



AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
DIVISION OF PROFESSIONAL ETHICS
PROFESSIONAL ETHICS EXECUTIVE COMMITTEE
OPEN MEETING MINUTES
MAY 16-17, 2017
CHICAGO

The Professional Ethics Executive Committee (Committee) held a duly called meeting on May 16 -17, 2017. The meeting convened 9:00 a.m. and concluded at 4:30 p.m. on May 16th and began at 8:30 a.m. and concluded at 9:55 a.m. on May 17th.

<p><u>Attendance:</u> Samuel L. Burke, Chair Coalter Baker Carlos Barrera Stanley Berman Chris Cahill Tom Campbell Robert E. Denham Anna Dourdourekas Janice Gray Greg Guin Brian S. Lynch</p>	<p>William Darrol Mann William McKeown Andrew Mintzer* Jarold Mittleider Steven Reed James Smolinski Laurie Tish Shelly Van Dyne Blake Wilson</p> <p><u>Not In Attendance:</u> Michael Brand</p>
<p><u>Staff:</u> Lisa Snyder, Senior Director James Brackens, VP - Ethics & Practice Quality Jason Evans, Associate Director Ellen Gorla, Sr. Manager Independence & Special Projects Shelley Truman, Coordinator</p>	<p>Michael Jones, Assistant General Counsel Brandon Mercer, Technical Manager* April Sherman, Technical Manager* Shannon Ziemba, Technical Manager* James West, Technical Manager* Michele Craig, Technical Manager* Liese Faircloth, Technical Manager*</p>
<p><u>Guests:</u> Jeff Lewis, Chair, Independence/Behavioral Standards Subcommittee Ian Benjamin, Chair, Technical Standards Subcommittee Kelly Hnatt, Outside Counsel Nancy Miller, KPMG Dan Dustin, VP State Board Relations, NASBA Catherine Allen, Audit Conduct Sonja Araujo, PwC Vince DiBlanda, Deloitte Jennifer Kary, Crowe Vassilios Karapanos, SEC* Karen Liu, SEC* Jennifer Beneke, EY* David East*, PwC Barbara Romer, PwC*</p> <p style="text-align: right;">*Via Phone</p>	

1. Leases

Mr. Wilson and Mr. Mercer presented the Leases Task Force agenda item to the Committee. Mr. Wilson opened the discussion by pointing out that the Task Force presented three revision options at the previous PEEC meeting, and that PEEC had requested the Task Force prepare a draft that combined certain elements of the different versions into a guided conceptual standard. Mr. Wilson noted that the Task Force held two conference calls to discuss the feedback and prepared a draft standard for possible exposure to membership.

After the discussions highlighted below, PEEC determined that the proposed standard was not yet ready for exposure but required some revisions to reflect the PEEC discussions.

Leases Material to Firm, Certain Individual Covered Members, or the Attest Client

Mr. Wilson noted that the proposed standard included a conceptual approach with minimum requirements, as requested by PEEC. At the previous PEEC meeting, the Committee expressed a preference for not including as a minimum requirement for all covered members, but acknowledged that materiality is and should be a factor in the standard. The Task Force discussed the issue and a majority of the Task Force thought that if a lease is material to the firm, a member of the engagement team, or an individual in a position to influence the attest engagement, the lease would impair independence. PEEC discussed the question and came to the following conclusions regarding materiality of leases:

1. In the case of the firm, the self-interest threat to the firm caused by a lease that is material to the firm cannot be reduced by safeguards and would impair independence, regardless of materiality to the client. The firm cannot be isolated from the engagement like an individual who has a material lease with the client.
2. In the case of an individual on the attest engagement team or an individual in a position to influence the attest engagement, safeguards may be available, such as isolation or removal of the covered member from the attest engagement team or applicable chain of command. The Committee did not think that material leases with individuals caused threats that could not be addressed by safeguards.
3. If the lease is material to the client, the covered member is opining on financial statements and the collectability of the lease obligation, which is directly tied to the financial well-being of the firm. The Committee did not think that firms should be determining their own financial well-being for purposes of expressing an opinion on the financial statements, and that the threat could not be reduced by the application of safeguards. A straw poll of 12-6 agreed with adding the client to the materiality safeguard. Mr. Mercer noted that the self-interest threat to the covered member would not be an issue if the lease is only material to the client, but that this would represent a different threat, possibly the self-review threat.

PEEC suggested adding a question to the exposure draft for members to provide feedback on adding the client to the safeguard. Based on the conclusions noted above, PEEC determined that materiality should be a minimum safeguard, but that it should only apply to the firm and the attest client, as shown below (PEEC revision highlighted):

- a. The lease is on market terms and established at arm's length;
- b. All amounts are paid in accordance with the lease terms or provisions; and

- c. The lease is not material to the firm **or the attest client**, ~~an individual participating on the attest engagement team, or an individual in a position to influence the attest engagement.~~

All leases that meet the safeguards above will continue to be subject to the conceptual framework evaluation in paragraph .03 of the proposal.

Primary Residence Leases

One Committee member noted that although he agrees with the Committee position on leases with the firm, in the case of individuals, he has more concerns with firm employee leases of housing, given that the AICPA Code currently has an exception for home mortgages in the Loans and Leases with Lending Institutions interpretation.

Mr. Wilson and Mr. Mercer explained that materiality appears to be the primary issue with residential leases, and that the materiality parameters vary widely depending on the covered member's career stage or position within the firm. The Task Force previously determined that a primary residence exemption may not be necessary if materiality is not a minimum safeguard. Mr. Wilson requested PEEC feedback on primary residence leases and materiality. After a straw poll of 15-0-3, PEEC determined that primary residence leases should be treated the same as a home mortgage.

One Committee member further suggested that individuals be addressed in a separate paragraph, which would allow the incorporation of the loan rule requirements for individuals. Primary residence leases being addressed in a separate paragraph would also allow the same incorporation of the loan rules. After discussion, it was determined that individuals and primary residences should be addressed in separate paragraphs from the firm.

Grandfathering

PEEC agreed paragraph .04 of the proposal was really a transitioning provision as it only addresses existing operating leases at the effective date of the standard ("Day 1 relief"), and does not address leases that should potentially be grandfathered that were entered into prior to the period of professional engagement, prior to the individual becoming a covered member, or prior to the client becoming a party to the lease by purchase or other assignment ("Day 2 relief"). It was suggested inserting Day 2 relief provisions into the guidance similar to those that apply to a home mortgage or other secured loan. Mr. Mercer presented a draft paragraph demonstrating the integration of the concept to leases.

The Committee suggested that the Task Force take its feedback and revise the proposed standard to the suggested structure addressing firms and individuals in separate paragraphs and applying the suggested grandfathering provisions.

Other Issues

One Committee member questioned whether covered members' immediate families should be added to the proposal where individual covered members are referenced. PEEC agreed immediate family should be added to the proposal and a question should be included in the exposure draft as to whether this is appropriate.

One member questioned whether “period of professional engagement” should be changed to “period of the attest engagement” to avoid confusion over the type of engagements referenced. Mr. Mercer noted that professional engagement can only be an attest engagement in the context of “period of professional engagement” as a defined term. PEEC agreed no change was needed.

Task Force Next Steps

The Task Force agreed to discuss the PEEC’s feedback and revise the proposal as suggested. The Task Force will bring another proposal for possible exposure to the July PEEC meeting and will include the additional exposure draft questions for membership as suggested by PEEC.

2. Part C Task Force – IESBA Convergence

Mr. Berman explained that the proposals are convergence projects with the IESBA standards and only two comment letters were received. He reviewed the comments received with the Committee and the recommendations of the Task Force.

One Committee member suggested that the term “operations” was not broad enough in the introduction of paragraph .02 and suggested the Committee should add the words, “and finances” after “operations”. The Committee agreed with this revision.

Another Committee member questioned the addition of “objectivity” within the guidance. Ms. Snyder explained that the term refers to the objectivity of the individual that the member will be relying on rather than the member’s objectivity.

Mr. Berman noted that the Task Force did not believe the interpretation would require significant changes in practice and therefore the Task Force recommends it be effective the last day of the month when published in the Journal of Accountancy.

It was moved, seconded and unanimously carried to adopt the *Knowing Misrepresentations in the Preparation and Presentation of Information* interpretation, as revised.

It was moved, seconded and unanimously carried to adopt the *Pressure to Breach the Rules* interpretation.

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

Ms. Miller highlighted that the most significant change since the last version seen by the Committee was to the upstream guidance. She explained that at the February meeting the Committee agreed that when looking upstream, instead of requiring members be independent of the primary government when it has more than minimal influence over the accounting or financial reporting process of a material fund or component unit that is a financial statement attest client, the interpretation should require an evaluation of relationships and circumstances that the member has with the primary government using the conceptual framework.

In response to a question regarding the application of the “Other Funds, Component Units or Activities” guidance, Ms. Miller confirmed that an evaluation of a relationship or circumstance would only have to be performed when the member finds out about the relationship or circumstance.

Ms. Miller went on to explain that the current guidance is silent as to how investments should be treated for independence purposes. The Task Force used the definition of investments found in the GASB guidance, and concluded as similarly as possible to the commercial sector position on investments as possible. The main difference was the use of a de minimis criteria for controlling investments since there was concern about operationalizing the tracking controlling investments that are de minimis. She explained the Task Force believes that the inclusion of this criteria provides an acceptable balance between operational costs and threats.

Ms. Gorla explained the conforming revision proposed to the “financial statement attest client” definition and proposed revisions to the “Plan is an Attest Client or Is Sponsored by an Attest Client” interpretation.

The Committee agreed that members would need time to implement this revised guidance and so recommended that the interpretation be effective for financial statements beginning on or after July 1, 2018.

The Committee also requested that a longer than usual exposure period be used so that members in the SLG sector had adequate time to respond. It was agreed that the comment period should close in the middle of October.

It was moved, seconded and unanimously carried to expose the proposed revised interpretation and conforming revisions to the “financial statement attest client” definition and the “Plan is an Attest Client or Is Sponsored by an Attest Client” interpretation.

4. Information Technology and Cloud Services

Hosting Services

Ms. VanDyne explained that in addition to adding the rationale for why the management participation threat would be so significant, the Task Force also recommends that the description of what would constitute hosting services be clarified. Specifically, the Task Force believes that it would be clearer if the description listed “accepting responsibility for providing electronic security or backup services” as a separate service instead of including it as one of several services. The Committee was supportive of this clarification.

The Committee noted that while the examples of hosting services made it clear that acting as the sole host of an attest client’s information system would impair independence, this was not clear in the description of hosting services. As such, the Committee clarified this by moving the substance of the example as a third item to the description of hosting services. The Committee also noted that since the description of hosting services included the concept of the “member accepting responsibility” for certain things, it was not necessary to repeat the concept in the explanation of why the management responsibility threat is so significant when providing hosting services but would be helpful to include in the lead-in to the examples of hosting services. As such, the phrase “accepting responsibility for” was removed from the first sentence of paragraph .02 “When a *member* provides hosting services, the *member* would be ~~accepting responsibility for~~ maintaining the *attest client’s* internal control over its data or records and added to the end of the lead-in to the examples in paragraph .03.

The Committee discussed the examples of hosting services. The Committee decided that since the description of hosting services now clarified that services would include being the sole host of an attest client information system, it would highlight as an example a scenario where a member might host an attest client's website. The Committee also decided to re-order the examples so that they were aligned with the corresponding description of hosting services bullets.

The Committee discussed the example of licensing software to an attest client that the attest client uses to input its data and receive an output that the attest client is responsible for maintaining. It was agreed to remove the tax provision software example from the item so that the focus was on the need for (1) the software to perform an activity that, if performed by the member, would not impair independence and (2) the licensing agreement be for a discrete software product and not an entire information system.

With respect to example g, the member having a depreciation schedule that they prepared, the Committee agreed it would be clearer to replace the term "maintaining" with "having possession of" a depreciation schedule.

It was agreed that a one year delayed effective date would be helpful so that members would have adequate time to implement the interpretation. It was moved, seconded and unanimously agreed to adopt the interpretation as revised by the Committee.

Information Systems Services

The Committee noted that since a member can design and develop an information system that is unrelated to the attest client's financial statements or accounting records when the safeguards in paragraph .02 are applied, at a minimum, members should be able to install such non-COTs systems. Accordingly, the Task Force was asked to discuss whether there are types of implementation services related to non-COTs software solutions that members could provide that do not impair independence.

Ms. VanDyne explained an open issue is that it is not clear to the Task Force what the intended difference is between the permitted service "perform network maintenance, such as updating virus protection, applying routine updates and patches, or configuring user settings consistent with management's request" and the prohibited service, operating "...an attest client's network". Specifically, the Task Force's initial thinking is that members shouldn't be maintaining an attest client's network but it wasn't clear where to draw the line. One member of the Committee noted that allowing members to install a network could give rise to the management responsibility threat, especially if the member were to make a mistake when installing the network. This member also believes similar threats exist when providing the attest client with training services (e.g., attest client asks if they can skip a step). Another member of the Committee believes that members should be allowed to assist attest clients with installing but should not be allowed to perform ongoing network maintenance. In response to this discussion, another member of the Committee noted that there needs to be a materiality component as it seems that the underlying question is whether the activity that the member is performing rises to the level of a management responsibility.

Ms. VanDyne noted that another open issue is that the extant guidance permits making insignificant modifications to source code. However, the members of the Task Force do not

believe their firms use this provision on the front end, rather use it to evaluate situations where after the fact, it is determined that the source code was modified. Given the new [Breach of an Independence Interpretation](#) standard, it is not clear if the provision is still needed or if could be used in a broader sense to help members determine if the activity the member is performing rises to the level of a management responsibility.

5. Minutes of the Professional Ethics Executive Committee Open Meeting

It was moved, seconded and unanimously agreed to adopt the minutes from the February 2017 open meeting.

6. IESBA Convergence – Long Association

Mr. Denham and Mr. Evans presented the activities of the Task Force. It was explained that the general requirements of the IESBA standard were recently changed to cover any member of the audit or assurance team, not just senior personnel. The Task Force considered the IESBA position and concluded that threats to independence created due to long association with an attest client generally would only occur with respect to senior personnel of the attest engagement as they are the individuals making any key decisions with regard to the attest engagement. Furthermore, any decision that is made by an attest engagement team member that is not considered senior personnel would be reviewed by a member of the senior personnel. Thus, the threats to independence based on the long association with an attest client of a member of the attest engagement team that is not included in the senior personnel would be mitigated due to review processes. The Committee agreed with the Task Force and concluded that the evaluation of threats and safeguards should only be required for senior personnel. It was also agreed that the difference in position from IESBA would not create a situation where the AICPA Code would be considered less restrictive than the IESBA Code, as, due to the review processes on attest engagements, threats created due to long association of non-senior personnel would be reduced to an acceptable level.

The Committee discussed the proposed definition of senior personnel in paragraph .01 of the proposed interpretation. On committee member noted that “anyone who maintains regular contact with client management or those charged with governance” is too broad since it could scope in the staff person or manager who do not create significant threats to independence. The Committee agreed and decided that the words “or who” should be replaced with “and” so that it reads “...senior personnel of the attest engagement team are partners, partner equivalents and any other individuals on the attest engagement team who have responsibility for decision making on significant auditing, accounting and reporting matters that affect the results of the attest engagement ~~or who~~ **and** maintain regular contact with client management or those who are charged with governance.”

The Committee agreed with all other recommendations of the Task Force including to limit applicable threats to the familiarity threat, to exclude a requirement for the firm to determine an appropriate rotation period when it concludes that rotation of an individual is an appropriate safeguard and the placement of the proposed interpretations in the Code.

It was moved, seconded and unanimously carried to expose the proposed interpretation "*Long Association of Senior Personnel with an Attest Client.*"

7. IESBA Update

Mr. Evans provided an update to the Committee on the following activities of the IESBA.

IESBA Strategy Survey

Mr. Evans noted that In April, the IESBA released an online survey seeking comments and views from stakeholders to help set its future strategic direction. The survey closes on July 18, 2017 and is a first step in the development of the IESBA's strategy and work plan beyond 2018. Mr. Evans walked the Committee through sections of the survey to identify any particular proposed topics that Committee members might consider to be of high priority. It was agreed that the PEEC's IESBA Convergence Task Force should recommend the prioritization of the various projects and respond on behalf of the Committee.

Professional Skepticism

Mr. Evans explained that the IESBA expects to issue an exposure draft, *Proposed Application Material Relating to: (a) Professional Skepticism –Linkage with the Fundamental Principles; and (b) Professional Judgment – Emphasis on Understanding Facts and Circumstances*. He noted that the proposed new application material will:

- (a) Describe how compliance with the fundamental principles in the Code supports the exercise of professional skepticism in the context of audit and other assurance engagements; and
- (b) Emphasize the importance of professional accountants obtaining a sufficient understanding of the facts and circumstances known to them when exercising professional judgment in applying the conceptual framework.

Ms. Snyder noted that the Appendix to the exposure draft explains that some stakeholders have suggested that the IESBA consider how the Code should address professional skepticism beyond audit and other assurance engagements and expressed the view that the concept of professional skepticism should be relevant to all professional accountants, including those in business. She explained that the IESBA is of the view that further work is needed in the long term to consider whether and, if so, how the Code should address the applicability of the concept of professional skepticism to other professional accountants. She also added that some IESBA members, including herself, believe the concept of professional skepticism should not be extended to other professional accountants and if necessary, different terminology should be used to represent the level of skepticism needed for such accountants.

8. Committee Project Agenda

This item was on the agenda for informational purposes only.