent capacity, regardless of their title, which may vary from jurisdiction to jurisdiction.
Engagement partner	The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.
Engagement Period	The engagement period starts when the audit team begins to perform audit services. The engagement period ends when the audit report is issued. When the engagement is of a recurring nature, it ends at the later of the notification by either party that the professional relationship has terminated or the issuance of the final audit report.
Engagement quality control review	A process designed to provide an objective evaluation, on or before the report is issued, of the significant judgments the engagement team made and the conclusions it reached in formulating the report.
Engagement team	<p>All partners and staff performing the engagement, and any individuals engaged by the firm or a network firm who perform assurance procedures on the engagement. This excludes external experts engaged by the firm or by a network firm.</p> <p>The term "engagement team" also excludes individuals within the client's internal audit function who provide direct assistance on an audit engagement when the external auditor complies with the requirements of ISA 610 (Revised 2013), <i>Using the Work of Internal Auditors</i>.</p>
Existing accountant	A professional accountant in public practice currently holding an audit appointment or carrying out accounting, taxation, consulting or similar professional services for a

Comment [IESBA336]: 290.30

client.

External expert	An individual (who is not a partner or a member of the professional staff, including temporary staff, of the firm or a network firm) or organization possessing skills, knowledge and experience in a field other than accounting or auditing, whose work in that field is used to assist the professional accountant in obtaining sufficient appropriate evidence.										
Financial interest	An interest in an equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.										
Financial statements	A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term can relate to a complete set of financial statements, but it can also refer to a single financial statement, for example, a balance sheet, or a statement of revenues and expenses, and related explanatory notes.										
Financial statements on which the firm will express an opinion	In the case of a single entity, the financial statements of that entity. In the case of consolidated financial statements, also referred to as group financial statements, the consolidated financial statements.										
Firm	<ul style="list-style-type: none"> (a) A sole practitioner, partnership or corporation of professional accountants; (b) An entity that controls such parties, through ownership, management or other means; and (c) An entity controlled by such parties, through ownership, management or other means. 										
Fundamental Principles	<p style="text-align: right;"><i>These terms are described in paragraphs:</i></p> <table border="0" style="width: 100%;"> <tr> <td style="padding-right: 20px;"><i>Integrity</i></td> <td><i>R111.1</i></td> </tr> <tr> <td><i>Objectivity</i></td> <td><i>R112.1</i></td> </tr> <tr> <td><i>Professional competence and due care</i></td> <td><i>R113.1</i></td> </tr> <tr> <td><i>Confidentiality</i></td> <td><i>R114.1</i></td> </tr> <tr> <td><i>Professional behavior</i></td> <td><i>R115.2</i></td> </tr> </table>	<i>Integrity</i>	<i>R111.1</i>	<i>Objectivity</i>	<i>R112.1</i>	<i>Professional competence and due care</i>	<i>R113.1</i>	<i>Confidentiality</i>	<i>R114.1</i>	<i>Professional behavior</i>	<i>R115.2</i>
<i>Integrity</i>	<i>R111.1</i>										
<i>Objectivity</i>	<i>R112.1</i>										
<i>Professional competence and due care</i>	<i>R113.1</i>										
<i>Confidentiality</i>	<i>R114.1</i>										
<i>Professional behavior</i>	<i>R115.2</i>										
Historical financial	Information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time										

information	periods or about economic conditions or circumstances at points in time in the past.
Immediate family	A spouse (or equivalent) or dependent.
Independence	<p>Independence comprises:</p> <p>(a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity, and exercise objectivity and professional skepticism.</p> <p>(b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm’s, or a member of the audit or assurance team’s, integrity, objectivity or professional skepticism has been compromised.</p> <p><i>The relationship of independence to objectivity is described in paragraphs 112.3 A1 and 400.1.</i></p>
Indirect financial interest	A financial interest beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has no control or ability to influence investment decisions.
Key audit partner	The engagement partner, the individual responsible for the engagement quality control review, and other audit partners, if any, on the engagement team who make key decisions on judgments on significant matters with respect to the audit of the financial statements on which the firm will express an opinion. Depending upon the circumstances and the role of the individuals on the audit, “other audit partners” may include, for example, audit partners responsible for significant subsidiaries or divisions.
Listed entity	An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.
Network	<p>A larger structure:</p> <p>(a) That is aimed at co-operation; and</p> <p>(b) That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand-name, or a significant part of professional resources.</p>
Network firm	<p>A firm or entity that belongs to a network.</p> <p><i>For further information see Subsection 401.</i></p>

Office	A distinct sub-group, whether organized on geographical or practice lines.
Professional accountant	<p>An individual who is a member of an IFAC member body.</p> <p><i>In Part A, the term “professional accountant” refers to professional accountants in business and to professional accountants in public practice and their firms.</i></p> <p><i>In Part B, the term “professional accountant” refers to professional accountants in business.</i></p> <p><i>In Part C, the term “professional accountant” refers to professional accountants in public practice and their firms.</i></p>
Professional accountant in business	A professional accountant employed or engaged in an executive or non-executive capacity in such areas as commerce, industry, service, the public sector, education, the not-for-profit sector, regulatory bodies or professional bodies, or a professional accountant contracted by such entities.
Professional accountant in public practice	<p>A professional accountant, irrespective of functional classification (for example, audit, tax or consulting) in a firm that provides professional services.</p> <p><i>This term is also used to refer to a firm of professional accountants in public practice.</i></p>
Professional activity	An activity requiring accountancy or related skills undertaken by a professional accountant, including accounting, auditing, taxation, management consulting, and financial management.
Professional services	Professional activities performed for clients.
Public interest entity	<p>(a) A listed entity; and</p> <p>(b) An entity:</p> <p style="padding-left: 20px;">(i) Defined by regulation or legislation as a public interest entity; or</p> <p style="padding-left: 20px;">(ii) For which the audit is required by regulation or legislation to be conducted in compliance with the same independence requirements that apply to the audit of listed entities. Such regulation may be promulgated by any relevant regulator, including an audit regulator.</p> <p><i>Other entities might also be considered to be public interest entities, as set out in paragraph 400.6.</i></p>
Reasonable and Informed Third Party	The reasonable and informed third party is a concept which involves a hypothetical person. Such person possesses skills, knowledge and experience to objectively evaluate the appropriateness of the professional accountant’s judgements and conclusions. This evaluation entails weighing all the relevant facts and circumstances that the professional accountant knows, or could reasonably be expected to know, at

Comment [IESBA337]: New sentences

the time that the evaluation is made, to determine whether the professional accountant has complied with the fundamental principles.

This term is described in paragraph 120.4 A1

Related entity	<p>An entity that has any of the following relationships with the client:</p> <ul style="list-style-type: none"> (a) An entity that has direct or indirect control over the client if the client is material to such entity; (b) An entity with a direct financial interest in the client if that entity has significant influence over the client and the interest in the client is material to such entity; (c) An entity over which the client has direct or indirect control; (d) An entity in which the client, or an entity related to the client under (c) above, has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity in (c); and (e) An entity which is under common control with the client (a "sister entity") if the sister entity and the client are both material to the entity that controls both the client and sister entity.
Review client	An entity in respect of which a firm conducts a review engagement.
Review engagement	An assurance engagement, conducted in accordance with International Standards on Review Engagements or equivalent, in which a professional accountant in public practice expresses a conclusion on whether, on the basis of the procedures which do not provide all the evidence that would be required in an audit, anything has come to the accountant's attention that causes the accountant to believe that the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework.
Review team	<ul style="list-style-type: none"> (a) All members of the engagement team for the review engagement; and (b) All others within a firm who can directly influence the outcome of the review engagement, including: <ul style="list-style-type: none"> (i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the engagement partner in connection with the performance of the review engagement, including those at all successively senior levels above the engagement partner through to the individual who is the firm's Senior or Managing Partner (Chief Executive or equivalent); (ii) Those who provide consultation regarding technical or industry specific issues, transactions or events for the engagement; and (iii) Those who provide quality control for the engagement, including those who

perform the engagement quality control review for the engagement; and

- (c) All those within a network firm who can directly influence the outcome of the review engagement.

Safeguards *This term is described in paragraph 120.7 A2*

Special purpose financial statements Financial statements prepared in accordance with a financial reporting framework designed to meet the financial information needs of specified users.

Those charged with governance The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities in some jurisdictions, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.

Threats *These terms are described in paragraphs:*

- Self Interest* 120.5 A2(a) & 300.2 A1(a)
- Self-review* 120.5 A2(b) & 300.2 A1(b)
- Advocacy* 120.5 A2(c) & 300.2 A1(c)
- Familiarity* 120.5 A2(d) & 300.2 A1(d)
- Intimidation* 120.5 A2(e) & 300.2 A1(e)

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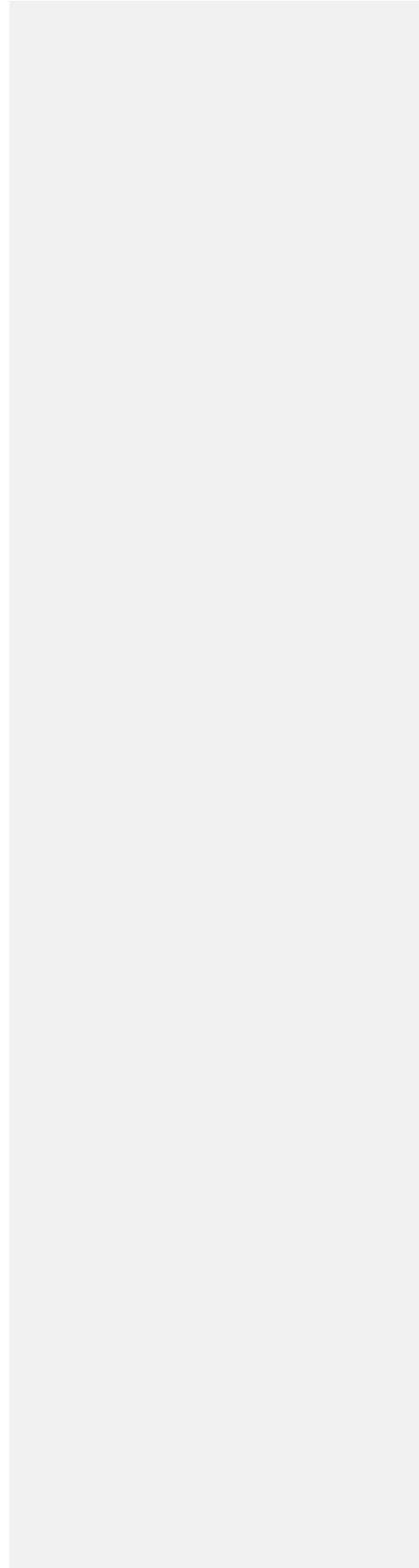
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IFAC Convergence – Proposed Revisions Pertaining to Safeguards in the Code – Phase I

Task Force:

Sam Burke, Rick David, Jana Dupree, Brian Lynch, and Larry Shapiro, Staff: Jason Evans. Observer: Lisa Snyder.

Task Force Objective:

To draft a comment letter on behalf of the PEEC in response to the IESBA exposure draft.

Reason for Agenda Item

The PEEC is asked to read the exposure draft entitled “Proposed Revisions Pertaining to Safeguards in the Code – Phase I” (ED) as issued by the International Ethics Standards for Board for Professional Accountants (IESBA).

Introduction

In December 2015, the IESBA released the ED with comments due on March 21, 2016. The Board heard regulatory concerns that safeguards included in the IESBA Code were not appropriate or were ineffective. For example, it was noted that some safeguards merely duplicate existing requirements imposed by the quality control standards. It was suggested that the IESBA should:

- Better correlate a safeguard with the threat;
- Clarify safeguards that are not clear and eliminate those that are not appropriate; and
- Clarify that not every threat can be addressed by a safeguard.

Overview of the Revisions Pertaining to Safeguards

Highlights from the revisions pertaining to safeguards include the following points noted below.

Section 120 pertaining to safeguards has been reorganized structurally and some of the proposed enhancements include the following:

- Conceptual framework
 - o Introduction
- Requirements and application material
 - o Reasonable and informed third party – proposed revised description. The newly proposed description was drafted to clarify that the test is intended to prompt an objective evaluation of the professional accountant’s judgments and conclusions given the facts available at the time as to compliance with the fundamental principles. The description is as follows:
 - The concept of a reasonable and informed third party is a test which involves an evaluation by a hypothetical person. Such a person possesses skills, knowledge and experience to objectively evaluate the appropriateness of the professional accountant’s judgments and conclusions. This evaluation entails weighing all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time that the evaluation is made to determine whether the accountant complies with the fundamental principles.
 - o Identifying threats – the proposed revised application material more clearly describes factors that may present threats to compliance with the fundamental

-
- principles and more clearly articulates that the identification supports compliance with the fundamental principles.
- Evaluating threats – the proposed application material has been revised to better describe the process by which a professional accountant should evaluate threats.
 - Addressing threats – the Board concluded that the term “safeguards” is used inconsistently in the extant IESBA Code. Thus, it is proposed that the term “safeguards” is only used to describe actions a professional accountant takes to address threats to compliance with the fundamental principles as follows:
 - Safeguards are actions, individually or in combination, that the professional accountant takes that effectively eliminate threats to compliance with the fundamental principles or reduce them to an acceptable level.

Considering the description of a safeguard, the Board is proposing to remove the following terms, as, they do not meet the description of a safeguard:

- Safeguards created by the profession or legislation;
- Safeguards in the work environment; and
- Safeguards implemented by the entity.

There is also a more robust requirement noting specific actions that a professional accountant must take when it is determined that threats to compliance with the fundamental principles are not at an acceptable level. The requirement was built on paragraph 100.9 of the extant IESBA Code and can be seen in proposed paragraph R120.7.

- Re-evaluating threats – The Board recognizes that acts and circumstances may change over the course of time and thus, the IESBA proposes a new requirement for the professional accountant to re-evaluate and address threats when new information becomes available, or when there are changes in facts or circumstances.
- Overall assessment – The Board included a new requirement for the professional accountant to perform an overall assessment by reviewing the judgments made and overall conclusions reached.

Other proposals include the following:

- The Board proposes a new description of a reasonable and informed third party which is intended to clarify that the test is intended to prompt an objective evaluation of the professional accountant’s judgments and conclusions given the facts available at the time as to compliance with the fundamental principles. The new description is as follows:
 - The concept of a reasonable and informed third party is a test which involves an evaluation by a hypothetical person. Such a person possesses skills, knowledge and experience to objectively evaluate the appropriateness of the professional accountant’s judgments and conclusions. This evaluation entails weighing all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time that the evaluation is made to determine whether the accountant complies with the fundamental principles.
- The proposed revision to the definition of “acceptable level” includes the following:
 - Definition is included in the main body of the IESBA Code to give it more prominence; and
 - Definition is revised to be more affirmative. The proposed definition states that “[a]n acceptable level is a level at which a reasonable and informed third party would

likely conclude that the professional accountant complies with the fundamental principles.”

Action Needed:

The PEEC is asked to read the exposure draft as found in Agenda Item 7D and provide feedback and comments for the comment letter.

Materials Presented

Agenda Item 7D – IESBA exposure draft: Proposed Revisions Pertaining to Safeguards in the Code– Phase I

Exposure Draft

December 2015

Comments due: March 21, 2016

*International Ethics Standards Board for
Accountants®*

**Proposed Revisions
Pertaining to Safeguards in
the Code—Phase 1**

IESBA

International
Ethics Standards
Board for Accountants®



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

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

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

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REQUEST FOR COMMENTS

This Exposure Draft, *Proposed Revisions Pertaining to Safeguards in the Code—Phase 1*, was developed and approved by the International Ethics Standards Board for Accountants® (IESBA®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by March 21, 2016.**

Respondents are asked to submit their comments electronically through the IESBA website, using the "[Submit a Comment](#)" link. Please submit comments in both PDF and Word files. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. Although IESBA prefers that comments are submitted via its website, comments can also be sent to Ken Siong, IESBA Technical Director at KenSiong@ethicsboard.org.

This publication may be downloaded from the IESBA website: www.ethicsboard.org. The approved text is published in the English language.

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EXPLANATORY MEMORANDUM

Introduction

1. This memorandum provides background to, and an explanation of, the proposed changes to the International Ethics Standards Board for Accountants (IESBA or the Board) *Code of Ethics for Professional Accountants* (the Code) in Section 100¹ and Section 200² of the extant Code (numbered proposed Sections 120 and 300 in the [restructured Code](#)³) pertaining to safeguards (herein referred to as the exposure draft (ED)). The Board approved these proposed changes for exposure at its November/December 2015 meeting.

Background

2. During its most recent consultation in developing its *Strategy and Work Plan 2014-2018*, the Board heard of regulatory concerns that certain safeguards identified in the Code may be inappropriate or ineffective. For example, it was suggested that some safeguards merely duplicate existing requirements imposed by quality control and auditing standards or the existing best practice for situations that do not involve a threat to independence. It was suggested that the Board should (a) bring clarity to safeguards that are not clear and eliminate those that are inappropriate, (b) better correlate a safeguard with the threat it is intended to address, and (c) make clear that not every threat can be addressed by a safeguard. In addition, some within the small and medium practices (SMP) community have expressed support for the Board to review the safeguards in the Code given the practical challenges SMPs tend to face from having limited resources, including numbers of partners.
3. The Board therefore determined to undertake this project with the aim of improving the clarity, appropriateness, and effectiveness of the safeguards in the Code. This ED has been developed under Phase I of the project.
4. This phase deals with a review of the conceptual framework and the sections relating to its general application for all professional accountants, as well as for professional accountants in public practice (i.e., proposed revisions to Sections 100 and 200 of the extant Code only). Through enhanced clarity and more robust application material relating to the conceptual framework, the proposals in the ED are aimed at further promoting the appropriate use of the conceptual framework among all professional accountants to comply with the fundamental principles of the Code. The Board believes that its proposals, which also include more robust application material to explain threats to compliance with the fundamental principles, will support professional accountants in fulfilling their responsibility to act in the public interest, and with respect to audits of financial statements, contribute to supporting audit quality.

Phase II

5. Informed by feedback from respondents on this ED, the Board plans to consider potential revisions to other sections of the extant Code with respect to safeguards as part of Phase II of the project. During this second phase, the Board will:
 - (a) Review the clarity, appropriateness and effectiveness of safeguards that pertain to non-

¹ Extant Section 100, *Introduction and Fundamental Principles*

² Extant Section 200, *Introduction* (Part B – Professional Accountants in Public Practice)

³ See Exposure Draft, [Improving the Structure of the Code of Ethics for Professional Accountants—Phase 1](#).

- assurance services (NAS) in extant Section 290 of the Code;⁴
- (b) Review the conceptual framework approach to independence,⁵ in light of the proposed revised description of the conceptual framework in proposed Section 120;
 - (c) Consider whether there is a need for alignment to the requirements and application material in ISA 220⁶ with respect to documentation of safeguards in the context of audits of financial statements; and
 - (d) Update other areas in the Code based on new terminology or revised concepts developed under the first phase of the project.
6. As part of this phase, the Board will consider, as appropriate, the unique challenges faced by the SMP sector in employing safeguards.
 7. As part of its future work, the Board plans to continue to consider whether additional guidance is needed in the Code to explain the differences in the evaluation of whether a threat is at an acceptable level for a public interest entity (PIE) and an entity that is not a PIE.
 8. In developing this ED, the Board agreed to apply the proposed structure and drafting conventions developed under its Structure of the Code project. See the [Safeguards Mapping Table](#). This Mapping Table is intended to assist respondents understand the proposed revisions to the extant Code.

Significant Matters

Public Interest Issues Addressed by this Project	
9.	<p>The Board believes that there are public interest benefits to be derived from its proposals because of the improved correlation between threats, safeguards and the fundamental principles. The proposed revisions:</p> <ul style="list-style-type: none"> (a) Include a strengthened emphasis on the requirements in the Code for professional accountants (including those in public practice) to: <ul style="list-style-type: none"> (i) Comply with the fundamental principles, rather than simply complying with specific requirements in the Code. The fundamental principles are not simply background information but establish the overarching objectives professional accountants are required to meet; and (ii) Apply the conceptual framework, which involves identifying, evaluating and addressing threats to compliance with the fundamental principles. The proposed revisions relating to the conceptual framework retain the principles-based approach in the extant Code, and continue to emphasize the need for professional accountants to exercise professional judgment in applying the conceptual framework. (b) Establish a new requirement and corresponding application material for the professional accountant to re-evaluate threats to compliance with the fundamental principles when the professional accountant becomes aware of new information or if there are changes in facts and circumstances that might impact whether a threat has been eliminated or reduced to an

⁴ Extant paragraphs 290.154–290.216

⁵ Extant paragraphs 290.14–290.12 and 291.4–291.11, *The Conceptual Framework Approach to Independence*; 290.100–290.101 and 291.100–291.101, *Application of the Conceptual Framework Approach to Independence*

⁶ International Standard on Auditing (ISA) 220, *Quality Control for an Audit of Financial Statements*

acceptable level.

- (c) Introduce a new requirement for the professional accountant to do an overall assessment by reviewing judgments made and overall conclusions reached to determine that threats to compliance with the fundamental principles are eliminated, or reduced to an acceptable level and that no further action is needed.
- (d) Provide a revised definition of the term “acceptable level” that explains, in an affirmative manner, what it means. This relates to the professional accountant’s evaluation of whether a threat to the fundamental principles is at an acceptable level and the requirements to address a threat that is not at an acceptable level by eliminating it or reducing it to an acceptable level.
- (e) Provide an enhanced description of, and more application material on, the “reasonable and informed third party” test. The professional accountant is required to perform a reasonable and informed third party test, as part of applying the conceptual framework, by taking into account whether such a third party would likely conclude that the professional accountant has complied with the fundamental principles. The proposals emphasize the importance of, and give more prominence to, the reasonable and informed third party test as part of evaluating and addressing threats.
- (f) Clarify what constitutes a safeguard. In particular, actions are safeguards only when they are effective in eliminating threats to compliance with the fundamental principles or reducing them to an acceptable level; and
- (g) Include enhanced application material that:
 - (i) Clarifies the types of threats to compliance with the fundamental principles; and
 - (ii) Better explains that certain conditions, policies and procedures are likely to assist professional accountants in evaluating the level of threats to compliance with the fundamental principles.

10. In addition, the proposals:

- (a) Build on the requirement in the extant Code for the professional accountant to decline or discontinue the specific professional activity when safeguards are not available, or cannot be applied by introducing a new, more robust requirement that better explains the actions the professional accountant should take to address threats.
- (b) Improve the examples provided on safeguards by more clearly linking them to the relevant threats to the fundamental principles.
- (c) Clarify that certain conditions, policies and procedures established by the profession, legislation, regulation, the firm or the employing organization are not regarded as safeguards (e.g., educational, training and experience requirements for the profession).

11. The remainder of this Explanatory Memorandum further explains each of the above proposed improvements to the Code with respect to safeguards.

Proposed Enhancements to the Conceptual Framework

Applicability of the Conceptual Framework and Approach Used to Develop the Proposals

12. Section 100 of the extant Code includes provisions that are applicable to all professional accountants and which address their responsibility to apply the conceptual framework in order to comply with the fundamental principles. Other sections of the extant Code (e.g., Section 200, in the case of professional accountants in public practice, and the provisions in Section 290 dealing with NAS) build

on Section 100 of the extant Code and provide more engagement-specific or service-specific guidance. The Board has agreed to retain this approach.

13. Accordingly, the proposed requirements and application material in proposed Section 120 pertaining to safeguards are applicable to all professional accountants, and are incorporated by reference in proposed Section 300 and therefore not repeated. Thus, proposed Section 300 includes revised application material for the appropriate application of the conceptual framework by professional accountants in public practice.
14. In developing proposed Section 120 pertaining to safeguards, the Board agreed to re-organize the conceptual framework in the extant Code as outlined below:
 - The Conceptual Framework
 - Introduction
 - Requirements and Application Material
 - Reasonable and Informed Third Party
 - Identifying Threats
 - Evaluating Threats
 - Addressing Threats
 - Re-evaluating Threats
 - Overall Assessment

Requirement to Apply the Conceptual Framework

15. The Board's proposals include a more explicit overarching requirement for all professional accountants to apply the conceptual framework to eliminate threats to compliance with the fundamental principles or reduce them to an acceptable level (see paragraph R120.3). The proposals also include a more extensive introduction that better explains that the conceptual framework is an approach, required by the Code, for professional accountants to identify, evaluate and address⁷ threats to compliance with the fundamental principles (see paragraphs 120.1–120.2).
16. The Board considered having only the overarching requirement described above, supported by corresponding application material to explain how professional accountants should apply the conceptual framework. However, on advice from its Consultative Advisory Group (CAG), the Board agreed that it is important to also establish explicit requirements and application material with respect to identifying, evaluating, addressing and re-evaluating threats in the Code as a way of giving more prominence to each of these steps (see paragraphs R120.5–R120.8; 120.5 A1 – 120.5 A4; 120.6 A1 – 120.6 A3; 120.7 A1 – 120.7 A2; and 120.8 A1 – 120.8 A2).

Overall Assessment

17. The Board felt it important to include—as part of, and not distinct from, the application of the conceptual framework—a new requirement for the professional accountant to perform an *overall* assessment by reviewing the judgments made and overall conclusions reached. Under the proposal,

⁷ Threats to compliance with the fundamental principles are addressed when they are eliminated, or reduced to an acceptable level.

the professional accountant is required to determine, through an objective lens, that threats to compliance with the fundamental principles are eliminated or reduced to an acceptable level, and that no further action is needed. The proposed requirement notes that the reasonable and informed third party test is relevant when performing the overall assessment (see paragraphs R120.9 and R120.4 A1).

Enhancing Consistency in the Terminology Used in the Code

18. The Board is of the view that the Code is clearer when terms are used in a consistent manner. Accordingly, in developing its proposals, the Board has sought to enhance the consistency in use of terms throughout the Code. Terms that were revisited as part of the Board's deliberations include:
 - (a) "Facts and circumstances," "circumstances and relationships," "facts, circumstances and relationships," and "interests and relationships." The Board agreed to use the term "facts and circumstances" in a broader context as an "umbrella" term, and the terms "...facts and circumstances, including professional activities (services), interests and relationships..." in situations where the Code requires a more specific reference or emphasis to "relationships" or "interests" (see paragraphs R120.5 and 300.1).
 - (b) Materiality and significance. Generally, the Board has not used the term "material" and "significant" or "significance" in proposed Sections 120 and 300. The Board believes that those terms, the meaning of which is consistent with the auditing concept of materiality as described in the ISAs, are not appropriate for establishing the overarching requirements and principles about threats and safeguards. However, the Board acknowledged that those terms may be relevant in the context of threats and safeguards relating to NAS, which the Board will consider under Phase II of this project.
19. The Board is of the view that the proposed changes relating to terminology will have implications for the rest of the Code and plans to consider potential conforming amendments in Phase II of the project.

Reasonable and Informed Third Party

20. The Board is of the view that applying the "reasonable and informed third party" concept is an important step established in the extant Code whereby the professional accountant considers whether there has been compliance with the fundamental principles.⁸ The ED clarifies this concept by proposing a more fulsome description of the term in paragraph 120.4 A1 as follows:

The concept of a reasonable and informed third party is a test which involves an evaluation by a hypothetical person. Such a person possesses skills, knowledge and experience to objectively evaluate the appropriateness of the professional accountant's judgments and conclusions. This evaluation entails weighing all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time that the evaluation is made to determine whether the accountant complies with the fundamental principles.
21. The proposed description of a "reasonable and informed third party" clarifies that the concept is a test intended to prompt an objective evaluation of the professional accountant's judgements and

⁸ Paragraphs 100.7 of the extant Code state that "..., 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 threats would be eliminated or reduced to an acceptable level by the application of the safeguards, such that compliance with the fundamental principles is not compromised."

conclusions. This evaluation takes into account all the relevant facts and circumstances that the professional accountant knows, or could be reasonably expected to know, at the time that the evaluation was made to determine whether the professional accountant complies with the fundamental principles.

22. The Board believes that its proposed description of a reasonable and informed third party supports professional accountants' appropriate application of the conceptual framework (i.e., in identifying, evaluating and addressing threats). The ED also provides practical guidance for how the reasonable and informed third party concept applies in re-evaluating threats and in performing the proposed required overall assessment explained above.
23. The Board has emphasized that the reasonable and informed third party is a hypothetical person (rather than an actual person). It is the Board's view that this hypothetical person should be competent and possess sufficient skills to objectively evaluate the appropriateness of the professional accountant's judgments and conclusions.

Identifying Threats

24. With respect to the identification of threats, the proposed revisions to the Code include a general discussion about threats, drawing from paragraphs 100.8 and 100.12 of the extant Code. The proposed revised application material describes the factors that may threaten compliance with the fundamental principles, and more clearly articulates that the identification of threats supports compliance with the fundamental principles (see paragraphs 120.5 A1 and 120.5 A2).
25. As part of its deliberations, the Board considered the threats listed in other national ethics codes, laws and regulations, including the way they were categorized. The Board ultimately concluded that the listing and categories of threats used in the extant Code remain appropriate.⁹

Conditions Policies and Procedures

26. The Board is proposing to withdraw the terms "safeguards created by the profession or legislation," "safeguards in the work environment" and "safeguards implemented by the entity" from the Code.
27. The Board accepts that there are conditions, policies and procedures that are established by the profession, legislation, regulation, the firm or employing organization that may impact the level of a threat to compliance with the fundamental principles. These conditions, policies and procedures can therefore affect the likelihood of identification of threats to compliance with the fundamental principles. Such conditions, policies and procedures, however, do not meet the revised description of "safeguards" (see discussion below). The Board has included examples of these conditions, policies and procedures in the ED (see paragraph 120.5 A4).

Evaluating Threats

28. The Board proposes to expand the application material in the extant Code¹⁰ to better describe the process by which professional accountants should evaluate threats. The Board believes that the conditions, policies and procedures (discussed above) might impact the professional accountant's evaluation of threats to compliance with the fundamental principles. Accordingly, the proposals include new application to this effect (see paragraph 120.6 A3).

⁹ See extant paragraph 100.12.

¹⁰ See extant paragraphs 100.8, 100.9, 100.14 and 100.16.

Revised Definition of Acceptable Level

29. The term “acceptable level” is critical to the proper understanding of the conceptual framework and the Code more broadly.¹¹ As a result, the Board accepted the advice of its CAG and proposes to:
 - (a) Include the definition of “acceptable level” (currently in the Glossary of the extant Code) in the main body of the Code to give this important term appropriate prominence; and
 - (b) Better explain, in an affirmative manner, what the term means. The proposed definition states that “[a]n acceptable level is a level at which a reasonable and informed third party would likely conclude that the professional accountant complies with the fundamental principles” (see paragraph 120.6 A1).
30. The Board acknowledges that the rest of the extant Code will need to be reviewed to ascertain the need for potential conforming changes. As noted in the Background section to this Explanatory Memorandum, the Board plans to undertake this review as part of Phase II of this project.

Addressing Threats

31. The Board observed inconsistencies in how the term “safeguards” is used in the extant Code. Specifically, the Board noted that there are instances where the term “safeguards” is intended to have a broad and conceptual meaning. In other instances, the term is used to more narrowly describe actions that the professional accountant undertakes to address threats to compliance with the fundamental principles. The Board proposes to discontinue using the term “safeguards” in its broader context. As discussed above, the Board is also proposing to withdraw the concepts of “safeguards created by the profession or legislation,” “safeguards in the work environment” and “safeguards implemented by the entity” from the Code.

Revised Description of Safeguards

32. In response to some of the concerns and suggestions raised by some stakeholders, the Board proposes a more robust description of safeguards in paragraph 120.7 A2 as follows:

Safeguards are actions, individually or in combination, that the professional accountant takes that effectively eliminate threats to compliance with the fundamental principles or reduce them to an acceptable level.
33. The Board is of the view that its proposed description of safeguards, together with the other proposed clarifications to the conceptual framework, establishes a stronger correlation between “threats and safeguards” and the fundamental principles in the Code.
34. Application of professional judgement continues to be a critical aspect of effectively applying safeguards. The professional accountant’s exercise of professional judgment is needed to determine

¹¹ The extant Code defines acceptable level as “A level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the professional accountant at that time, that compliance with the fundamental principles is not compromised.”

whether an action is a safeguard, and whether the safeguard remains appropriate to address the identified threat, if new information becomes available or if facts or circumstances change.

New Guidance for Addressing Threats to Compliance with the Fundamental Principles

35. The Board’s proposal builds on the principles in paragraph 100.9 of the extant Code¹² and establishes a more robust requirement that specifies the actions the professional accountant should take to address threats (see paragraph R120.7). The new requirement states that if the professional accountant determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, the accountant shall address the threats by eliminating or reducing them to an acceptable level by:
- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
 - (b) Applying safeguards, where available and capable of being applied; or
 - (c) Declining or discontinuing the specific professional activity or service involved.
36. New application material has also been included in the Code to note that there are some situations where the threat created would be so significant that no safeguards could reduce the threat to an acceptable level (see paragraph 120.7 A1).

Re-evaluating Threats

37. The Board acknowledges that facts and circumstances might change over time and new information about threats and the appropriateness of safeguards might come to the attention of the professional accountant that might either:
- (a) Impact the level of a threat; or
 - (b) Affect the professional accountant’s conclusions about whether safeguards applied continue to be appropriate to address identified threats.

Accordingly, the Board’s proposals include a new requirement for the professional accountant to re-evaluate and address threats when new information becomes available, or when there are changes in facts or circumstances (see paragraph R120.8).

38. This new requirement is supported by new application material which explains that if the professional accountant identifies a new threat, the application of the conceptual framework requires that the professional accountant evaluate and address the threat as set out in accordance with the requirements and application material pertaining to evaluating and addressing threats in paragraphs R120.5–R120.8 (see paragraph 120.8 A2).

Application of the Conceptual Framework by Professional Accountants in Public Practice

39. As part of its Structure of the Code project, the Board has clarified the scope of proposed Section

¹² Paragraph 100.9 of the extant Code states: “... When applying the conceptual framework, a professional accountant may encounter situations in which threats cannot be eliminated or reduced to an acceptable level, either because the threat is too significant or because appropriate safeguards are not available or cannot be applied. In such situations, the professional accountant shall decline or discontinue the specific professional activity or service involved or, when necessary, resign from the engagement (in the case of a professional accountant in public practice) or the employing organization (in the case of a professional accountant in business).”

300 to better describe how the conceptual framework set out in proposed Section 120 applies to professional accountants in public practice (see paragraph 300.1). As this paragraph provides important context to the Safeguards proposals, it is also repeated in this ED.

More Prominent Overarching Requirement for Professional Accountants in Public Practice

40. The Board believes that the professional accountant should apply the requirements in the conceptual framework to address threats to compliance with the fundamental principles. Accordingly, the ED includes a proposed requirement upfront in proposed Section 300 that requires the professional accountant to comply with each of the fundamental principles and apply the conceptual framework set out in proposed Section 120 (see paragraph R300.2).
41. Through the revised introduction discussed above, and better alignment with proposed Section 120, the Board intends to strengthen the provisions in the extant Code that address the application of the conceptual framework for professional accountants in public practice.

Enhanced Application Material for Professional Accountants in Public Practice

42. As noted above, the application material in proposed Section 300 has been improved and builds on, but does not repeat, the proposals in Section 120. For example, proposed new application material has been developed for professional accountants in public practice to explain the conditions that might impact the evaluation of whether a threat is at an acceptable level. Similarly, enhanced application material has been added to assist professional accountants in evaluating and addressing threats to compliance with the fundamental principles (see paragraphs 300.2 A2–300.2 A8).

Streamlined Examples of Threats and Safeguards

43. With a new lead-in, the inclusion of sub-headings and improved drafting, the Board has streamlined and thereby clarified the examples of the types of threats that are included in the extant Code¹³ (see paragraph 300.2 A1).
44. In response to concerns from certain stakeholders about the quality and usefulness of the examples of safeguards in the extant Code, the Board is proposing to:
 - (a) Clarify that certain matters formerly characterized as safeguards in the extant Code¹⁴ are in fact conditions that might impact the professional accountant's evaluation of whether a threat is at an acceptable level. Those conditions include the nature of the client and its operating environment; the professional service being provided, and the firm and its operating environment (see paragraph 300.2 A2).
 - (b) Streamline the list of examples of conditions in the work environment within a firm that might impact the evaluation of the level of a threat (see paragraph 300.2 A6). To do so, the Board considered and leveraged the requirements in ISQC 1¹⁵ as well as analogous requirements and best practices included in the ethics codes of national standard setters.

¹³ See paragraphs 200.4–200.8 of the extant Code.

¹⁴ See paragraphs 200.12 and 200.15 of the extant Code.

¹⁵ International Standard on Quality Control (ISQC 1), *Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements*, paragraphs 21 – 25

Examples of Safeguards

45. The Board is proposing to retain some of the examples of engagement-specific safeguards that are included in the extant Code.¹⁶ To better assist professional accountants in public practice address threats, those examples of safeguards now indicate the type of threat that is being addressed – an approach that assists in clarifying the correlation between the safeguards and threats in the Code (see paragraph 300.2 A9). For example, the Board agreed to include as an example of a safeguard the use of different partners and engagement teams with separate reporting lines for the provision of NAS to an assurance client to address self-review and familiarity threats.
46. The Board is also proposing to delete the examples included in the extant Code that no longer meet the proposed revised description of safeguards (for example, discussing ethical issues with those charged with governance of the client; and disclosing to those charged with governance of the client the nature of services provided and extent of fees charged).¹⁷

Re-evaluating Threats

47. The Board's proposals in Section 300 emphasize the requirement in proposed Section 120 pertaining to re-evaluating threats and state that new information or changes in facts or circumstances might:
 - (a) Impact the level of a threat; or
 - (b) Affect the professional accountant's conclusions about whether safeguards applied continue to be appropriate to address identified threats. (See paragraph 300.2 A10.)
48. A list of examples of new information or changes in facts and circumstances that might trigger the need for a professional accountant to re-evaluate threats is included in the ED (see paragraph 300.2 A11).
49. The proposals emphasize that in those situations, certain actions that have already been implemented as safeguards might no longer be effective in eliminating the threats or reducing them to an acceptable level (see paragraph 300.2 A11).

Overall Assessment

50. The proposals in Section 300 also emphasize that the requirement for an overall assessment or "step-back" in Section 120 that is discussed in paragraph 17 of this Explanatory Memorandum is also applicable to professional accountants in public practice (see paragraph 300.3 A12).

Project Timetable and Effective Date

51. As noted above, the Board's proposals pertaining to safeguards in this ED have been developed using the structure and drafting conventions established by the Structure of the Code project. The December 2015 [IESBA Update, Restructuring the Code of Ethics for Professional Accountants](#), outlines the IESBA's plan for coordination of its work on this project with the Structure of the Code project.
52. The Board intends to align the effective date of the revisions pertaining to safeguards with the effective date of the restructured Code.

¹⁶ See paragraph 200.13 of the extant Code.

¹⁷ See fourth and fifth bullet in paragraph 200.13 of the extant Code.

Guide for Respondents

53. The IESBA welcomes comments on all matters addressed in this ED, but especially those identified in the *Request for Specific Comments* below. Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in this ED, it will be helpful for the IESBA to be made aware of this view.

Request for Specific Comments

Proposed Revisions to the Conceptual Framework

1. Do respondents support the Board's proposed revisions to the extant Code pertaining to the conceptual framework, including the proposed requirements and application material related to:
 - (a) Identifying threats;
 - (b) Evaluating threats;
 - (c) Addressing threats;
 - (d) Re-evaluating threats; and
 - (e) The overall assessment.

If not, why not?

Proposed Revised Descriptions of "Reasonable and Informed Third Party" and "Acceptable Level"

2. Do respondents support the proposed revisions aimed at clarifying the concepts of (a) "reasonable and informed third party;" and (b) "acceptable level" in the Code. If not, why not?

Proposed Revised Description of Safeguards

3. Do respondents support the proposed description of "safeguards?" If not, why not?
4. Do respondents agree with the IESBA's conclusions that "safeguards created by the profession or legislation," "safeguards in the work environment," and "safeguards implemented by the entity" in the extant Code:
 - (a) Do not meet the proposed description of safeguards in this ED?
 - (b) Are better characterized as "conditions, policies and procedures that affect the professional accountant's identification and potentially the evaluation of threats as discussed in paragraphs 26–28 of this Explanatory Memorandum?"

If not, why not?

Proposals for Professional Accountants in Public Practice

5. Do respondents agree with the IESBA's approach to the revisions in proposed Section 300 for professional accountants in public practice? If not, why not and what suggestions for an alternative approach do respondents have that they believe would be more appropriate?

Request for General Comments

54. In addition to the request for specific comments above, the IESBA is also seeking comments on the matters set out below:
- (a) Small and Medium Practices (SMPs) – The IESBA invites comments regarding the impact of the proposed changes for SMPs.
 - (b) *Developing Nations*—Recognizing that many developing nations have adopted or are in the process of adopting the Code, the IESBA invites respondents from these nations to comment on the proposals, and in particular, on any foreseeable difficulties in applying them in their environment.
 - (c) *Translations*—Recognizing that many respondents may intend to translate the final pronouncement for adoption in their environments, the IESBA welcomes comment on potential translation issues respondents may note in reviewing the proposals.

PROPOSED REVISIONS PERTAINING TO SAFEGUARDS IN THE CODE (PHASE 1)

Section 120

The Conceptual Framework

Introduction

- 120.1 The circumstances in which professional accountants operate might create specific threats to compliance with the fundamental principles. The conceptual framework assists the accountant in complying with the fundamental principles and meeting the responsibility to act in the public interest. It accommodates the many variations in facts and circumstances that create threats to compliance with the fundamental principles and deters an accountant from concluding that a situation is permitted if it is not specifically prohibited by this Code.
- 120.2 The conceptual framework specifies an approach for the professional accountant to:
- (a) Identify threats to compliance with the fundamental principles;
 - (b) Evaluate the threats identified; and
 - (c) Address the threats by eliminating or reducing them to an acceptable level.

Requirements and Application Material

- R120.3** The professional accountant shall apply the conceptual framework which involves identifying, evaluating and addressing threats to compliance with the fundamental principles.
- R120.4** When applying the conceptual framework, the professional accountant shall exercise professional judgment, remain alert to changing circumstances, and take into account whether a reasonable and informed third party would likely conclude that the accountant has complied with the fundamental principles.

Reasonable and Informed Third Party

- 120.4 A1 The concept of a reasonable and informed third party is a test which involves an evaluation by a hypothetical person. Such a person possesses skills, knowledge and experience to objectively evaluate the appropriateness of the professional accountant's judgments and conclusions. This evaluation entails weighing all the relevant facts and circumstances that the accountant knows, or could reasonably be expected to know, at the time that the evaluation is made to determine whether the accountant complies with the fundamental principles.

Identifying Threats

- R120.5** The professional accountant shall identify threats to compliance with the fundamental principles. An understanding of the facts and circumstances, including professional activities, interests and relationships, that might compromise compliance with the fundamental principles is a prerequisite to the accountant's identification of threats to such compliance.
- 120.5 A1 Threats might be created by a broad range of facts and circumstances. It is impossible to define every situation that creates threats. In addition, the nature of engagements and work assignments might differ and, consequently, different types of threats might be created.

- 120.5 A2 Threats to compliance with the fundamental principles fall into one or more of the following categories:
- (a) Self-interest threat – the threat that a financial or other interest will inappropriately influence the professional accountant’s judgment or behavior;
 - (b) Self-review threat – the threat that a professional accountant will not appropriately evaluate the results of a previous judgment made, or activity or service performed by the accountant, or by another individual within the accountant’s firm or employing organization, on which the accountant will rely when forming a judgment as part of performing a current activity or providing a current service;
 - (c) Advocacy threat – the threat that a professional accountant will promote a client’s or employer’s position to the point that the accountant’s objectivity is compromised;
 - (d) Familiarity threat – the threat that due to a long or close relationship with a client or employer, a professional accountant will be too sympathetic to their interests or too accepting of their work; and
 - (e) Intimidation threat – the threat that a professional accountant will be deterred from acting objectively because of actual or perceived pressures, including attempts to exercise undue influence over the accountant.
- 120.5 A3 A circumstance might create more than one threat, and a threat might affect compliance with more than one fundamental principle.
- 120.5 A4 Certain conditions, policies and procedures established by the profession, legislation, regulation, the firm or the employing organization can affect the likelihood of the accountant’s identification of threats to compliance with the fundamental principles. Examples of such conditions, policies and procedures include:
- Corporate governance requirements.
 - Educational, training and experience requirements for the profession.
 - Effective complaint systems.
 - An explicitly stated duty to report breaches of ethical requirements.
 - Professional or regulatory monitoring and disciplinary procedures.

Evaluating Threats

- R120.6** When the professional accountant identifies a threat, the accountant shall evaluate whether such a threat is at an acceptable level.
- 120.6 A1 An acceptable level is a level at which a reasonable and informed third party would likely conclude that the professional accountant complies with the fundamental principles.
- 120.6 A2 The existence of qualitative as well as quantitative factors is relevant to the professional accountant’s evaluation of threats, as is the combined effect of multiple threats, if applicable.
- 120.6 A3 The existence of conditions, policies and procedures discussed in paragraph 120.5 A4 above might impact the professional accountant’s evaluation of threats to compliance with the fundamental principles.

Addressing Threats

R120.7 If the professional accountant determines that the identified threats to compliance with the fundamental principles are not at an acceptable level, the accountant shall address the threats by eliminating or reducing them to an acceptable level. The accountant shall do so by:

- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (b) Applying safeguards, where available and capable of being applied; or
- (c) Declining or discontinuing the specific professional activity or service involved.

120.7 A1 There are some situations where the threat created would be so significant that no safeguards could reduce the threat to an acceptable level. International Independence Standards C1 and C2 of the Code provide examples of such situations.

Safeguards

120.7 A2 Safeguards are actions, individually or in combination, that the professional accountant takes that effectively eliminate threats to compliance with the fundamental principles or reduce them to an acceptable level.

Re-evaluating Threats

R120.8 If the professional accountant becomes aware of new information or changes in facts and circumstances that might impact whether a threat has been eliminated or reduced to an acceptable level, the accountant shall re-evaluate and address that threat accordingly.

120.8 A1 Remaining alert throughout the professional activity or service assists the professional accountant in determining whether new information has emerged or changes in facts and circumstances have occurred that:

- (a) Impact the level of a threat; or
- (b) Affect the professional accountant's conclusions about whether safeguards applied continue to be appropriate to address identified threats.

120.8 A2 If the professional accountant identifies a new threat, the application of the conceptual framework requires that the accountant evaluate and address this new threat as set out in paragraphs R120.5–R120.8 above.

Overall Assessment

R120.9 The professional accountant shall review judgments made and overall conclusions reached to determine that threats to compliance with the fundamental principles are eliminated or reduced to an acceptable level, and that no further action is needed. The reasonable and informed third party test described in paragraph 120.4 A1 is relevant to this assessment.

[Extant 100.17 – 100.25 that deal with Conflicts of Interest and Communicating with Those Charged With Governance are dealt with by the [Structure Project](#).]

C. SECTION 300 PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

Section 300

Application of the Conceptual Framework Approach by Professional Accountants in Public Practice

Introduction

300.1 This Part of the Code describes considerations for professional accountants in public practice in the application of the conceptual framework set out in Section 120. This Part does not describe all of the facts and circumstances, including professional services, interests and relationships, that could be encountered by accountants¹⁸ that create or might create threats to compliance with the fundamental principles. Therefore, accountants are encouraged to be alert for such facts and circumstances.

Requirements and Application Material

R300.2 A professional accountant shall comply with each of the fundamental principles and apply the conceptual framework set out in Section 120 to eliminate threats to compliance with those fundamental principles or to reduce them to an acceptable level.

Identifying Threats

300.2 A1 Compliance with the fundamental principles might be threatened by a broad range of facts and circumstances. The following are categories of threats, and examples of facts and circumstances that might create those threats for a professional accountant when undertaking a professional activity or providing a professional service:

(a) Self-interest Threats

- A professional accountant having a direct financial interest in a client.
- A firm having undue dependence on total fees from a client or the possibility of losing a significant client.
- A professional accountant having a significant close business relationship with a client.

(b) Self-review Threats

- A professional accountant issuing an assurance report on the effectiveness of the operation of financial systems after designing or implementing the systems.
- A professional accountant having prepared the original data used to generate records that are the subject matter of the assurance engagement.
- A professional accountant being, or having recently been, a director or officer of the client, or having recently been employed by the client in a position to exert significant influence over the subject matter of the engagement.

¹⁸ In Part C and in C1 and C2, the term “professional accountant” refers to professional accountants in public practice and firms of professional accountants in practice.

- (c) Advocacy Threats
 - The professional accountant promoting shares in a client.
 - A professional accountant acting as an advocate on behalf of an audit client in litigation or disputes with third parties.
- (d) Familiarity Threats
 - A member of the engagement team having a close or immediate family member who is a director or officer of the client, or is an employee of the client who is in a position to exert significant influence over the subject matter of the engagement.
 - A director or officer of the client, or an employee in a position to exert significant influence over the subject matter of the engagement, having recently served as the engagement partner.
 - Senior personnel having a long association with the assurance client.
- (e) Intimidation Threats
 - A firm being threatened with dismissal from a client engagement.
 - A professional accountant feeling pressured to agree with the judgment of a client employee because the employee has more expertise on the matter in question.
 - A professional accountant being informed by a partner of the firm that a planned promotion will not occur unless the accountant agrees with an audit client's inappropriate accounting treatment.

The categories of threats are also discussed in Section 120.

Evaluating Threats

- 300.2 A2 Conditions that might impact the evaluation of whether a threat is at an acceptable level include the nature of:
- (a) The client and its operating environment;
 - (b) The professional service being provided; and
 - (c) The firm and its operating environment.

The Client and its Operating Environment

- 300.2 A3 The level of a threat might be impacted by the following types of client or professional service that is provided:
- (a) An audit client and whether the audit client is a public interest entity;
 - (b) An assurance client that is not an audit client; or
 - (c) A non-assurance client.

For example, providing a service to an audit client might be perceived to result in a higher level of threat to the fundamental principle of objectivity. Such a threat might be further increased when the audit client is a public interest entity with a large number and wide range of stakeholders.

300.2 A4 A professional accountant's evaluation of the level of the threat might also be impacted by a client's operating environment. For example:

- The client requires appropriate persons other than management to ratify or approve the appointment of a firm to perform an engagement.
- The client has competent employees with experience and seniority to make managerial decisions.
- The client has implemented internal procedures that facilitate objective choices in tendering non-assurance engagements.
- The client has a corporate governance structure that provides appropriate oversight and communications regarding the firm's services.

The Professional Service Being Provided

300.2 A5 The level of a threat is impacted by the nature and scope of the professional service. Examples of professional services, the threats that might arise as a result, and how a professional accountant may address those threats are discussed in International Independence Standards C1 and C2.

The Firm and its Operating Environment

300.2 A6 A professional accountant's evaluation of the level of a threat might be impacted by the work environment within a firm and its operating environment. For example:

- Leadership of the firm that promotes compliance with the fundamental principles and establishes the expectation that professional accountants will act in the public interest.
- Methods and processes for establishing and monitoring compliance with the fundamental principles by all personnel.
- Compensation, performance appraisal and disciplinary policies and procedures that promote compliance with the fundamental principles.
- Management of the reliance on revenue received from a single client.
- The engagement partner having authority for compliance with the fundamental principles, including decisions about the permissibility of services to an audit client.
- Educational, training and experience requirements.
- Processes to facilitate and address internal and external complaints.

Addressing Threats

300.2 A7 If the professional accountant determines that the identified threats to compliance are not at an acceptable level, Section 120 requires that the accountant address those threats by:

- (a) Eliminating the circumstances, including interests or relationships, that are creating the threats;
- (b) Applying safeguards, where available and capable of being applied; or
- (c) Declining or discontinuing the specific professional activity or service involved.

300.2 A8 There are some situations where the threat created would be so significant that no safeguards could reduce the threat to an acceptable level, and the threats may not be addressed by applying

the requirements in Section 120. International Independence Standards C1 and C2 provide examples of such situations.

Examples of Safeguards

300.2 A9 Safeguards vary depending on the facts and circumstances. The following are examples of actions that in certain circumstances might be safeguards in addressing threats:

- Having a professional accountant who was not involved with the non-assurance service provided to an audit client review the non-assurance work performed, or otherwise advise as necessary might address a self-review threat.
- Having a professional accountant who was not a member of the team review the work performed or otherwise advise as necessary might address self-review threats.
- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client might address self-review and familiarity threats.
- Consulting those charged with governance or an independent third party, including a committee of independent directors, a professional regulatory body or another professional accountant might address advocacy or intimidation threats.
- Involving another firm to perform or re-perform part of the engagement might address self-interest, self-review, advocacy or familiarity threats.
- Rotating assurance team personnel might address self-interest and familiarity threats.

Re-evaluating Threats

300.2 A10 New information or changes in facts and circumstances might:

- (a) Impact the level of a threat; or
- (b) Affect the professional accountant's conclusions about whether safeguards applied continue to be appropriate to address identified threats.

300.2 A11 Examples of new information or changes in facts and circumstances include:

- When the scope of a professional service is expanded.
- When the client becomes a listed entity or acquires another business unit.
- When the firm merges with another firm.
- Where the engagement partner's immediate family member is recently employed by the client.

In those situations described above, actions already implemented as safeguards might no longer be effective in eliminating those threats or reducing them to an acceptable level.

Overall Assessment

300.2 A12 When applying the conceptual framework, Section 120 requires that the professional accountant reviews judgments made and overall conclusions reached to determine that threats to compliance with the fundamental principles are eliminated, or reduced to an acceptable level and that no further

action is needed. The reasonable and informed third party test described in Section 120 is relevant to this assessment.

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**International
Ethics Standards
Board for Accountants®**

529 Fifth Avenue, New York, NY 10017
T + 1 (212) 286-9344 F +1 (212) 286-9570
www.ethicsboard.org

**AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
DIVISION OF PROFESSIONAL ETHICS
PROFESSIONAL ETHICS EXECUTIVE COMMITTEE
OPEN MEETING MINUTES
OCTOBER 29-30, 2015
LAGUNA BEACH, CA**

The Professional Ethics Executive Committee (Committee) held a duly called meeting on October 29, 2015. The meeting convened 9 a.m. and concluded at 4:45 p.m.

<p><u>Attendance:</u> Samuel L. Burke, Chair Carlos Barrera Stanley Berman Tom Campbell Richard David Robert E. Denham Anna Dourdourekas Jana Dupree Janice Gray Greg Guin Brian S. Lynch*</p>	<p>William Darrol Mann Andrew Mintzer Jarold Mittleider Steven Reed Lawrence I. Shapiro James Smolinski Laurie Tish Shelly Van Dyne* (Until 12:15 p.m.)</p> <p><u>Not In Attendance:</u> Michael Brand</p>
<p><u>Staff:</u> Lisa Snyder, Director Susan Coffey, SVP – Public Practice and Global Alliances James Brackens, VP - Ethics & Practice Quality Michael Buddendeck, General Counsel Ellen Gorla, Sr. Manager</p>	<p>Jason Evans, Sr. Technical Manager Liese Faircloth, Technical Manager Michele Craig, Technical Manager* Brandon Mercer, Technical Manager* April Sherman, Technical Manager* Shannon Ziemba, Technical Manager* James West, Technical Manager*</p>
<p><u>Guests:</u> Bill McKeown, KPMG Blake Lewis, BDO Jeff Lewis, Chair, Independence/Behavioral Standards Subcommittee Ian Benjamin, Chair, Technical Standards Subcommittee Dan Dustin, VP State Board Relations, NASBA Nancy Miller, KPMG Vincent DiBlanda, DT Sonja Araujo, PwC Catherine Allen, Audit Conduct Ray Johnson, PSU Eric Holbrooke, GAO* George Dietz, PwC* Edith Yaffe, E&Y* Joan Sterling, BDO*</p> <p style="text-align: right;">*Via Phone</p>	

1. Transfer and Return of Client Files

Mr. Barrera presented the revised draft of the proposed new interpretation, *Transfer of Files and Return of Client Records in Sale or Transfer of Member's Practice*. He explained that based on the Committee's feedback, various edits were made to the interpretation including, a revision to the title and deletion of the requirement to "expend best efforts." The Committee agreed with these revisions.

Mr. Barrera noted that the proposal does not specifically address the case of death or incapacity of a member and the responsibilities of such member's authorized representative (e.g., executor, trustee). He offered draft language that could be included in the proposal to address this issue if the Committee believed it should be addressed. One member commented that he did not believe it would be appropriate to extend requirements to non-members. It was noted that this issue had been discussed at the AICPA/NASBA leadership meeting and a document had been drafted (currently under review by NASBA leadership) addressing this situation for state boards to post on their Web sites as guidance. The Committee discussed whether or not a question should be included in the exposure draft asking respondents whether guidance on this issue should be added to the interpretation but it was agreed that it was not necessary to include such a question. The Committee did agree, however, that it might be helpful to better understand what guidance exists on this issue at the state level as well as for other professions.

Mr. Barrera explained that the Task Force believes that notification to the client should be in writing and the proposal has been drafted with such a requirement. The Committee agreed that written notification was appropriate.

Mr. Barrera reported that no further revisions had been made to the to the *Disclosing Client Information in Connection With a Review or Acquisition of the Member's Practice* Interpretation since the last meeting.

It was moved, seconded and unanimously agreed to expose the proposed new interpretation, *Transfer of Files and Return of Client Records in Sale or Transfer of Member's Practice* to membership.

It was moved, seconded and unanimously agreed to expose the proposed revisions to the *Disclosing Client Information in Connection With a Review or Acquisition of the Member's Practice* Interpretation to membership.

2. Definition of Client

Mr. Mintzer provided a brief background of the Task Force's activities and that the Committee tentatively approved revised definitions of "client" and "attest client" at the July meeting. He reviewed a visual aid developed by the Task Force to recap how the proposed definitions would be applied. He explained that members would no longer need to be independent of the engaging entity unless the engaging entity meets any of the affiliate criteria or the attest entity is also the engaging party.

Mr. Mintzer explained that he believes the phrase "other than the member's employer" was removed in error from the definition of client and as such, recommends that the phrase be added back in. Specifically, he believes that the Task Force had intended on relocating the phrase within the definition but during the drafting process inadvertently eliminated it. The

Committee agreed the phrase should be added back into the definition and tentatively approved the updated definition of client.

Mr. Mintzer explained that he believes there could be an unintended consequence related to the Commissions and Referral Fees Rule and the revised definition of attest client. Specifically, he explained that the rule could be read as allowing a member to have commission arrangements with an audit client when the member is not engaged by the audit client to perform the audit. He explained that to remedy this unintended consequence he recommends a sentence be added to the definition of attest client that explains that “For purposes of the Commissions and Referral Fees Rule, client includes attest client.” The Committee was supportive of addressing this concern and also requested the Task Force consider whether it would be helpful to add to the definition a cross reference to the Commissions and Referral Fees Rule.

It was suggested that it was awkward and confusing to use the term attest client when the proposed definition states that an attest client is not always a client. Instead, it was suggested that the term “attest client” be replaced by the term “attest entity.” Some believed that using the term “attest entity” could be confusing since (1) it is a new term while “attest client” is an established term and (2) then there would be three terms to navigate between “client”, “attest entity” and “nonattest client”. It was noted that the term “attest client” is still relatively new as the Code only started using it in lieu of the term “client” as part of the Codification project. It was asked if the term “attest client” was used in any of the other technical standards and in response it was noted that it is used in the international standards. The Committee directed the Task Force to replace the term “attest client” with the term “attest entity” and in the exposure draft to ask if respondents believed the term was confusing. The Committee also asked the Task Force to consider drafting a FAQ or other application guidance that would explain to members that when an attest entity is also the client, it could be referred to as an attest client.

The Committee was asked if it was necessary to include the government provision in the definition of “attest entity” or if it could be moved elsewhere such as to the independence topic. The Committee directed the Task Force to consider relocating the government provision from the “attest entity” definition.

3. Council Resolution – Form of Organization and Name

Ms. Snyder explained that Staff has received a number of inquiries concerning whether or not certain CPA firm ownership structures would be permitted under the *Council Resolution Concerning the Form of Organization and Name Rule* (“Council Resolution”), particularly those that involve situations where the owners of a firm include not only individuals but also ownership by a CPA firm or a grantor trust.

Ownership by CPA firm

With regard to ownership by a CPA firm, Ms. Snyder asked the Committee for its input on whether or not ownership by a CPA firm would be permissible under the Council Resolution, provided the CPA firm was owned by (a majority of) CPAs and such CPAs (and non-CPAs) were actively engaged as members of the successor firm. She stated that this issue was recently discussed by the Texas State Board Rules Committee and the Committee agreed to allow CPA firms to include corporate ownership provided the corporation is owned by CPAs of the firm. Ms. Snyder noted that in interpreting the Council Resolution, the Committee might

wish to consider the meaning of “ownership” to constitute “beneficial ownership.” She referred the Committee to the definition of “beneficially owned” in the AICPA Code.

The Committee discussed the issue and agreed that the Council Resolution could be interpreted to allow ownership by a CPA firm. The Committee further agreed that in determining whether a firm has complied with the requirement of “majority of ownership by CPAs,” the firm should refer to the partnership or other agreements in place that set forth the beneficial ownership interests and voting rights of each CPA and non-CPA owner.

Ownership held by grantor trust

Ms. Snyder explained that for estate planning purposes, some owners of CPA firms have been advised to move their equity accounts into a living trust whereby a grantor trust is established that allows the grantor (i.e., CPA firm owner) to control and manage the trust while they are alive and thus, serve as the trustee as well as the beneficiary of the trust during their lifetime. Ms. Snyder asked the Committee for its input on whether or not ownership by a grantor trust would be permissible under the Council Resolution provided the CPA firm owner served in the capacity of trustee and beneficiary and remained actively engaged in the CPA firm. She noted that if such ownership were permitted, upon the death of the owner, the equity would need to be transferred to the firm or qualified owners within a reasonable period as set forth in paragraph five of the Council Resolution.

The Committee discussed the issue and agreed that the Council Resolution could be interpreted to allow ownership by a grantor trust and that the equity held in the trust should be attributed to the CPA firm owner for purposes of determining ownership interests. Accordingly, such ownership would be permitted provided there is a majority beneficial ownership interest by CPAs and the CPA firm owner was actively engaged as a member of the firm. The Committee was also asked to consider the scenario where the owner serves as a co-trustee of the trust with his or her non-CPA spouse and the spouse is not actively engaged in the firm’s activities. The Committee agreed such an arrangement would not be permissible under the Council Resolution since it would violate the provision that all non-CPAs (e.g., spouse) be actively engaged in the firm’s activities.

4. Information Technology and Cloud Services

Ms. VanDyne and Ms. Gorla reported on the activities of the Task force. The Committee agreed that what was intended by the term, “authoritative source” was the version of the client’s data or records that is used by the client. The Committee requested that the examples of hosting services included in the interpretation specifically identify if the service is considered a hosting service because the member is the “authoritative source” of the client’s data or records or if the service is considered a hosting service because the member is a repository of the client’s data or records. One member expressed concern that members may take possession of a client’s original records even if it is just temporary custody so that the member can provide a permitted nonattest service.

The Committee then discussed whether the use of portals by members to communicate with their clients could be viewed as hosting services if information remains in the portal for some time. The example discussed was a tax return and related supporting records. One member noted that her firm discloses to tax compliance clients that the client is responsible for maintaining its books and records even if the firm chooses to send the client information through a portal. The Committee believed it would be helpful if the guidance issued includes

examples of situations that the Task Force is specifically trying to address as well as examples of situations that it does not intend to address.

When discussing hosting services connected with a technology solution, it was suggested that the service might be a prohibited service under the *Information Systems Design, Implementation, or Integration* interpretation. It was also noted that it was unclear what “licensing” is intended to mean and whether the member was retained to provide hosting services or if this was another example of what hosting services would not include.

5. AICPA Codification/State Board Rules Review

Mr. Johnson reported on the results of the Records Requests Questionnaire that was distributed to state boards of accountancy in order to gain insight into the underlying reasons for any similarities and/or differences identified between the state boards’ position on records requests and that of the AICPA. He explained that the Questionnaire was sent to twenty-seven state boards that had been identified as either having records requests rules that were different from the AICPA’s rules (thirteen jurisdictions) or identified as being silent on records requests relating to withholding records for non-payment of fees (fourteen jurisdictions). Seventeen of the twenty-seven state boards responded to the Questionnaire.

The Questionnaire requested input on the AICPA’s position on the following provisions of the Records Requests interpretation:

- *Categorization of Records*
- *Return of Client Provided Records*
- *Withholding Client Records for Unpaid Fees*
- *Period Allowed For Returning Records*
- *Subsequent Requests for Records*
- *Working Papers*

Withholding Client Records for Unpaid Fees

Mr. Johnson noted that AICPA and NASBA had previously identified “withholding certain records due to unpaid client fees” as an issue where a significant number of state boards had a different position than that of AICPA or were silent on the issue. Mr. Johnson stated that based on the responses received, the Task Force had updated the Records Requests Research Summary prepared by the AICPA State Regulation & Legislation Team. He reported that of the fifty-five jurisdictions, thirty-six state boards allow for retention of certain records for nonpayment of fees, eight state boards remain silent on the issue and eleven state boards prohibit retention of records for nonpayment of fees. Accordingly, the state boards that allow retention of certain records for nonpayment of fees comprise sixty-five percent of the fifty-five jurisdictions whereas those that prohibit retention of records for nonpayment of fees comprise twenty percent (fifteen percent remain silent). It was further noted that those state boards that allow for retention of records for nonpayment of fees comprise sixty-one percent of the total CPAs regulated in the fifty-five jurisdictions, whereas the state boards that prohibit the retention of records for nonpayment of fees comprise thirty percent.

Mr. Johnson explained that while there is a significant minority of states that prohibit withholding certain records for nonpayment of fees, there is a clear majority of state boards that agree with the AICPA’s position that allows withholding of certain records for nonpayment of fees. He explained that overall, the Task Force believes that revisiting the AICPA’s guidance and potentially prohibiting retention of certain records for nonpayment of fees would be contrary to the PEEC’s overall objective of uniformity of AICPA and state boards’ rules and

therefore, the Task Force recommends that the AICPA's guidance in the *Records Requests* interpretation on this issue should not be revisited.

Ms. Snyder noted that in discussing this issue, the Task Force also considered the rules governing attorneys regarding withholding client files due to unpaid fees. She stated that the law regarding such "retaining liens" varies significantly among the various states but case law in a majority of states allows an attorney to retain all client documents until the fees are paid. In addition, the American Bar Association's Model Rules of Professional Conduct permits an attorney to obtain a lien to secure the attorney's fees or expenses.

The Committee was asked whether or not it agreed with the Task Force's recommendation to not revisit the AICPA's position on withholding certain records due to unpaid client fees. There was unanimous agreement not to revisit the position and therefore, retain the existing guidance.

Mr. Johnson reported on the responses from state boards received on the other issues addressed in the Questionnaire and stated that based on the responses, the Task Force does not believe there is any basis to recommend that the Committee revisit any other provisions within the interpretation. The Committee did not object to any of the recommendations of the Task Force.

Mr. Johnson also noted that the Questionnaire did ask whether or not state boards would be open to reconsidering their current rules in order to conform to the AICPA rule. Overall, more than half of the state boards that provided a substantive response to the question responded "maybe" to the inquiry. Only one state responded "no" and believed that the AICPA should raise the bar and conform to the board's rules. Some state boards did not respond to this inquiry.

6. IESBA Update

Ms. Snyder provided highlights of the October 2015 IESBA meeting held in New York City.

Long Association of Personnel with an Audit or Assurance Client

Ms. Snyder reported that the IESBA received a brief update from the Long Association Task Force. She explained that the Board supported an increase in the cooling off period of the lead engagement partner from two years to five years for an audit of a public interest entity (PIE) but agreement had not been reached yet on the cooling off period for the engagement quality control review (EQCR) partner. She noted that the IESBA's Consultative Advisory Group (CAG) supported a cooling-off period of five years for the EQCR partner whereas others believe a three year cooling-off period is appropriate. Ms. Snyder also explained that the Board is considering providing an alternative to elements of the partner rotation requirements for PIE audits in the Code where jurisdictions have established different regulatory safeguards, or a package of safeguards, to address threats created by long association; and activities that can be performed by the rotated partner with respect to the client during the cooling-off period. The IESBA will consider a final draft of the proposed provisions at its November/December 2015 meeting, and vote on whether to re-expose the changes to the Code on specific issues.

Structure of the Code

Ms. Snyder reported that the IESBA considered a revised draft of "Tranche I" and a first-read draft of "Tranche II" of the draft Exposure Draft. The IESBA continued to broadly support the

direction of the restructuring. She noted that the IESBA discussed, among other matters: the approach to describing the relevance of application material in the Code versus requirements and articulation of the linkage between independence and objectivity. The IESBA will consider a revised draft of Tranches I and II at its November/December 2015 meeting for possible exposure.

Review of Safeguards in the Code

Ms. Snyder reported that the IESBA considered a first-read draft of the proposed revised provisions in extant Section 100, *Introduction and Fundamental Principles* and Section 200, *Introduction* (Part B – Professional Accountants in Public Practice) of the Code as they relate to safeguards. Topics discussed included: a proposed revised description of the concept of “safeguards;” re-characterization of certain examples of safeguards in extant Section 200 as conditions in the work environment, within a firm or within an entity’s systems and procedures that may affect the level of threats to compliance with the fundamental principles; a proposed description for the concept of a “reasonable and informed third party;” and “stepping back” to evaluate the continued effectiveness of safeguards in the light of changed circumstances or new information concerning threats. The IESBA will consider a revised draft of the proposed Sections 100 and 200 at its November/December 2015 meeting for possible exposure.

Review of Part C of the Code – Phase I

Ms. Snyder reported that the IESBA considered significant comments received on proposed revised Section 370 included in the Exposure Draft, [Proposed Changes to Part C of the Code Addressing Presentation of Information and Pressure to Breach the Fundamental Principles](#). Topics discussed included: how to evaluate and respond to pressure to breach the fundamental principles, including in a conflict of interest situation; whether the proposed guidance should distinguish between “senior” professional accountants in business (PAIBs) and other PAIBs; and the adequacy of the guidance in Section 300 in highlighting the greater expectations of “senior” PAIBs. The IESBA agreed to consider revised drafts of Sections 300, 320 and 370 by conference call and then possibly adopt final standards at its November/December 2015 meeting.

Responding to Non-Compliance or Suspected Non-Compliance with Laws and Regulations (NOCLAR)

Ms. Snyder reported that the IESBA received a preliminary update on significant comments from respondents to the Exposure Draft, [Responding to Non-Compliance with Laws and Regulations](#). The IESBA will consider a full analysis of the comments received on the Exposure Draft at its November/December 2015 meeting.

7. Entities Included in State and Local Government Financial Statements

Ms. Miller explained that while the Task Force still has many issues to discuss, the preliminary thinking of the Task Force is that it would like to retain the “making reference to another auditor’s report” exception (making reference exception) that exists today. She explained that another exception the Task Force has discussed is the possibility of not having to remain independent of an immaterial fund or component unit unless the member knows or has reason to believe a significant threat exists. If the member knows or has reason to believe a significant threat exists, then Ms. Miller explained the Task Force is considering that the member would likely need to evaluate the situation using the conceptual framework. She emphasized that the notion of “knows or has reason to believe” would not require the member to “search” for possible threats.

Ms. Miller explained that to test the preliminary conclusion that members do not have to remain independent of an immaterial fund or component unit unless the member knows or has reason to believe a significant threat exists, a subgroup of the Task Force applied examples to situations where a covered member or firm had a direct financial interest in discreetly presented component units. Discreetly presented component units were used since these entities have the most distance from the primary government, that is, the primary government has the least amount of fiscal responsibility over these entities. Ms. Miller explained that the subgroup was not able to conclude that the immateriality of a discreetly presented component unit was a sufficient safeguard by itself and so she believes that it is unlikely that the Task Force will be able to conclude that a blanket exception for immaterial funds and component units is workable. For the February Committee meeting, the Task Force expects to work through all the examples and bring a recommendation for downstream entities to the Committee.

Ms. Miller also explained that there are a number of entities in the state and local environment that do not use GASB GAAP (e.g., tribal entities that need audits because they receive federal funding but exclude certain entities that don't receive any federal funding and entities that use cash basis). She explained that the Task Force has briefly discussed what state and local entities members should be independent of when GASB GAAP is not used by the primary government, and hopes to have a recommendation for the Committee at its next meeting.

Ms. Miller concluded by explaining that the Task Force has been unable to identify why the extant interpretation contains an exception for the "making reference" provision when certain individuals are in a key position and as such, may recommend it be removed.

8. Minutes of the Professional Ethics Executive Committee Open Meeting

It was moved, seconded and unanimously agreed to approve the minutes of the July 2015 open meeting

9. Commissions and Contingent Fees Task Force

Ms. Tish explained that the Task Force reviewed the commissions and referral fees rules of 18 states and identified that 12 of those states require disclosure be in writing. In addition, 10 of the 12 states call for specific information to be included in the written disclosure; however, the specific information required to be disclosed varied by states.

Ms. Tish explained that the Task Force discussed the merits of both issues; whether the disclosure should be in writing and if so, should the written disclosure include specific information. Ultimately, the Task Force believed that requiring disclosure be in writing would result in enhanced transparency since it would bring the arrangement to the client's attention and could also assist in avoiding misunderstandings. Ms. Tish explained that with respect to the disclosure of specific information, while the Task Force thought there was some merit to identifying the party involved with the commission or referral fee and the amount paid, depending upon the situation, other information may also be important. Accordingly, she explained the Task Force is recommending that the required disclosure be in writing and only encourage that significant terms be included since this will bring the arrangement to the client's attention and allow the client to inquire as to additional specifics if he or she is interested.

After some discussion, it was agreed the proposed interpretation should be silent as to what terms should be included in the written documentation and instead, the Committee should

draft non-authoritative guidance such as FAQs or examples of draft documentation for members.

It was moved, seconded and unanimously agreed to expose the revised interpretation to membership.

Ms. Tish then explained that back in 2006, the Committee agreed that the current prohibition period associated with receiving contingent fees was inconsistent with the way other financial relationships are treated in the Code of Conduct (i.e., under the independence rules) and since contract terms can be amended prior to completion of a professional service, the Committee agreed it would be appropriate to provide for a “cure” for new attest engagements (e.g., where a nonattest client requests that the member perform an audit and the member received a contingent fee from such client during the period covered by the financial statements). She further explained that the recommended basis provided by the prior Task Force was that when performing an engagement for a contingent fee, the primary threat to a member’s independence and objectivity is the financial self-interest threat. Under the *Independence Rule* of the AICPA Code, a member need only be independent *during the period of the professional engagement* for purposes of financial interests/relationships with an attest client. She explained that the prior Task Force believed that any threat to a member’s independence (or objectivity) would be eliminated once the financial interest is disposed of (i.e., the financial relationship is terminated or otherwise settled) and therefore, provided such disposition occurs prior to the performance of any attest procedures or formal agreement to perform the attest engagement, independence would not be considered impaired. Using this conceptual basis, the former Task Force believed that if the contingent fee relationship was terminated (e.g., paid in full or fixed in price) prior to the period of the professional engagement, there would be no threat to the member’s independence or objectivity.

Ms. Tish explained that the Committee tabled this issue in 2006 because at the time, there were no other revisions that needed to be made to either the commissions or contingent fees rules nor was there a planned membership ballot that such a revision to the rules could be included in. Ms. Tish explained that while the Task Force believes the prior Task Force’s conclusions had merit, unless there are other reasons to amend the rules it recommends this issue remain tabled. The Committee agreed to table this issue since there were no other planned revisions to any of the rules in the Code.

10. Exposure Draft – Maintaining the Relevance of the Uniform CPA Examination

For informational purposes only.

11. Conceptual Framework Toolkits

For informational purposes only.

12. Electronic Records

For informational purposes only.

13. IESBA Suspected Noncompliance with Laws and Regulations Exposure Draft

For informational purposes only.

14. PEEC Planning Subgroup

For informational purposes only.

