



# PROFESSIONAL ETHICS EXECUTIVE COMMITTEE

Open Meeting Agenda

**February 13-14, 2018  
Nashville, TN**



**AICPA Professional Ethics Executive Committee  
Open Agenda  
February 13, 2018  
Nashville, TN**

<b>Phone Access:</b> +1 646 876 9923 (US Toll) or +1 669 900 6833 (US Toll) <b>Meeting ID:</b> 919 402 4936 <b>Web Access:</b> <a href="https://aicpa.zoom.us/j/9194024936" style="color: white;">https://aicpa.zoom.us/j/9194024936</a>		
February 13 <sup>th</sup>	<i>Open Meeting Begins</i>	
9:30 a.m. – 9:45 a.m.	<b>Welcome</b> Mr. Burke will welcome the Committee members and discuss administrative matters.	
9:45 a.m. – 10:30 a.m.	<b>PEEC Planning Subgroup</b> Mr. Burke and Ms. Lee-Andrews will report on the feedback received from key stakeholders concerning emerging issues and the Subgroup’s recommendations. ❖ External Link – <a href="#">Project Agenda</a>	<b>Agenda Item 1A</b> <b>Agenda Item 1B</b> <b>Agenda Item 1C</b>
10:30 a.m. – 10:45 a.m.	<i>Break</i>	
10:45 a.m. – 11:45 a.m.	<b>Information Technology and Cloud Services</b> Ms. VanDyne and Ms. Gorla will seek the Committee’s approval to expose a revised interpretation for comment.	<b>Agenda Item 2A</b> <b>Agenda Item 2B</b>
11:45 a.m. – 12:30 p.m.	<b>Long Association</b> Ms. Dourdourekas and Ms. Ziembra will request the Committee’s feedback on non-authoritative guidance proposed by the Task Force. ❖ External Link – <a href="#">Long Association Exposure Draft</a>	<b>Agenda Item 3A</b> <b>Agenda Item 3B</b>
12:30 p.m. – 1:30 p.m.	<i>Lunch</i>	
1:30 p.m. – 2:00 p.m.	<b>State and Local Government</b> Ms. Miller and Ms. Gorla will update the Committee on the Task Force activities and seek input on the Task Force’s project plan. ❖ External Link – <a href="#">SLG Exposure Draft</a>	
2:00 p.m. – 2:45 p.m.	<b>Leases</b> Mr. Mercer will update the Committee on comment letters received to date. ❖ External Link – <a href="#">Leases Exposure Draft</a> ❖ External Link – <a href="#">Comment Letters</a>	<b>Agenda Item 4A</b> <b>Agenda Item 4B</b> <b>Agenda Item 4C</b>
2:45 p.m. – 3:15 p.m.	<b>NOCLAR</b> Mr. Denham will update the Committee on the Task Force’s activities.	

3:15 p.m. – 3:30 p.m.	<i>Break</i>	
3:30 p.m. – 4:30 p.m.	<b>Staff Augmentation (Loaned Staff) Task Force</b> Ms. Snyder and Mr. Mercer will seek the Committee's feedback on the Task Force's direction.	<b>Agenda Item 5A</b> <b>Agenda Item 5B</b> <b>Agenda Item 5C</b>
4:30 p.m. – 4:45 p.m.	<b>Compilation of Pro-forma and Prospective Financial Information</b> Mr. Brand and Mr. Mercer will update the Committee on the Task Force's activities and request additional Committee members for the Task Force.	<b>Agenda Item 6A</b>
4:45 p.m. – 5:00 p.m.	<b>IESBA Update</b> Ms. Gorla will update the Committee on IESBA activity.	
5:00 p.m. – 5:20 p.m.	<b>IESBA Fees Questionnaire</b> Ms. Gorla will discuss the IESBA Fees Questionnaire with the Committee. ❖ External Link - <a href="#">IESBA Fees Questionnaire</a>	
5:20 p.m. – 5:30 p.m.	<b>Minutes of the Professional Ethics Executive Committee Open Meeting</b> The Committee is asked to approve the minutes from the November 2017 open meeting.	<b>Agenda Item 7</b>
	<i>Open Meeting Concludes</i>	
Informational Purposes Only	<b>Outstanding Exposure Drafts</b> ❖ External Link - <a href="#">SLG Exposure Draft</a> ❖ External Link - <a href="#">Long Association Exposure Draft</a> ❖ External Link - <a href="#">Leases</a>	
Informational Purposes Only	<b>Committee Project Agenda</b> ❖ External Link - <a href="#">Project Agenda</a>	
	<b>Future Meeting Dates</b> <ul style="list-style-type: none"> <li>• May 8-9, 2018 – Scottsdale, AZ</li> <li>• August 8-9, 2018 – TBD</li> <li>• November 7-8, 2018 – Durham, NC</li> <li>• February 2019 - TBD</li> </ul>	

**PEEC Planning Subgroup****Subgroup Members**

Sam Burke (Chair), Bob Denham, Carlos Barrera, Lisa Snyder, and Mike Brand.  
Staff: Jim Brackens, Toni Lee-Andrews, Ellen Gorla, Brandon Mercer.

**Subgroup Charge**

The Subgroup's charge was to determine where the PEEC should be focusing efforts over the next 12-36 months.

**Reason for Agenda Item**

Staff consulted with external and internal stakeholders to identify issues for the PEEC Planning Subgroup's (Subgroup) consideration, and for possible inclusion in the PEEC [Three-Year Project Agenda](#) (Project Agenda). A summary of issues was previously presented to the Subgroup for consideration on January 12, 2018. The Subgroup proposes that the issues noted below be added to the Project Agenda. Other items were designated to be addressed by Staff (**Agenda Item 1B**) and/or on a list for future projects (**Agenda Item 1C**). The purpose of this agenda item is to obtain PEEC feedback on the items proposed by the Subgroup and to determine prioritization of the items for inclusion in the PEEC Project Agenda.

**Summary of Issues***Relevance of specific independence rules*

- Evaluation of the existing Code to consider, in today's environment, if certain rules have unintended consequences or have become impracticable
- Consideration of what could be missing from the Code as additional services and technology is ever-changing and evolving

*Convergence*

- Discussion regarding process surrounding convergence, including timing of opportunities for dialogue

*Members' responsibility for protecting client data*

- Evaluation of whether the Code should address protection of client data, including compliance with federal and state rules

*Member Enrichment*

- Discussion regarding ways to provide education and communication on various topics and to add value to the member experience

**Action Needed**

Staff requests that PEEC discuss the issues presented by the Subgroup and determine additions and prioritization for PEEC's Three-Year Project Agenda.

**Communications Plan**

Staff will update the Subgroup on any additional feedback received from external and internal stakeholders.

## **Materials Presented**

**Agenda Item 1B** Summary of Comments/Questions/Issues to be addressed by Staff

**Agenda Item 1C** Summary of Comments/Issues for future consideration

**Summary of Comments/Questions/Issues to be addressed by Staff***Professional Skepticism*

- Discussion that IESBA's desire is to make this a responsibility for all professional accountants; there is a belief that professional skepticism is an assurance concept.

*AU-C-230*

- Confusion regarding documentation required for non-attest services (unrelated to government audits). It has been mentioned that in order to show a firm considered independence related to non-attest services, it needs to be documented. Does AU-C 230 conflict with the ethics standard?

*Independence interpretations in the Code regarding previous employment/association with an attest client*

- Possible inconsistency between two independence interpretations in the Code.

*Ethics Hotlines*

- Should state societies have hotlines, responding to ethics questions from its members and others, called in or submitted electronically, or by regular mail? Should members of the societies' professional ethics committees be the people responding to such inquiries, or should they not be the ones responding? Questions can often be complicated and unclear, and answers also not easily determined. What can the responses say, and what should they not say? Can opinions be voiced? Can responses be either verbal or in writing? The matter of ethics hotlines at the state level seem to be handled in different ways, and some guidance could be very helpful.

*Conceptual Framework*

- How is a CPA to determine that "safeguards" put into effect at some point in the audit process, will eliminate a "threat" or reduce it to an "acceptable level"? How is someone supposed to determine "acceptable level"? What's acceptable to me may not be acceptable to you or to her. Is something a threat? Maybe, maybe not. Same thing with a so-called safeguard.

*Unethical Behavior*

- Members in public practice or business, who have the misfortune to find themselves employed by or partners with unethical people who violate Code of Conduct and laws. What is the member's obligations regarding reporting the transgressions to legal authorities, state boards, the AICPA, etc.? If the employee leaves the firm or company, what does he or she say to a prospective employer about the reason for leaving? What good advice does the AICPA have for such situations?

*Compilation vs. Examination/Review of Pro Forma Financial Information*

- In an examination or review (performed in accordance with the SSAEs), the member need only be independent of the responsible party.
- A compilation of pro forma financial information is required to be performed in accordance with SSARs. A compilation is a lower level service than an examination or

review. However, in a compilation, the member would have to be independent of both sides of the transaction.

- Code section 1.297.010 Application of the Independence Rule to Engagements Performed in Accordance With Statements on Standards for Attestation Engagements does not apply to SSARs engagements. Does your project with respect to “definition of client” fix this? It is an inconsistency that does not make sense.

*Would the proposed Selected Procedures engagement have the same independence rules as AUP?*

- Code section 1.297.020 *Agreed-Upon Procedure Engagements Performed in Accordance With SSAEs* – could this be extended to Selected Procedures?

*Concern over how the PEEC’s actions affect services performed subject to Consulting Standards*

- There seems to be an increasing disconnect, and potentially unintended adverse consequences, of the PEEC’s decisions. For example, the Proposed Interpretations Responding to Non-Compliance with Laws and Regulations could create significant problems for members who perform forensic investigations. There is concern that our members could be adversely affected by changes made by PEEC. These adverse effects could be financial (loss of work), or professional (improper performance of work).

*SLG*

- Concern regarding the SLG Exposure Draft, believing PEEC is creating far too much work with little public benefit.

*Long Association*

- The IAASB is talking to IESBA about long association and a required cooling-off period for engagement quality control reviewers. This should not be advocated.

**Summary of Comments/Issues for Future Consideration***Cybersecurity*

- Consider addition of interpretations to the Code under independence and non-attest services specific to the provision of non-attest cybersecurity services.

*CPAs in public practice serving as directors of and audit committee members of IDIs while providing services to management and other board members and having clients that are customers of the IDI; may also involve retired partners of an IDI's audit firm*

- Currently, when responding to questions regarding the composition of audit committees and the independence of management criteria pertaining to members of the audit committees of insured depository institutions (IDIs), we have observed that CPAs in public practice are not only serving as directors of IDIs but they are also serving as members of audit committees. The main reason for a CPA in public practice serving as a director of an IDI is for the CPA in public practice to serve on the audit committee. In this regard, the Code of Professional Conduct (1.110.020.01 and 1.700.080.01) suggests that CPAs in public practice not serve on the board of directors of a financial institution but it does not expressly prohibit it. Based on my observations, some CPAs in public practice are providing services to management and other board members pertaining to tax and other services related to their personal and non-bank entities. These CPAs may also have clients that are customers of the IDI. I am also concerned that this issue may involve retired partners of an IDI's audit attest firm. Being retired from an audit firm does not necessarily mean that the "retired partner" is not performing services for management and directors of IDIs as well as customers of the IDIs.

*Auditor-prepared financial statements*

- Enhancement of PEEC's requirements to harmonize with GAO.

*Independence interpretation in the Code on indemnification/limitation of liability provisions in engagement letters*

- There is member confusion in applying the independence interpretation in the Code on indemnification/limitation of liability provisions in engagement letters (1.228.010). It appears that the words in the interpretation and some illustrative engagements letters in the SSARS do not align.

### Information Technology and Cloud Services

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

#### Task Force Objective

Recommend to the Committee any changes necessary to the nonattest services subtopic considering current information technology (including cloud) service offerings by members.

#### Reason for Agenda

Approve the revised *Information Systems Design, Implementation, or Integration* interpretation for exposure and provide feedback on questions received on the Hosting Services interpretation.

#### Summary of Issues

*Information Systems Design, Implementation, or Integration Interpretation*

##### Committee Direction

At the November meeting, the Committee requested the Task Force:

1. Discuss the proposed definition of “financial information system”.
2. Incorporate more examples of maintenance issues members may encounter into paragraph .20.
3. Discuss if the example “monitors the attest client’s network on a routine or continual basis” in paragraph .20 would include cybersecurity monitoring as a second level of security.
4. Make some specific editorial revisions to the proposed revised interpretation.

##### Financial Information System

The proposed revised interpretation sets the tone in paragraph .02 that when the nonattest service does not relate to the attest client’s financial information systems, threats to compliance with the Independence Rule would be at an acceptable level when certain conditions are met. At the November meeting the Committee was asked if a definition for financial information systems should be added and if so, consideration be given to add a definition that Staff believed was consistent with guidance provided by the SEC.

The Committee requested the Task Force discuss the suggested definition. The Task Force recommends defining “financial information system” consistent with the SEC guidance because defining it differently would likely cause confusion and a need to clarify the differences between the two. To provide guidance on how to apply the definition, the Task Force is also recommending that definition include guidance on how to determine if the nonattest services are *related to* a financial information system. Following is the Task Force’s recommendation which also appears in **Agenda Item 2B**:

Financial information system is a system that aggregates source data underlying the financial statements or generates information that is significant to the financial statements or other financial information systems taken as a whole. ***To determine if a nonattest service is related to a financial information system, members may consider factors, such as, whether the nonattest service will impact***

- i. ***system controls or system output that will be subject to attest procedures***

- ii. ***a system that generates data that is used as an input to the financial statement amounts or footnotes***
- iii. ***a system that gathers data that assists management in making decisions that directly impact financial reporting***
- iv. ***a system that is part of the client's information technology general controls or internal controls over financial reporting?***

**Question For Committee**

1. Are there any other factors that should be added?

Examples of Maintenance, Support and Monitoring Services

At the November meeting, the Committee requested the Task Force incorporate additional examples into paragraph .20 of typical maintenance, support and or monitoring services that would impair independence and to if the example “monitors the attest client's network on a routine or continual basis” would include cybersecurity monitoring as a second level of security. The Task Force recommends the following additions and clarifications to paragraph .20:

- a. operates the attest client's network ***such as managing the attest client's systems or software applications.***
- b. supervises ***client personnel involved in*** the operation of the attest client's information systems.
- c. monitors the attest client's network ***performance*** on a routine or continual basis.
- d. ***operate or manage the attest client's help desk.***
- e. ***has responsibility to perform ongoing network maintenance such as updating virus protection solutions, applying routine updates and patches or configuring user settings.***
- f. ***accepts responsibility for maintaining the security of the attest client's networks and systems.***

The Task Force also recommends the following additional examples be added to paragraph .21 of typical cyber security services that would not impair independence

- a. analyze a network.
- b. apply virus protection solutions or updates that the member did not design or develop.
- c. apply certain updates and patches that the member did not design or develop.
- d. provide training or instruction on a new software solution.
- e. ***assess an attest client's security over information technology systems.***
- f. ***conduct an assessment of the attest client's information technology security practices.***

**Questions For Committee**

1. Does the Committee believe it is clear that example f in paragraph .20 would be apply to cyber security as well as any other network or system security that the attest client chooses to put in place?
2. Are there any other examples that the Committee would like to add?

### Editorial Revisions

The Committee requested that the Task Force try to reword: (1) paragraph .04 so that it reads more clearly, and (2) paragraphs .20 and .21 so that the wording conforms to the PEEC's editorial revisions to paragraph .02 related to the member assuming a management responsibility. The Task Force's recommended editorial revisions can be found in **Agenda Item 2B**.

### *Hosting Services*

Staff has run some questions by the Task Force related to inquires received on how to apply the Hosting Services interpretation. Staff plans to monitor the inquires and will likely develop some member enrichment tools around this topic. Members of the Committee are asked to submit any questions they have related to the Hosting Services interpretation to Staff for possible consideration.

### **Action Needed**

The Committee is asked to approve the proposed revised interpretation for exposure.

### **Communication Plan and Member Training Tools**

TBD

### **Materials Presented**

**Agenda Item 2B** Proposed Revised Information Systems Services Interpretation

Edits in **Green Highlight** Were Made By the Committee During  
the November 2017 Meeting

Edits in **Yellow Highlight** Are the Task Force's Recommendations

### 1.295.145 Information Systems Services

- .01 Self-review and management participation threats to the **covered** member's compliance with the "Independence Rule" [1.200.001] may exist when a member provides services related to an attest client's information systems.
- .02** When performing **nonattest** services described in this interpretation for an attest client that are not related to a financial information system, threats to compliance with the "Independence Rule" would be at an acceptable level provided all the requirements of the **Nonattest Services** subtopic [1.295] of the Independence Rule [1.200.001] are met including that the attest client has not **in-essence** outsourced a function, process or activity to the member **which in effect would result in the member assuming a management responsibility**.
- .03 When a member designs or develops an attest client's financial information system, threats to compliance with the "Independence Rule" [1.200.001] would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards **and independence would be impaired**. Designing and developing a template that performs a discrete calculation such as a tax provision or depreciation calculation does not constitute designing or developing an information system and will not impair independence provided the **template does not perform an activity that, if performed directly by the member, would impair independence and the** member complies with all the requirements of the **Nonattest Services** subtopic [1.295] of the Independence Rule [1.200.001].
- .04 Paragraphs .06 through .19 explain the impact on independence when a member provides services related to a financial information system that is a COTS package that the member has not designed or developed. Paragraphs .20 and .21 explain the impact on independence when a member provides services related to system and network maintenance, support and monitoring.** When performing services described in this interpretation for an attest client that relate to a financial information system that is a commercial off the shelf software (COTS) package that the member has not designed or developed, threats to compliance with the "Independence Rule" would be at an acceptable level **except as** provided **in the remaining paragraphs of** this interpretation.

### Terminology

- .05 The following terms are defined solely for the purpose of applying this interpretation:
- a.** Financial information system is a system that aggregates source data underlying the financial statements or generates information that is significant to the financial statements or other financial information systems taken as a whole. **To determine if a nonattest service is related to a financial information system, members may consider factors, such as, whether the nonattest service will impact**

- i. system controls or system output that will be subject to attest procedures**
  - ii. a system that generates data that is used as an input to the financial statement amounts or footnotes**
  - iii. a system that gathers data that assists management in making decisions that directly impact financial reporting**
  - iv. a system that is part of the client's information technology general controls or internal controls over financial reporting**
- b. Designing an information system means determining how a system or transaction will function, process data and produce results (for example, reports, journal vouchers and documents such as sales and purchase orders) to provide a blueprint or schematic for the development of software code (programs) and data structures.
  - c. Developing an information system entails creating software code, for individual or multiple modules, and testing such code to confirm it is functioning as designed.
  - d. Commercial Off-the-Shelf ("COTS") means a software package developed, distributed, maintained and supported by a third-party **vendors (vendor(s))**, sometimes simply referred to as an "off the shelf" package or solution. COTS solutions have generally referred to traditional on-premises software that runs on a customer's own computers or on a vendor's "cloud" infrastructure. COTS solutions range from software packages requiring only installation on a computer and are ready to run to large scale, complex enterprise applications.
  - e. Data mapping involves assisting the client in understanding and identifying how the fields in the legacy system relate to fields in the new system.

### ***Implementation of a Commercial-Off-The-Shelf Financial Information System Software Solution***

- .06 Implementation services involve activities related to an attest client's information systems after the design and development of the system. Implementation ceases when the system is available on a regular basis to the client for its intended use. For example, implementation services can include activities such as installing, configuring, interfacing, customizing, data translation and data mapping. Services that are performed post-implementation, such as the maintenance, support and monitoring of the system, are not considered to be implementation services.
- .07 Threats created by certain COTS implementation services related to the attest client's financial information system may be reduced to an acceptable level by the application of safeguards, while in other situations threats to compliance with the "Independence Rule" [1.200.001] would be significant and could not be reduced to an acceptable level by the application of safeguards.

### ***Install a Commercial-Off-The Shelf Financial Information System Software Solution***

- .08 To install a COTS financial information system software solution means the initial loading of software on a computer, normally onto a customer's server(s). Software configuration, **development**, integration and conversion activities may follow installation.
- .09 When a member installs a COTS financial information system software solution, threats to compliance with the "Independence Rule" would be at an acceptable level provided all the

requirements of the [Nonattest Services](#) subtopic [1.295] of the Independence Rule [1.200.001] are met.

#### **Configure a Commercial-Off-The Shelf Financial Information System Software Solution**

- .10 To configure a COTS financial information system software solution means selecting the software features, functionality options, and settings **provided by the vendor** that will determine how the software will perform certain transactions and process data. Configuration options may also include selecting the predefined format of certain data attributes and the inclusion or exclusion of such attributes. For purposes of this interpretation, configuring a COTS financial information system software solution does not **generally** involve developing new software code or features to modify or alter the functionality of the COTS software solution in ways not pre-defined by the vendor.
- .11 When a member configures a COTS financial information system software solution, threats to compliance with the “Independence Rule” would be at an acceptable level provided all the requirements of the [Nonattest Services](#) subtopic [1.295] of the Independence Rule [1.200.001] are met.

#### **Customize a Commercial-Off-The Shelf Financial Information System Software Solution**

- .12 To customize a COTS financial information system software solution means altering or adding to the features and functions provided for by the vendor, which go beyond all options available when configuring the COTS software solution. For purposes of this interpretation, customizing can either involve modification or enhancements:
- a. Modification involves altering the COTS software solution code to change or add to the functionality provided by the vendor, or
  - b. Enhancements involve developing new code, external to the COTS software solution, **and works which work** in concert with the COTS software solution to provide altered or additional functionality.
- .13 If a member customizes an attest client’s COTS financial information system software solution, 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**.

#### **Interface a Commercial-Off-The Shelf Financial Information System Software Solution**

- .14 Providing interface services for a COTS financial information system software solution means connecting two or more systems by designing and developing software code that passes data from one system to another. Interfaces may flow in one direction or be bidirectional. Interfaces may involve the performance of an end-to-end transaction or they may pass data from one system to another.
- .15 If a member provides interface services for a COTS financial information system software solution, 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** except as provided for in paragraph .16.
- .16 If a member uses an Application Program Interface (API) that is developed by a third party to interface one or more legacy or third-party COTS financial information system software solutions, threats to independence would be at an acceptable level provided the member will

not be designing or developing code for the API to work and all the requirements of the [Nonattest Services](#) subtopic [1.295] of the Independence Rule [1.200.001] are met.

### **Data Translation Services Related to a Commercial-Off-The Shelf Financial Information System Software Solution**

- .17 Performing data translation services for a COTS financial information system software solution involves designing and developing the rules or logic necessary to convert legacy system data to a format that is compatible with that of the new system.
- .18 If a member performs data translation services for a COTS financial information system software solution, 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** except as provided for in paragraph .19.
- .19 If a member uses an API that is developed by a third party to perform data translation services for a COTS financial information system software solution, threats to independence would be at an acceptable level provided the member will not be designing or developing code for the API to work and all the requirements of the [Nonattest Services](#) subtopic [1.295] of the Independence Rule [1.200.001] are met.

### **System and Network Maintenance, Support and Monitoring Services**

- .20 Maintenance, support and monitoring services are activities that are provided after a financial or non-financial system or network is implemented. If post-implementation services involve ~~ongoing functions, processes or activities where~~ the attest client ~~has in essence outsourced these functions, processes or activities~~ **outsourcing an ongoing function, process or activity** to the member **which in effect would result in the member assuming a management responsibility**, 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. Examples of services that involve ~~an ongoing functions, processes~~ **function, process or activity** would include a service whereby the member directly or indirectly:
  - a. operates the attest client's network **such as managing the attest client's systems or software applications.**
  - b. supervises **client personnel involved in** the operation of the attest client's information systems.
  - c. monitors the attest client's network **performance** on a routine or continual basis.
  - d. **operate or manage the attest client's help desk.**
  - e. **has responsibility to perform ongoing network maintenance such as updating virus protection solutions, applying routine updates and patches or configuring user settings.**
  - f. **accepts responsibility for maintaining the security of the attest client's networks and systems.**
- .21 Independence will not be impaired provided all the requirements of the [Nonattest Services](#) subtopic [1.295] are met and where the maintenance, support and monitoring services are discrete nonrecurring engagements where the attest client has ~~not in essence~~ outsourced a function, process or activity to the member **which in effect would result in the member**

**assuming a management responsibility.** Examples of such services may include being engaged for a discrete project to:

- a. analyze a network.
- b. apply virus protection solutions or updates that the member did not design or develop.
- c. apply certain updates and patches that the member did not design or develop.
- d. provide training or instruction on a new software solution.
- e. **assess an attest client's security over information technology systems.**
- f. **conduct an assessment of the attest client's information technology security practices.**

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

**IFAC Convergence – Long Association****Task Force Members**

Anna Dourdourekas (Chair), Coalter Baker, Bob Denham, and Shelly Van Dyne.  
Staff: Shannon Ziemba. Observer: Ellen Gorla.

**Task Force Charge**

The Task Force is charged with reviewing the International Ethics Standards Board for Accountants' (IESBA) standard entitled, Long Association of Personnel with an Audit or Assurance Client (Long Association) and recommend to PEEC revisions to the AICPA Code for purposes of convergence.

**Reason for Agenda Item**

To seek feedback from the Committee on staff's non-authoritative frequently asked questions related to Long Association.

**Background Summary*****Feedback from the PEEC***

At the November 2017 PEEC meeting, the Committee agreed, by a straw poll, not to adopt the proposed *Long Association* interpretation. Instead the Committee recommended the Task Force develop non-authoritative guidance to supplement the existing guidance in the *Conceptual Framework for Independence*.

The Committee agreed that the existing guidance in the *Conceptual Framework for Independence* of the extant Code addresses the substance of the IESBA's Long Association standard, but that additional guidance would be beneficial to the members.

***Nonauthoritative Application Guidance******FAQ***

Staff prepared the two Frequently Asked Questions (FAQs) found in Agenda Item 3B to provide members with some additional application guidance regarding senior personnel's long association on the attest engagement team. Staff recommends these FAQs be added to the [General Ethics FAQ](#) document and a link to this document be added to the text box at the end of the *Conceptual Framework for Independence* interpretation that states:

Nonauthoritative questions and answers regarding senior personnel's long association on an attest engagement is available in the Ethics FAQ at [www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf](http://www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf).

**Questions For Committee**

1. Does the Committee have any feedback on the FAQs found in Agenda Item 3B?
2. Does the Committee believe there are any other issues related to long association that staff should draft FAQ guidance on?
3. Does the Committee believe the text box containing the link to the Ethics FAQ be placed at the end of the *Conceptual Framework for Independence* interpretation or after *Familiarity threat (1,210,010.14)*?
4. Does the Committee believe links to these FAQs should appear anywhere else in the Code?

*Plain English Guide to Independence*

Staff believes many members consult the [Plain English Guide to Independence](#) (Guide) before they consult the actual Code. Accordingly, Staff recommends that a new section be added to Chapter 3 of the *Guide* entitled “Do Threats Exist When A Member is On An Attest Engagement Team for An Extended Period of Time?” and that the following be added as the text to that topic:

“The familiarity threat exists when senior personnel are on an attest engagement team for an extended period of time. Nonauthoritative questions and answers regarding senior personnel’s long association on an attest engagement is available in the Ethics FAQ at [www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf](http://www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf).

When developing this recommendation, Staff noted that there is other nonauthoritative independence guidance, such as FAQs, that the Guide does not reference and seeks the Committee’s input on whether Staff should analyze the nonauthoritative independence guidance that has been issued and develop recommendations on how to incorporate references into the Guide.

**Questions For Committee**

1. Does the Committee agree with Staff’s recommendation that a new section be added to Chapter 3 to cross reference to these FAQs?
2. Does the Committee have any concerns if additional references to nonauthoritative independence guidance was added to the Plain English Guide to Independence?

**Effective Date:**

Not applicable.

**Materials Presented**

**Agenda Item 3B** – Proposed Frequently Asked Questions – Long Association

## Frequently Asked Questions - Long Association

**Question.** Does the familiarity threat to independence increase when senior personnel<sup>1</sup> of the engagement team have been on the attest engagement team for an extended period of time?

**Answer.** Yes, the familiarity threat to independence may increase in significance when senior personnel serve on the engagement team for an extended period. The senior personnel will need to determine the significance of these *threats* and relevant factors for evaluating the threat to independence. Some of the factors to consider:

- a. Factors relating to senior personnel who are on the *attest engagement team* include:
  - i. The overall length of the individual's relationship with the *attest client*, including if such relationship existed while the individual was at a prior *firm*
  - ii. How long the *individual* has been on the *attest engagement team* and the nature of the roles performed
  - iii. The extent to which the work of the individual is directed, reviewed, and supervised by other senior personnel
  - iv. The extent to which, due to the *individual's* seniority, the *individual* has the ability to influence the outcome of the *attest engagement*, for example, by making key decisions or directing the work of others on the *attest engagement team*
  - v. The closeness of the *individual's* personal relationship with the *attest client's* senior management or *those charged with governance*
  - vi. The nature, frequency, and extent of the interaction between the individual and the *attest client's* senior management or *those charged with governance*
- b. Factors relating to the *attest client* include the following:
  - i. The *attest client's* accounting and financial reporting issues and whether they have changed
  - ii. Whether there have been any recent changes in senior management or *those charged with governance*
  - iii. Whether there have been any structural changes in the *attest client's* organization that affect the nature, frequency, and extent of interactions the *member* may have with senior management or *those charged with governance*

The combination of two or more factors may increase or reduce the significance of these *threats*. For example, familiarity *threats* created over time by an increasingly close relationship between the senior personnel on the *attest engagement team* and an individual in the *attest client's* senior management would be reduced by the departure of that individual in the *attest client's* senior management and the start of a new relationship. This change in senior management at the *attest client* could reduce or eliminate the familiarity threat.

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<sup>1</sup> For the purposes of this FAQ, senior personnel are defined as *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* and who maintain regular contact with *attest client* management or *those charged with governance*.

**Question.** A *member* has determined that there is a significant familiarity *threat*, because senior personnel<sup>2</sup> has served on the engagement team for an extended period. May the *member* still perform the *attest engagement*?

**Answer.** Yes, the member may still be able to perform that the attest engagement, if the member can apply *safeguards* to eliminate the *threat* or reduce it to an *acceptable level*. Examples of such *safeguards* include the following (this list is not all inclusive):

- a. Changing the role of the *member* on the *attest engagement team* or the nature and extent of the tasks the *member* performs
- b. Having a professional accountant who was not included in the *attest engagement team* review the work of the *member*
- c. Performing regular independent internal quality review of the engagement
- d. Performing an independent external quality review of the engagement
- e. Rotating the *member* off the *attest engagement team* for an appropriate period based on the significance of the *threats*

If there are no *safeguards* which could be applied that would eliminate the *threat* or reduce it to an *acceptable level*, then *independence* would be *impaired*.

The member should document the identified *threats* and *safeguards* that were applied to eliminate or reduce the signification *threats* to an *acceptable level* as required in the Code.

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<sup>2</sup> For the purposes of this FAQ, senior personnel are defined as *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* and who maintain regular contact with *attest client* management or *those charged with governance*.

**COMMENT SUMMARY**  
**PROPOSED Revised “Leases” interpretation of the “Independence Rule”**

	<b>Comment Letter</b>	<b>Feedback Highlights</b>	<b>Task Force Response (TBD)</b>
<b>CL 1</b>	AICPA Technical Issues Committee (TIC) <b>Support</b>	<b>General Comments</b> <ul style="list-style-type: none"> <li>• TIC believes that the specific identification of familiarity and undue influence threats in paragraph 01 of the ED should be removed; TIC believes that these would not be significant threats.</li> <li>• TIC also notes that ET sec 1.260.020, Loans and Leases with Lending Institutions, only identifies self-interest as a threat. TIC believes this is appropriate. The ED does a very good job of conforming ET sec 1.260.040 with 1.260.020 except for the references to familiarity and undue influence threats, which based on the definitions, would not be significant threats.</li> </ul>	
<b>CL 2</b>	NASBA <b>Support</b>	<b>General Comments</b> <ul style="list-style-type: none"> <li>• In comparing the proposed revisions to the existing loan interpretation (1.260.020), we noted that the loan interpretation includes a fundamental safeguard that is absent from this proposal, i.e., the Code only permits loans to a covered member from an attest client if the attest client makes loans as part of its normal business operations. We understand the PEEC considered this fact and concluded that because real estate investment trusts, which are not lending institutions, frequently issue real estate leases, the addition would not be appropriate. However, we also note that the current definition of “lending institution” does incorporate automobile lessors. Thus, for consistency purposes and</li> </ul>	

Comment Letter	Feedback Highlights	Task Force Response (TBD)
	<p>to significantly strengthen the proposed leases interpretation, we suggest that PEEC consider whether a similar notion pertaining to lessors more broadly should be incorporated into this standard as a fundamental safeguard.</p> <ul style="list-style-type: none"> <li> <i>Lending institution. An entity that, as part of its normal business operations, makes loans.</i> This definition is not meant to include an organization that might schedule payment for services for a client over a period of time. Examples of such entities are banks, credit unions, certain retailers, and insurance and finance companies. For example, for automobile leases addressed by the “Loans and Leases with Lending Institutions” interpretation [1.260.020] of the “Independence Rule” [1.200.001], an entity is considered a lending institution if it leases automobiles as part of its normal business operations. [Prior reference: paragraph .09 of ET section 92] </li> </ul>	
<p><b>CL 3</b> KPMG <b>Support</b></p>	<p><b>General Comments</b></p> <ul style="list-style-type: none"> <li>           We recommend that PEEC consider an exemption...for short-term leases such as short-term rental properties, car rentals, and technology rentals. Self-interest, familiarity, and undue influence threats related to such leases are low because of the brief duration of the lease. The burden on the firm and covered member to track such leases could be prohibitively high with respect to the low level of threats to independence resulting from short-term leases. We believe that a reasonable lease term to qualify for the exemption would be a term not to exceed thirty days. In order to qualify for the short- term lease exclusion, the lease should not have a renewal option that extends the rental period beyond the period defined as short-term. We         </li> </ul>	<ul style="list-style-type: none"> <li></li> </ul>

Comment Letter	Feedback Highlights	Task Force Response (TBD)
	<p>propose PEEC consider the following wording be added to paragraph .01 in order to address the comments reflected above:</p> <p><i>1.260.040.01.b</i>  <i>This interpretation excludes short-term leases entered into by a covered member with an attest client, as threats to compliance with the “Independence Rule” [1.200.001] would be at an acceptable level and independence would not be impaired provided that the lease term is ## days or less, and there is no renewal or extension to the lease term beyond ## days.</i></p> <ul style="list-style-type: none"> <li>• We believe that paragraph .06 is repetitive of the second paragraph of .01, as both discuss the exclusions around leases addressed by paragraph .04 of the “Loans and Leases with Lending Institutions” interpretation [1.260.020] of the “Independence Rule” [1.200.001]. We recommend that PEEC replace the second paragraph of paragraph .01 with paragraph .06, and remove paragraph .06.</li> </ul>	
<p><b>CL 4</b> Deloitte LLP  <b>Support</b></p>	<p><b>General Comments</b></p> <ul style="list-style-type: none"> <li>• Paragraph .02 – <i>Materiality Considerations for multiple leases</i>. Paragraph .02 (c) describes materiality safeguards for the firm, individuals participating on the attest engagement team, individuals in a position to influence the attest engagement, and the attest client that must be met to be able to conclude that threats to compliance with the Independence Rule (1.200.001) are or can be reduced to an acceptable level to avoid an independence impairment. However, there is no specific guidance in paragraph .02 related to the materiality considerations for multiple leases. We request the PEEC consider clarifying whether it is necessary to</li> </ul>	

Comment Letter	Feedback Highlights	Task Force Response (TBD)
	<p>consider aggregate materiality for purposes of applying the paragraph .02(c) safeguards in cases where multiple leases exist between the covered member and the attest client.</p> <ul style="list-style-type: none"> <li>Paragraph .04 – <i>Grandfathered Leases</i>. We request the PEEC consider clarification to Paragraph .04(c) which states, “The attest client entered into the lease with a counterparty which was not required to be independent of the attest client, and that counterparty to the lease later acquires or is acquired by the covered member.” The current wording is not clear. We believe the intent of this paragraph is to address situations whereby an existing attest client is party to a lease, and the counterparty to such lease, at inception, was not associated with the covered member. However, such counterparty is subsequently acquired by, or acquires the covered member (i.e., the counterparty becomes associated with the covered member, in which case the independence rules would then be applicable to that counterparty). Please clarify PEEC’s intent. In addition, the final sentence in paragraph .04 of the Proposed Interpretation states that “Automatic renewals provided for in the original lease are not considered changes in terms for purposes of this Interpretation.” We believe that addressing only this narrow aspect of a lease in the Interpretation could be read to imply that the application of other common lease terms (e.g., an election to extend a lease on a month-to-month basis at the end of its primary lease term) would be a change in terms for purposes of the Interpretation. We request that the PEEC consider broadening the scope of this sentence to indicate that the application of any provision of an original lease agreement is not considered a change in terms for purposes of this Interpretation.</li> </ul>	

Comment Letter	Feedback Highlights	Task Force Response (TBD)
	<ul style="list-style-type: none"> <li>• <i>Paragraph .05 - Covered Member Leases Primary Residence from Attest Client.</i> In our view, paragraph .05 of the Proposed Interpretation does not provide any special exception for leases related to primary residences. Rather, it appears to serve as a reinforcement of the grandfathering provisions already included in paragraph .04 that are available for any leasing arrangement and therefore may be superfluous/unnecessary. If our understanding is correct, PEEC should consider omitting the paragraph if it does not intend to provide any specific exception for primary residence leases. As an alternative, PEEC could consider including an explicit reference to leases on primary residences as an example of leases that can be grandfathered under the provisions of paragraph .04.</li> <li>• <i>Decision Tree.</i> We request the PEEC consider creating a decision tree to assist practitioners in understanding the new requirements under the interpretation. Given the complexity and analysis that may be required for implementation, a decision tree would provide greater clarity and guidance to members in applying the interpretation.</li> </ul>	
<b>CL 5</b> Grant Thornton <b>Support</b>	<b>General Comments</b> <ul style="list-style-type: none"> <li>• Grant Thornton suggests the PEEC consider providing examples or illustrations to assist in the application of the new interpretation.</li> </ul>	<ul style="list-style-type: none"> <li>•</li> </ul>
<b>CL 6</b> PwC <b>Support</b>	<b>General Comments</b> <ul style="list-style-type: none"> <li>• We agree with the PEEC’s position that the financial statement presentation of a lease should not result in a de-facto conclusion that the lease is permissible or impermissible from an independence perspective.</li> </ul>	<ul style="list-style-type: none"> <li>•</li> </ul>

Comment Letter	Feedback Highlights	Task Force Response (TBD)
	<p>Regardless of whether a lease is classified as an operating or a capital lease, we believe that independence should be evaluated on the basis of the lease’s effect on the auditor’s objectivity and professional skepticism. However, while we support a model that doesn’t default to US GAAP classification, we do have concerns regarding the approach being proposed by the PEEC.</p> <ul style="list-style-type: none"> <li>• In our view, goods and services obtained as a consumer in the ordinary course of business do not, generally, impair an auditor’s objectivity or professional skepticism. The current “Leases” interpretation implicitly recognizes this by permitting covered members to enter into an operating lease with an attest client, provided that the terms and conditions set forth in the lease agreement are comparable with other leases of a similar nature, and all amounts are paid in accordance with the lease terms and provisions.</li> <li>• Accordingly, our overarching recommendation is for the PEEC to align more closely with the IESBA Code of Ethics for Professional Accountants by establishing a more principles-based approach that treats leases as permissible provided they are entered into in the normal course of business and on an arm’s length basis. Under a principles-based approach such as this, the materiality of the lease to the covered member would be one of the factors to be considered when evaluating threats to independence, rather than the automatic trigger for an independence impairment as is being proposed. Because of the pervasive use of leasing arrangements to acquire a wide range of consumer goods, this approach would also help to mitigate the potential for</li> </ul>	

Comment Letter	Feedback Highlights	Task Force Response (TBD)
	<p>any undue burden or hardship that a bright-line test might otherwise create. It would also ensure consistency with the current treatment of automobile leases in the Code of Conduct, which takes the preferred approach of exempting such transactions from the prohibition on loans without regard to materiality. Appendix A expands on the principal suggestion described above, and also offers detailed comments and recommendations regarding other areas of the proposal.</p>	
<p><b>CL 7</b></p> <p>EY <b>Support</b></p>	<p><b>General Comments</b></p> <p>We are supportive of PEEC’s Proposed Revision that prescribes a conceptual framework to evaluate threats and safeguards to independence arising from leases between attest clients and covered members. We believe that the approach of evaluating lease transactions similar to the evaluation required for other business relationships is the most appropriate approach and consistent with other regulatory schemes. Fundamentally, lease transactions are procurement transactions whereby the lessee is contracting for the right to use an asset for a period of time. While the Code generally permits procurement by the member from attest clients, we agree that the typical terms of a lease arrangement often results in additional independence threats, thus requiring an additional evaluation of threats and safeguards that are generally not needed for typical, one-off procurement transactions. While we are generally supportive, we do wish to provide the following comments.</p> <ul style="list-style-type: none"> <li>• <i>Applicability and application of paragraph .02 and .03.</i> Consideration should be given to clarifying the leases subject to 1.260.040.02. The phrase “a covered member enters into a lease” could be read to apply to only new leases entered into during the period of professional engagement by a professional that is a covered member</li> </ul>	<ul style="list-style-type: none"> <li>•</li> </ul>

Comment Letter	Feedback Highlights	Task Force Response (TBD)
	<p>when the lease is executed, and not include leases entered into by a professional prior to becoming a covered member. The business relationship and loan interpretations use terms such as “has” or “had”. Use of the term “has”, in this situation seems to be more appropriate when considering the application of the grandfathering provisions.</p> <ul style="list-style-type: none"> <li>• If 1.260.040.02 was intended to only apply to new leases entered into during the period of professional engagement by a professional that is a covered member when the lease is executed, then we believe that paragraph 1.260.040.04 is not a grandfathering provision but rather addresses circumstances other than those described in 1.260.040.02, and should therefore be titled differently than “Grandfathered Leases”.</li> <li>• In addition, we believe that the requirements of paragraph 1.260.040.03, and its interaction with paragraph 1.260.040.02 could be confusing to members and in some circumstances place an undue burden on a firm to document safeguards when there are minimal threats. Paragraph 1.260.040.03 provides that even if the minimum safeguards required in paragraph 1.260.040.02 are met, the member should consider other threats and potential safeguards. It is unclear why there is a need to consider other threats if the lease is immaterial to the attest client and the covered members, since we believe that threats in those facts and circumstances are already at an acceptable level. We believe that it would be more appropriate to provide for a general evaluation of threats and safeguards consistent with paragraph .03 when the lease is immaterial to the attest client but material to a category of covered member not specified in paragraph .02c</li> </ul>	

Comment Letter	Feedback Highlights	Task Force Response (TBD)
	<p>(i.e., a partner, partner equivalent or manager that provides more than 10 hours of nonattest services to the attest client within any fiscal year, or 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 client). That approach would recognize that immaterial leases do not result in significant threats, and provide guidance to firms on how leases with certain categories of covered members, despite being material to that covered member, may have sufficient safeguards to objectivity and professional skepticism.</p>	

**COMMENT SUMMARY – RESPONSES TO SPECIFIC QUESTIONS  
PROPOSED Revised “Leases” interpretation of the “Independence Rule”**

<b>Question 1: Are there any exceptions that should be extended to affiliates of financial statement attest clients?</b>		
<b>CL 1</b>	TIC	TIC agrees that the provisions of this section should apply to affiliates and exceptions should not be extended.
<b>CL 2</b>	NASBA	No, NASBA does not believe that the PEEC should add any exceptions to a covered member’s leasing arrangements with affiliates of financial statement attest clients as (i) exceptions would add unnecessary complexity to the interpretation, and (ii) such treatment would be inconsistent with the way that other financial relationships (e.g., banking or brokerage relationships) are treated under the Code.
<b>CL 3</b>	KPMG	We do not believe that exceptions should be provided for affiliates of attest clients.
<b>CL 4</b>	Deloitte	n/a
<b>CL 5</b>	Grant Thornton	Grant Thornton believes that as ownership interests can change frequently in our current business environment, it would be our recommendation to only require leases that exist between a covered member and the attest client to be evaluated. We do not believe that a lease that exists between an affiliate (e.g., parent or a brother-sister entities not audited by the firm) and a covered member would impair the ability of a firm to be compliant with the Independence rule.
<b>CL 6</b>	PwC	Yes, we believe that exceptions should be extended to certain affiliates. Under the principles-based approach that we’ve recommended in Section I, a lease entered into with an unaudited affiliate under common control with (i.e., a “sister entity”) or upstream of the financial statement attest client could be deemed to raise threats to independence that are less significant than those created by a leasing arrangement with a material subsidiary. This is because, among other considerations, the former would not be subject to financial statement attest procedures or financial statement disclosures. However, the proposal makes no such distinction. In this scenario, the impact on independence would be considered to be the same, incorrectly in our view, and would represent a breach of the Code of Conduct reportable to those charged with governance. Establishing a more principles-based approach for evaluating the permissibility of leases, as we’ve suggested, would allow for flexibility in the

		<p>independence evaluation and help to avoid disparate and overly prescriptive conclusions relating to certain affiliates, such as those described above.</p> <p>If the PEEC decides to retain the prohibition on material leases with respect to members of the attest engagement team and those individuals in a position to influence the attest engagement, the prohibition should only apply to arrangements with the financial statement attest client and with those affiliates subject to financial statement attest procedures (i.e., downstream affiliates). Limiting the proposed prohibition as such would establish a more meaningful framework that appropriately restricts transactions based on whether they may be subject to financial statement attest procedures or financial statement disclosures.</p>
<b>CL 7</b>	EY	<p>We believe PEEC should consider whether all of the minimum safeguards in paragraph 1.260.040.02 of the Proposed Revision should apply to leases with affiliates that are not subject to an audit by the member. When the lease is with a parent or a sister affiliate, one of the major threats to independence related to leases (having to audit your own transaction) is non-existent. This indicates that a lesser level of safeguards are generally necessary to reduce the relevant threats to an acceptable level. We believe that a general threats and safeguards evaluation consistent with paragraph 1.260.040.3 will be sufficient in these circumstances.</p>

**Question 2: Are there any other situations or circumstances that should be grandfathered which are not grandfathered in the proposal?**

<b>CL 1</b>	TIC	TIC cannot think of any other situations or circumstances that should be grandfathered.
<b>CL 2</b>	NASBA	No, NASBA does not believe there are other situations involving a covered member's lease with an attest client that should be grandfathered (in addition to those scenarios suggested).
<b>CL 3</b>	KPMG	<p>We believe that PEEC should consider modifying the interpretation to include the following items as circumstances that should be grandfathered:</p> <ul style="list-style-type: none"> <li>a) When a covered member enters into a lease with a counterparty prior to independence being required, but the lease with the counterparty is later sold or transferred to a counterparty who is an attest client; and</li> <li>b) When a covered member enters into a lease with an attest client that is immaterial to the covered member or the attest client but subsequently becomes material to the covered member</li> </ul>

		or the attest client.
CL 4	Deloitte	Paragraph .04 of the Proposed Interpretation does not address the circumstances whereby a member enters into a lease with a counterparty for which independence is not required, and such lease is subsequently sold / transferred to a counterparty for which independence is required. In our view, the interpretation should allow for grandfathering of such leases similar to the grandfathering provisions applicable for mortgages and immaterial unsecured loans described in Interpretation 1.260.020.02(b)(ii), Loans and Leases With Lending Institutions.
CL 5	Grant Thornton	Grant Thornton agrees with the circumstances provided in the proposal for grandfathered leases. However, we suggest that PEEC consider providing further guidance on whether renewal of terms (or specific terms) of the original lease would be covered under grandfathered leases in the interpretation or in a frequently asked questions document. Specific examples should be provided. The proposal does state that automatic renewals provided for in the original lease are not considered changes in terms. However, specific guidance is not provided on whether other renewal of terms (not automatic renewals), but may be acceptable if the term revisions are not material to the original lease or are an extension of the original lease.
CL 6	PwC	As described in more detail in Section III.A, if the PEEC decides to retain the prohibition on material leases as proposed, we recommend that an exemption be provided for leases of primary residences entered into after the covered member is required to be independent of the lessor. An exemption for new leases of primary residences would help to eliminate a potentially significant hardship for covered members and their immediate family members who may otherwise see their range of options for housing in certain markets of the country considerably reduced by the independence restriction on material leases.
CL 7	EY	Since many leasing transactions, particularly in residential real estate, are for periods of one year or less without automatic renewals, the grandfathering provisions in paragraph 1.260.040.04 will provide insufficient relief in many situations. We believe that PEEC should consider whether there are safeguards available that would allow for a on-time, arms-length, ordinary course renewal of a short term lease on market terms as part of its grandfathering provision, subject to the general evaluation of threats and safeguards in 1.260.040.03, even if such renewals are not “automatic” or provided for in the lease document, particularly with respect to primary residence leases.

**Question 3: Do you agree with the application of the materiality safeguard in paragraph .02? Specifically, do you agree that**

**there are no safeguards available when a covered member specified in paragraph .02 has a lease with the attest client that is material to the covered member?**

<b>CL 1</b>	TIC	TIC agrees that with the application of the materiality safeguard in paragraph .02 and TIC agrees that no safeguards would be available in the case of a material lease with a covered member.
<b>CL 2</b>	NASBA	Yes, NASBA agrees that the materiality safeguard is essential within the context described in paragraph .02 of the proposed interpretation, that is, entering into a lease that is material to certain covered members creates an insurmountable threat to the firm's independence.
<b>CL 3</b>	KPMG	We agree that when a lease with a covered member is material to the covered member, there are no safeguards available that would reduce the threat to an acceptable level.
<b>CL 4</b>	Deloitte	We agree with the application of the materiality safeguard in paragraph .02, and that there are no safeguards available when a covered member specified in such paragraph has a lease with the attest client that is material to that covered member.
<b>CL 5</b>	Grant Thornton	Grant Thornton agrees with the application of materiality in evaluating leases between a covered member and an attest client.
<b>CL 6</b>	PwC	We do not agree with the application of the materiality safeguard in paragraph .02 as it relates to members of the attest engagement team and individuals in a position to influence the attest engagement for the reasons outlined in our detailed comments and suggestions above. However, as described in more detail in Section III.A, if the revised interpretation is to establish some form of a bright-line test based on materiality, we recommend that the PEEC give consideration to limiting that prohibition to those leasing transactions entered into by the attest engagement partner (or partner equivalent) and by the firm. Please refer to our detailed comments and recommendations in Section III.A.
<b>CL 7</b>	EY	n/a

**Question 4: Do you agree that there are no safeguards that would reduce the threat to an acceptable level when the lease with a covered member is material to the attest client?**

<b>CL 1</b>	TIC	TIC agrees that there are no safeguards that would reduce the threat to an acceptable level in this
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		circumstance.
<b>CL 2</b>	NASBA	Yes, NASBA agrees that a lease agreement between a covered member (as described in paragraph .02 of a proposed interpretation) and an attest client that is material to the attest client impairs independence.
<b>CL 3</b>	KPMG	We agree that when a lease with a covered member is material to the attest client, there are no safeguards available that would reduce the threat to an acceptable level.
<b>CL 4</b>	Deloitte	n/a
<b>CL 5</b>	Grant Thornton	Grant Thornton agrees there are no safeguards that would reduce the threat to an acceptable level when the lease with a covered member is material to the attest client. We do believe firms could appropriately segregate an individual that is not in the chain of command (or does not meet the other criteria for being a covered member) with leases that were material to an attest client which would result in the individual not being classified as a covered member.
<b>CL 6</b>	PwC	As indicated in Section I, we believe that independence would be impaired by a lease that is material to the attest client and agree that such leases should be prohibited. However, although we agree with the direction of the PEEC's proposal in this respect, we note that, for financial statement attest clients, a lease that is material to any affiliate of the financial statement attest client would also be prohibited under the proposal. As described in more detail in our response to Question 1, we believe that a lease entered into with an unaudited entity that is under common control with (i.e., a "sister entity") or upstream of the financial statement attest client raises threats to independence that can be less significant than those created by a lease entered into with the financial statement attest client itself or with a material subsidiary. Therefore, for the reasons outlined in our response to Question 1, we do not agree that a lease that is material to a sister entity or an upstream affiliate represents an unequivocal impairment of independence in all circumstances. A more principles-based approach that looks at whether the material lease could be subject to financial statement attest procedures or financial statement disclosures may be more appropriate.
<b>CL 7</b>	EY	n/a

**Question 5: Do you agree that the requirements of the proposal should extend to immediate family, as proposed?**

<b>CL 1</b>	TIC	TIC agrees that the requirements should extend to immediate family.
<b>CL 2</b>	NASBA	Yes, NASBA agrees that the requirements of the proposed interpretation should also apply to the covered member's immediate family, which is generally consistent with the application of other independence interpretations in the Code to those persons.
<b>CL 3</b>	KPMG	We agree with the proposed interpretation with respect to including the immediate family members of the covered members.
<b>CL 4</b>	Deloitte	In our view, it is reasonable to expect that rules on leases applicable to covered members should also apply to the immediate family of those individuals. We note, however, that while the Explanation of the Proposed Revision section of the Exposure Draft (see "Applicability") indicates that "the requirements of the proposed revision extend to the immediate family of the covered member and to affiliates of a financial statement attest client," the Proposed Interpretation does not explicitly include such language. This appears inconsistent with other areas of the AICPA Code where the rules and interpretations intended to apply to the immediate family member of covered members are explicitly stated in the rule/interpretation. PEEC should consider including such language in the body of the proposal to avoid any ambiguity or confusion in applying the standard.
<b>CL 5</b>	Grant Thornton	Grant Thornton agrees immediate family member should also be required to comply with the requirements of the proposal for leases similar to other financial relationship requirements under the AICPA's Independence Rules.
<b>CL 6</b>	PwC	We agree that the provisions of the proposed revised interpretation should also apply to leases entered into by the immediate family members of covered members.
<b>CL 7</b>	EY	n/a

**Question 6: What do you foresee as major obstacles to implementation or hardships? Do you expect significant changes in quality controls, procedures, tools, or technology to monitor leases?**

<b>CL 1</b>	TIC	TIC believes that the only threat to independence represented by leases is a self-interest threat. Based on the definitions of familiarity threat and undue influence threat, they are not significant in a lease
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		<p>between a covered member and an attest client that meets the safeguards in paragraph 02. The standard as written would create a hardship by adding the requirement to evaluate (and document) these threats and safeguards when TIC does not believe these threats would ever be significant. In addition, TIC does not believe any other threats, as contemplated in paragraph 03, would be relevant or significant to a lease that meets the safeguards in paragraph 02. Rather than requiring an evaluation of any other threats, TIC recommends this requirement be removed from the ED and the factors in paragraph 03 be retained solely for purposes of evaluating the self-interest threat. Since these other threats are not relevant or significant, this effort will not add anything to the independence determination.</p> <p>Other than the issues in the preceding paragraph, the interpretation should not require significant changes to monitor leases.</p>
<b>CL 2</b>	NASBA	<p>NASBA believes that two possible challenges to implementation may fall more heavily on practitioners in smaller firms:</p> <ul style="list-style-type: none"> <li>(i) lack of awareness of the revised independence requirements, which would prevent firms from preparing for the changes, and</li> <li>(ii) inter-relationships between the smaller firms and their clients are likely to be more prevalent than in larger firm environments, thus the smaller firms (especially in more rural areas) may find it challenging to avoid or safeguard against situations that create significant threats to their independence. Thus, we believe these practitioners will need significant lead time to develop appropriate safeguards and effectively implement the proposed revisions.</li> </ul>
<b>CL 3</b>	KPMG	<p>Other than the impact on short-term leases as previously discussed, we don't anticipate significant changes in processes as a result of implementing this interpretation.</p>
<b>CL 4</b>	Deloitte	<p>In our view, the Proposed Interpretation as written may require significant consideration of and potential revisions to a member's existing controls, processes, procedures, systems and human resources in order to appropriately identify and effectively monitor its professionals' leasing arrangements. This view is based in part on the notion that under the Proposed Interpretation, a significant population of operating leases, which are currently "scoped out" under the extant code, will need to be identified, monitored and evaluated. We ask PEEC to consider the following:</p> <ul style="list-style-type: none"> <li>• We believe the Proposed Interpretation covers all leasing arrangements, regardless of the substance or length of the arrangements. Lease arrangements may include, for example, (a) short-term auto leasing arrangements (also known as "buy-back" or "purchase-repurchase" arrangements</li> </ul>

		<p>that are popular for extended vacations and which technically qualify as a lease rather than a rental), (b) short-term lodging arrangements on vacation and apartment rentals such as those offered by Airbnb or VRBO and (c) personal leases for appliances, home furnishings, and computers. We ask PEEC to evaluate the potential threats to independence arising from these type of lease arrangements and consider whether excluding such arrangements from the scope of the Proposed Interpretation would be appropriate based on the potential threats. We recognize the likelihood of such leases being material to the firm, its professionals or to the attest client may be very low, and thus, will likely not violate the Proposed Interpretation. However, absent specific exclusion of such arrangements, members will be responsible for gathering necessary information (likely a very significant volume of information for many firms) to be able to evaluate such arrangements and make a determination on compliance with the Proposed Interpretation.</p> <ul style="list-style-type: none"> <li>• Paragraph .02 includes certain “bright-line” conditions and considerations for evaluating leasing arrangements. We agree that such bright-line conditions and related safeguards are responsive in addressing the most significant threats to independence arising from leasing arrangements. Additionally, paragraph .03 of the Proposed Interpretation establishes a requirement for further analysis to be performed on lease arrangements that have already met the safeguards in paragraph .02. While this additional analysis of threats to independence may have precedent in the rules and interpretations of the AICPA Code, we ask the PEEC to consider that the requirement for additional analysis be limited to circumstances whereby the covered member “knows or has reason to believe” that certain factors may be present. Such an approach has been adopted in other sections of the Code, including Interpretation 1.224.010 Client Affiliates related to certain lending relationships and acquisitions; and Interpretation 1.270.100 Close Relatives, with respect to financial interests of close relatives. We believe that the additional analysis that may be necessary under this approach, coupled with the bright line conditions and safeguards included in paragraph .02, should serve to adequately address the most significant threats to independence arising from leasing arrangements.</li> </ul>
CL 5	Grant Thornton	<p>Grant Thornton believes it would be appropriate to have a period of transition to allow firms to determine if changes need to be made to internal policies in identifying any leases that exist between the firm or covered members and attest clients. Firms will also need to determine whether their existing quality control procedures require revision due to the new interpretation. We do not believe that significant changes would be needed as long as attest clients are only considered to be the attest client and downward affiliates. We agree that existing leasing relationship between a covered member and an attest client could be grandfathered which should alleviate potential hardships.</p>

CL 6	PwC	<p>Given the pervasive use of leasing arrangements, our main concern relates to the potential hardship and disruption that a bright-line test based on materiality would create for covered members and their immediate family members. Although real estate property and automobiles are perhaps the most prominent examples of assets available for leasing, the PEEC must recognize that leases are also widely utilized for a broad spectrum of other routine consumer goods, ranging from technology products – for example, cellular phones, tablets, computers, cable and internet equipment – to household equipment such as appliances, furniture, and power tools. A blanket prohibition on the basis of materiality could restrict the opportunities currently available to covered members and their immediate family members to acquire housing and personal consumer goods.</p> <p>As a practical matter, a prohibition based on the materiality of the lease would also disproportionately affect junior-level professional staff on the attest engagement team, in particular those persons with a high student loan debt burden. A junior-level staff person could easily find himself or herself running afoul of the materiality threshold, especially if leases have to be aggregated (such as may be the case, for example, if an associate on the attest engagement team and his or her spouse lease their personal cell phones, tablets, and cable and internet equipment from the same wireless service provider). Furthermore, this could also potentially have a detrimental effect on the ability of firms to attract and retain first-rate talent, such as interns, associates, and senior associates, increasing staff recruiting and retention costs for firms.</p> <p>The potential impact of a prohibition on these consumer relationships is exacerbated by the fact that the grandfathering provisions in paragraph .04 of the proposed revised interpretation do not provide the same level of relief as the grandfathering currently available for pre-existing loans, as discussed in more detail in Section III.A. While a firm could theoretically reassign a staff person holding an impermissible lease to a different attest engagement, this may not be a practical solution for certain firms, especially smaller firms (where the pool of available staff with the requisite expertise may be limited) as well as those firms with a large portfolio of attest clients from an industry involved in the business of leasing (such as real estate). This safeguard would likely also not be available to the firm if the staff person holding the impermissible lease is a covered member by virtue of being in a position to influence the attest engagement as it may not be feasible to “isolate” the individual.</p>
CL 7	EY	n/a

**Question 7: Do you agree that it is appropriate to grandfather primary residence leases in a similar manner to home mortgages, as proposed?**

<b>CL 1</b>	TIC	TIC believes it is appropriate to grandfather primary residence leases.
<b>CL 2</b>	NASBA	Yes, NASBA believes it is appropriate to grandfather primary residence leases in a similar manner to home mortgages, as proposed, since under the new lease accounting standard, leases generally will be treated as secured loans.
<b>CL 3</b>	KPMG	We believe it is appropriate to grandfather primary residence leases. However, since primary residence leases meet the grandfathering criteria in paragraph .04, we don't believe that paragraph .05 is necessary and could be confusing to practitioners.
<b>CL 4</b>	Deloitte	<p>We agree. Also see Item B in the Additional Comments and Feedback section (below)</p> <p>Paragraph .04 – Grandfathered Leases. We request the PEEC consider clarification to Paragraph .04(c) which states, “The attest client entered into the lease with a counterparty which was not required to be independent of the attest client, and that counterparty to the lease later acquires or is acquired by the covered member.” The current wording is not clear. We believe the intent of this paragraph is to address situations whereby an existing attest client is party to a lease, and the counterparty to such lease, at inception, was not associated with the covered member. However, such counterparty is subsequently acquired by, or acquires the covered member (i.e., the counterparty becomes associated with the covered member, in which case the independence rules would then be applicable to that counterparty). Please clarify PEEC’s intent.</p> <p>In addition, the final sentence in paragraph .04 of the Proposed Interpretation states that “Automatic renewals provided for in the original lease are not considered changes in terms for purposes of this Interpretation.” We believe that addressing only this narrow aspect of a lease in the Interpretation could be read to imply that the application of other common lease terms (e.g., an election to extend a lease on a month-to-month basis at the end of its primary lease term) would be a change in terms for purposes of the Interpretation. We request that the PEEC consider broadening the scope of this sentence to indicate that the application of any provision of an original lease agreement is not considered a change in terms for purposes of this Interpretation.</p>
<b>CL 5</b>	Grant Thornton	Grant Thornton agrees it would be appropriate to grandfather primary residence leases and individuals could renew the lease if the leases meet the safeguards established. We suggest the PEEC consider providing examples to assist with the application of this change, including clarification regarding automatic renewals and if rent increases are considered a change in terms.

<b>CL 6</b>	PwC	Yes, if the PEEC decides to retain the prohibition on material leases as proposed, it would be appropriate to grandfather leases for primary residences as these transactions would likely be material to covered members, particularly junior-level professional staff. Please also refer to our detailed comments and recommendations in Section III.A.
<b>CL 7</b>	EY	Since many leasing transactions, particularly in residential real estate, are for periods of one year or less without automatic renewals, the grandfathering provisions in paragraph 1.260.040.04 will provide insufficient relief in many situations. We believe that PEEC should consider whether there are safeguards available that would allow for a on-time, arms-length, ordinary course renewal of a short term lease on market terms as part of its grandfathering provision, subject to the general evaluation of threats and safeguards in 1.260.040.03, even if such renewals are not “automatic” or provided for in the lease document, particularly with respect to primary residence leases.

**Question 8: Are there any other factors affecting the significance of the threats to independence that you believe should be added to paragraph .03? Do you believe any of the factors in paragraph .03 should be removed?**

<b>CL 1</b>	TIC	TIC believes the factors affecting the significance of the threats in paragraph .03 are appropriate.
<b>CL 2</b>	NASBA	NASBA believes that the factors in paragraph .03 are sufficient as proposed, however, paragraph .03(d), the extent to which the lease will be subject to attest procedures or financial statement disclosures, seems to imply a possible self-review threat, which is not otherwise mentioned in the proposed interpretation. Also, from a practical standpoint, it is questionable whether the practitioner will be able to effectively assess this factor during pre-engagement.
<b>CL 3</b>	KPMG	We have no changes to propose to paragraph .03.
<b>CL 4</b>	Deloitte	n/a
<b>CL 5</b>	Grant Thornton	Additional considerations that could be given would be the length of time of the lease as well as the date the lease originated. These factors could potentially impact the significance of a leasing relationship as well as the determination of whether a leasing relationship between a covered member or firm and the attest client may impair the firm’s independence in fact or appearance.
<b>CL 6</b>	PwC	The possible factors to consider in evaluating the significance of the threats to independence created

		<p>by a lease would vary based on the specific facts and circumstances of the leasing arrangement. Therefore, as it relates specifically to paragraph .03 of the proposed revised interpretation, a list of the most likely and relevant factors, that is not intended to be all-inclusive (as proposed by the PEEC in paragraph .03) should be sufficient.</p> <p>However, as it relates to the proposal as a whole (and as described in more detail in Section I), we recommend that the materiality of the lease to the attest engagement team member or to the individual in a position to influence the attest engagement be identified in the revised interpretation as one of the factors to be considered when evaluating the impact on independence. Under this approach, rather than cause an automatic impairment of independence in all circumstances, the materiality of the lease should trigger a “threats and safeguards” evaluation taking into consideration factors such as those we have suggested in Section I and others as relevant.</p>
<b>CL 7</b>	EY	n/a

**Question 9: Do you agree that an effective date consistent with the FASB Update effective date for private companies is appropriate (December 15, 2019)? If not, what is a more appropriate effective date?**

<b>CL 1</b>	TIC	TIC believes the effective date is appropriate as proposed.
<b>CL 2</b>	NASBA	NASBA believes it is appropriate to sync the effective date of the proposed independence standard, which requires a new approach to addressing leasing relationships, to that of the FASB Update for leases.
<b>CL 3</b>	KPMG	We believe the proposed December 15, 2019 effective date, with early implementation allowed, is appropriate.
<b>CL 4</b>	Deloitte	Given the nature of the potential operational and procedural changes that may be necessary to comply with the Proposed Interpretation, members will need to perform a comprehensive review of their existing processes. While we believe that the proposed December 15, 2019 effective date should provide sufficient time to allow firms and practitioners to update their controls, procedures, tools or technology to effectively implement the provisions of the interpretation, such determination will be contingent upon its final scope and requirements.
<b>CL 5</b>	Grant Thornton	Grant Thornton does not believe the effective date of the proposal needs to be consistent with that of

		the FASB leasing standard. Based on the proposed revisions, we believe the proposed replacement of the extant GAAP categorization approach with a conceptual framework approach can be effective at any date. PEEC should consider allowing a one year effective date to provide adequate time for members to implement the proposed revisions.
<b>CL 6</b>	PwC	Yes, we agree that the PEEC's proposed effective date of December 15, 2019 is appropriate, provided that, upon adoption of the revised interpretation by the PEEC, this date still allows members sufficient time (for example, 1 year) to make the necessary changes to their policies, processes and procedures to implement the interpretation.
<b>CL 7</b>	EY	n/a

**Text of Proposed Revision to “Leases” Interpretation**

[Additions appear in boldface italic and deletions are in strikethrough.]

**1.260.040 Leases**

- .01** ~~If a covered member enters into a lease ing agreement with an attest client during the period of the professional engagement, the self-interest, familiarity, and undue influence threats to the covered member’s compliance with the “Independence Rule” [1.200.001] may exist. would be at an acceptable level and independence would not be impaired if all the following safeguards are met:~~
- ~~a. The lease meets the criteria of an operating lease (as described in GAAP).~~
  - ~~b. The terms and conditions set forth in the lease agreement are comparable with other leases of a similar nature.~~
  - ~~c. All amounts are paid in accordance with the lease terms or provisions.~~

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

- .02** ~~If a covered member enters into a lease with an attest 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, and independence would be impaired, if a covered member has a lease that meets the criteria of a capital lease (as described in GAAP). Accordingly, independence would be impaired because the lease would be considered to be a loan with an attest client. unless all of the following safeguards are met during that period:~~
- a. The lease is entered into on market terms and established at arm’s length.**
  - b. All amounts are paid in accordance with the lease terms or provisions.**
  - c. The lease is not material to any of the following parties to the lease:**
    - i. The firm**
    - ii. An individual participating on the attest engagement team**
    - iii. An individual in a position to influence the attest engagement**
    - iv. The attest client**

- .03** ~~If the covered member meets the safeguards in paragraph .02, as applicable, the covered member should evaluate the significance of any other threats to determine whether the threats are at an acceptable level. If the covered member determines that threats are not at an acceptable level, the covered member should apply additional safeguards to eliminate or reduce the threats to an acceptable level. If no safeguards are available to eliminate or reduce threats to an acceptable~~

**level, independence would be impaired. The significance of the threats will depend on factors such as the following:**

- a. The role of the covered member on the attest engagement or with the firm**
- b. Materiality of the lease to the covered member, other than those covered members identified in paragraph .02**
- c. Whether multiple leases are entered into with the attest client and, if so, the aggregate materiality of those leases to the covered member or the attest client**
- d. The extent to which the lease will be subject to attest procedures or financial statement disclosures**

#### **Grandfathered Leases**

**.04 Irrespective of materiality, threats to compliance with the “Independence Rule” [1.200.001] would be at an acceptable level and independence would not be impaired provided that the lease is entered into on market terms and established at arm’s length, and during the period of professional engagement all amounts are paid in accordance with the lease terms and provisions, the terms do not change in any manner not provided for in the original lease, and any of the following conditions are met:**

- a. The covered member entered into the lease with the attest client prior to becoming a covered member with respect to the attest client.**
- b. The covered member entered into the lease with a counterparty for which independence was not required, and that counterparty to the lease later becomes, acquires, or is acquired by an attest client.**
- c. The attest client entered into the lease with a counterparty which was not required to be independent of the attest client, and that counterparty to the lease later acquires or is acquired by the covered member.**
- d. The lease existed prior to December 15, 2019 and the lease was permitted under the preexisting requirements of the “Independence Rule” [1.200.001] and its interpretations.**

**Automatic renewals provided for in the original lease are not considered changes in terms for purposes of this interpretation.**

#### **Covered Member Leases Primary Residence from Attest Client**

**.05 Irrespective of materiality, if a covered member leases his or her primary residence from a lessor attest client, threats to compliance with the “Independence Rule” [1.200.001] would be at an acceptable level and independence would not be impaired, provided the covered member complies with the provisions in paragraph .04.**

**.06** This paragraph *interpretation* 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].

**.07** *This interpretation is effective December 15, 2019, with early implementation allowed.*

## Final Text of Proposed Revision to “Leases” Interpretation

### 1.260.040 Leases

.01 When a *covered member* enters into a lease with an *attest client*, self-interest, familiarity, and undue influence *threats* to the *covered member’s* compliance with the “Independence Rule” [1.200.001] may exist.

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

.02 If a *covered member* enters into a lease with an *attest 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*, and *independence* would be *impaired*, unless all of the following *safeguards* are met during that period:

- a. The lease is entered into on market terms and established at arm’s length.
- b. All amounts are paid in accordance with the lease terms or provisions.
- c. The lease is not material to any of the following parties to the lease:
  - i. The *firm*;
  - ii. An individual participating on the attest engagement team;
  - iii. An *individual in a position to influence the attest engagement*;
  - iv. The *attest client*.

.03 If the *covered member* meets the *safeguards* in paragraph .02, as applicable, the *covered member* should evaluate the significance of any other *threats* to determine whether the *threats* are at an *acceptable level*. If the *covered member* determines that *threats* are not at an *acceptable level*, the *covered member* should apply additional *safeguards* to eliminate or reduce the *threats* to an *acceptable level*. If no *safeguards* are available to eliminate or reduce *threats* to an *acceptable level*, *independence* would be *impaired*. The significance of the *threats* will depend on factors such as the following:

- a. The role of the *covered member* on the *attest engagement* or with the *firm*
- b. Materiality of the lease to the *covered member* other than those *covered members* identified in paragraph .02

- c. Whether multiple leases are entered into with the *attest client* and, if so, the aggregate materiality of those leases to the *covered member* or the *attest client*
- d. The extent to which the lease will be subject to attest procedures or financial statement disclosures

### **Grandfathered Leases**

- .04 Irrespective of materiality, *threats* to compliance with the “Independence Rule” [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired* provided that the lease is entered into on market terms and established at arm’s length, and during the *period of professional engagement* all amounts are paid in accordance with the lease terms and provisions, the terms do not change in any manner not provided for in the original lease, and any of the following conditions are met:
- a. The *covered member* entered into the lease with the *attest client* prior to becoming a *covered member* with respect to the *attest client*.
  - b. The *covered member* entered into the lease with a counterparty for which *independence* was not required, and that counterparty to the lease later becomes, acquires, or is acquired by an *attest client*.
  - c. The *attest client* entered into the lease with a counterparty which was not required to be independent of the *attest client*, and that counterparty to the lease later acquires or is acquired by the *covered member*.
  - d. The lease existed prior to December 15, 2019 and the lease was permitted under the preexisting requirements of the “Independence Rule” [1.200.001] and its interpretations.

Automatic renewals provided for in the original lease are not considered changes in terms for purposes of this interpretation.

### **Covered Member Leases Primary Residence from Attest Client**

- .05 Irrespective of materiality, if a *covered member* leases his or her primary residence from a lessor *attest client*, *threats* to compliance with the “Independence Rule” [1.200.001] would be at an *acceptable level* and *independence* would not be *impaired*, provided the *covered member* complies with the provisions in paragraph .04.

- .06 This interpretation 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].

- .07 This interpretation is effective December 15, 2019, with early implementation allowed.

**Professional Ethics Executive Committee  
Staff Augmentation Task Force**

**Task Force Members**

Lisa Snyder (Chair), Shelly Van Dyne, Coalter Baker, Jeff Lewis, Brian Lynch, Bill Mann  
Staff: Brandon Mercer, CPA CGMA; Summer Young, CPA

**Task Force Charge**

The Task Force's initial charge is to study the issue of staff augmentation and independence, and determine whether additional guidance for members is warranted.

**Reason for Agenda Item**

The purpose of this agenda item is to solicit PEEC feedback on significant issues related to staff augmentation, including the threats to independence, and on the Task Force's preliminary direction. Staff has prepared a preliminary draft proposal for feedback (see **Agenda Item 5C**).

**Background**SEC Investigation Report

In 2014, the SEC found a firm was not independent due to a staff augmentation arrangement with an audit client. Pursuant to the findings, the SEC issued an [investigation report](#) "in order to address uncertainty regarding the Commission's interpretation of the 'acting as an employee' provisions of Rule 2-01," which prohibit an accountant from providing certain non-audit services to an audit client, including "acting temporarily or permanently as a director, officer, or employee of an audit client." The SEC noted the following primary points in the discussion section of its report regarding the nature of the delivery of otherwise permitted non-audit services:

1. "An auditor may not provide otherwise permissible non-audit services to an audit client in a manner which is inconsistent with other provisions of the independence rules. Thus, the auditor must scrutinize both the nature of the proposed non-audit services, *as well as the manner in which those services are to be delivered.*"
2. "An arrangement or relationship that results in an accountant acting as an employee of the audit client implicates Rule 2-01(c)(4)(vi)...An accountant is not independent under Rule 2-01(c)(2)(i) when a current 'professional employee of the accounting firm is employed by the audit client'...*Rule 2-01(c)(4)(vi) prohibits accountants from doing indirectly (acting as an employee) what they may not do directly (being an employee).*"
3. "Rule 2-01...requires accountants and audit committees to *carefully consider whether the relationship or service in question would cause the accounting firm's professionals to resemble...the employees of the audit client. A key inquiry into this analysis is the degree of control that the audit client exercises over audit firm personnel.*

Compared to the AICPA Code, the SEC provisions explicitly require the accountant to consider whether the accountant resembles an employee of the audit client in all situations, and further prohibits acting as an employee of the audit client on a "temporary or permanent" basis. The AICPA Code also prohibits simultaneously being an employee of the audit client but does not explicitly address the appearance as it relates to temporary staffing arrangements and does not

distinguish between temporary and permanent employment. As discussed later in this agenda item, the AICPA Code does address the appearance of employment as it relates specifically to internal audit services provided by the member in the “Nonattest Services” interpretation [1.295], and provides examples of factors that may create such an appearance.

### IESBA Ethics Handbook – Temporary Staff Assignments

The IESBA Code specifically addresses staff augmentation at Section 290.140 *Temporary Staff Assignments*, shown below:

#### ***Temporary Staff Assignments***

*290.140 The lending of staff by a firm to an audit client may create a self-review threat. Such assistance may be given, but only for a short period of time and the firm’s personnel shall not be involved in:*

- a) Providing non-assurance services that would not be permitted under this section; or*
- b) Assuming management responsibilities.*

*In all circumstances, the audit client shall be responsible for directing and supervising the activities of the loaned staff.*

*The significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards include.*

- a) Conducting an additional review of the work performed by the loaned staff;*
- b) Not giving the loaned staff audit responsibility for any function or activity that the staff performed during the temporary staff assignment; or*
- c) Not including the loaned staff as a member of the audit team.*

The IESBA provisions only identify the self-review threat to independence and prohibit assuming management responsibilities, emphasizing the fact that the client is responsible for supervising the loaned staff activities. These concepts do not appear significantly different from the concepts outlined in the General Requirements of the “Nonattest Services” interpretation [1.295]. As noted below, the Task Force considered the IESBA provisions and discussed the identification of threats and safeguards for inclusion of similar items in any AICPA guidance.

The Task Force thought that the concept of “temporary” staff augmentation may be appropriate for independence purposes, but also believed that the guidance would need to discuss what “temporary” means in the context of staff augmentation. There were concerns raised that if an activity is something that is repeated or recurring, it may not be viewed as temporary; whereas many nonattest services such as tax or bookkeeping may be repetitive and/or recurring by nature.

#### **Question for PEEC:**

**What are the PEEC’s views on use of the term “temporary” and does PEEC believe that a staff augmentation arrangement must be temporary to safeguard against threats to independence? What would PEEC define as “temporary” in the context of staff augmentation arrangements?**

**Does PEEC believe that activities that are recurring or repeated increase the significance of the additional threats to independence? If so, are there any safeguards that would mitigate the threats?**

#### Extant AICPA Code – Employment Relationships

The AICPA Code addresses simultaneous employment relationships in the “Simultaneous Employment or Association with an Attest Client” interpretation [1.275] (see **Agenda Item 5B**) in the context of a prohibited relationship that impairs independence, rather than a prohibited nonattest service. As previously noted, the appearance of employment relationships is also addressed in the “Internal Audit” subtopic [1.295.150] of the “Nonattest Services” interpretation [1.295] (see **Agenda Item 5B**) as it relates to the performance of internal audit services. In that subtopic, it states that independence would be impaired if the member “is connected with the attest client as an employee or in any capacity equivalent to a member of management.” The subtopic also notes certain factors that may create that appearance of employment, such as:

- the member being listed as an employee in the attest client’s directories or other attest client publications,
- the member permitting himself or herself to be referred to by title or description as supervising or being in charge of the attest client’s internal audit function, or
- the member using the attest client’s letterhead or internal correspondence forms in communications).

Under the extant AICPA Code, if a member had a staff augmentation agreement with an attest client, and the activities otherwise complied with 1.295, the member would be safeguarding against the self-review and management participation threats via the 1.295 safeguards, but may not consider the threats related to simultaneous employment (familiarity, advocacy). As noted below, the Task Force requests PEEC’s feedback on the threats and safeguards applicable in staff augmentation situations.

#### **Summary of Issues**

##### Service Environment

Firms providing staff augmentation services appear to be mid-size and larger firms where a staff augmentation arrangement may be a cost effective option for the client and the services being provided are either permitted by 1.295 or the client is a nonattest client. Feedback obtained from some small firms indicates that some do not have staff augmentation arrangements with attest clients due to the threat of appearing to be simultaneously employed and the related lack of resources to have separate engagement teams or divisions of the firm to safeguard against threats to independence. Some firms providing these services have entirely separate departments providing the staff augmentation services. Some firms provide the service only to nonattest clients, and some only provide the service for a limited time. For those firms providing staff augmentation services to attest clients, other safeguards in place include only providing services that would be permitted under 1.295, separate engagement teams for the staff

augmentation, no management roles taken by the augmented staff, and no loaned staff oversight of client personnel.

#### Nonattest Service [1.295] and Simultaneous Employment [1.275]

The Task Force considered the question of whether staff augmentation services are a nonattest service, employment of staff by the attest client, or both. Most thought it was a nonattest service, but since the distinction of providing people instead of a service is one that is not present in other nonattest services, the consensus was that it may be a hybrid of the two and may present independence threats that are created under both situations. Members also noted that staff augmentation could be viewed as a type of human resources service where the service (i.e., deliverable) is the provision of personnel.

Related to the provision of personnel, the SEC Investigation Report listed various factors that created the appearance of prohibited employment at the audit client in the specific investigation. Specifically, the loaned staff:

- a. Were supervised by, took sole direction from, and had their performance evaluated by, the audit clients' managers;
- b. Performed the same work as employees of the audit clients;
- c. Worked exclusively and continuously at the audit client's places of business during such engagements for extended periods of time, ranging up to six(6) months; and
- d. Used the audit clients' resources, including physical work spaces, client-issued computers and email addresses, and internal networks, spreadsheets and shared folders, to perform their loaned staff work.

In light of the factors noted by the SEC in its Investigation Report as well as the extant AICPA Code (e.g., Internal Audit subtopic), the Task Force further discussed factors related to the appearance of employment, and considered the question of whether there is a bright-line factor that causes an individual to become an employee for purposes of threats to independence. Some additional considerations noted by staff and the Task Force included the following:

- If the client has an individual with skills, knowledge, and experience to supervise the activities, the augmented staff are less likely to perform management responsibilities;
- If the activities are non-routine but are repeated or recurring, at what point, if any, is the appearance created that the individual is an employee;
- If the activities result in the augmented staff being the primary means by which the client's internal activity is accomplished on an ongoing basis; (i.e., work that should normally be performed by an employee), does that create a significant threat;
- The role of the individual at the firm (e.g., managerial) may need to be a consideration in conjunction with the augmented staff's role in the client's process.

The Task Force agreed that any guidance should offer some factors for consideration to assist members in determining when the appearance of employment becomes a significant threat for purposes of the Code.

#### **Question for PEEC:**

**Does PEEC agree that staff augmentation arrangements are the provision of the**

**personnel rather than the provision of the specific activities being performed by firm personnel?**

**Where does PEEC see the boundary between prohibited employment and the permitted provision of nonattest services? That is, at what point does a member appear to become an employee of the attest client for independence purposes? Are there any single factors that would render the member's independence impaired solely based on appearance?**

**Does PEEC agree that the matter of staff augmentation should be addressed in the AICPA Code and include guidance related to the appearance of employment with the attest client?**

#### Similarities with Other Nonattest Services

The Task Force view is that staff augmentation services are unique as a nonattest service that carries a human resources element. Specifically, the fact that the service provided is the staff person, rather than the activity or service being performed by that staff person creates additional considerations compared to other nonattest services. The Task Force discussed similarities with internal audit services and employee recruiting services, noting that when providing those services, the member is assigning and providing personnel to the client, or recommending certain candidates to perform activities or functions for the client. The main difference is that in a staff augmentation arrangement, the member is also providing the personnel that will perform the activities needed by the client and is being directly supervised by the client.

The Task Force noted that when providing internal audit or recruiting services, the member is required to meet the General Requirements of the "Nonattest Services" interpretation [1.295] at a minimum, with additional specific modifications to the General Requirements for those types of services. The Task Force found that there may be some overlap with these other nonattest services in the threats to independence as well as possible safeguards. As noted above, the Internal Audit Services subtopic references this overlap by providing examples of what could cause the appearance of prohibited simultaneous employment. Pursuant to its discussions, the Task Force determined that any guidance should a) require members to comply with the General Requirements, at a minimum, b) provide additional modifications to the General Requirements specific to staff augmentation arrangements, and c) address the issue of simultaneous employment while providing factors or examples of what would constitute simultaneous employment in a staff augmentation arrangement.

#### **Question for PEEC:**

**Does PEEC agree with requiring compliance with the General Requirements? Further, does PEEC agree that the requirements should be supplemented with the requirement that client management be responsible for activities such as:**

- a) determining the nature and scope of activities to be performed,**
- b) supervising and overseeing the activities performed and**
- c) evaluating the adequacy of the results of the services performed.**

### Identifying Threats to Independence

The Task Force considered threats to independence that may exist in a staff augmentation arrangement, and initially determined that the self-review and management participation threats should be identified, as the “Nonattest Services” interpretation [1.295] identifies the self-review and management participation threats to independence as existing when nonattest services are provided. However, the “Simultaneous Employment or Association with an Attest Client” interpretation identifies the familiarity threat and the advocacy threat as existing in situations of simultaneous employment. Given the additional potential threats and necessary safeguards, the Task Force discussed the identification of specific threats and requests PEEC’s feedback on which threats should be specifically identified.

#### *Self-Review Threat*

The Task Force view is that the self-review threat should be identified to address the threat that the member or firm may review the augmented staff’s work as part of the attest service. The safeguards within the extant 1.295 are intended to address the self-review threat, including the requirement that a person with the client who has the appropriate skills, knowledge, and experience takes responsibility for the results of the nonattest services.

**.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 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*.

#### *Management Participation Threat*

The Task Force determined that the management participation threat should be identified as with any nonattest service, due to the risk that augmented staff may step outside the intended scope and perform management responsibilities (“scope creep”). In addition, augmented staff may be at risk if supervising or overseeing client personnel related to the activities, or making decisions that are not approved by the client. As this threat is identified in 1.295, the extant safeguards may address this threat to an extent, for example, the General Requirements of 1.295 address the threat of acting in a management capacity.

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

- a. A *member* serves as an officer or a director of the *attest client*. [1.275.005]
- b. A *member* accepts responsibility for designing, implementing, or maintaining internal controls for the *attest client*. [1.295.030]
- c. A *member* hires, supervises, or terminates the *attest client’s* employees. [1.295.135]

#### *Familiarity Threat*

The Task Force noted that the familiarity threat is not identified by the “Nonattest Services” interpretation, but is identified by the “Simultaneous Employment or Association with an Attest

Client” interpretation. While realizing that some staff augmentation arrangements may add familiarity with a client in various aspects, the Task Force was unable to come to a consensus on whether the familiarity threat should be specifically identified, as it is not identified for all other nonattest services. Staff noted that the risk of employment is specifically addressed as it relates to internal audit services, but that the familiarity threat is not specifically identified in that context. The Task Force requests PEEC’s feedback on whether it believes the familiarity threat should be specifically identified, or whether a possible reference to the “Simultaneous Employment or Association with an Attest Client” interpretation would be more appropriate.

**.14 Familiarity threat.** The *threat* that, because of a long or close relationship with an *attest client*, a *member* will become too sympathetic to the *attest client’s* interests or too accepting of the *attest 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 client*, such as the *attest client’s* CEO. [1.270.020 and 1.270.100]
- 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 client*. [1.277.010]
- d. A member of the *attest engagement team* has a close friend who is in a *key position* at the *attest client*.

#### *Advocacy Threat*

Similar to the familiarity threat, the advocacy threat is identified in the “Simultaneous Employment or Association with an Attest Client” interpretation but is not identified in the “Nonattest Services” interpretation. The Task Force did not believe this threat exists in all situations, but could exist dependent upon the type of activities being performed. The Task Force did not come to a consensus on whether the advocacy threat should be specifically identified, but requests PEEC’s feedback on whether a reference to the “Simultaneous Employment or Association with an Attest Client” interpretation would be appropriate.

**.13 Advocacy threat.** The *threat* that a *member* will promote an *attest 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 client’s* securities as part of an initial public offering. [1.295.130]
- b. A *member* provides expert witness services to an *attest client*. [1.295.140]
- c. A *member* represents an *attest client* in U.S. tax court or other public forum. [1.295.160]

#### **Questions for PEEC:**

**The Task Force requests that PEEC discuss the threats above and determine which threats should be specifically identified for staff augmentation arrangements, and whether a reference to the “Simultaneous Employment or Association with an Attest Client” interpretation would be appropriate to address the familiarity and advocacy threats.**

### Task Force Approach

Pursuant to the Task Force's initial discussions, staff prepared a working draft for the Task Force's use in determining the best approach for possible guidance. The Task Force supported the approach of starting with the General Requirements for nonattest services and modifying those requirements to be specific to staff augmentation, while adding a separate paragraph regarding simultaneous employment in a manner similar to the Internal Audit Services subtopic. The draft guidance is presented at **Agenda Item 5C** and below. The draft below was formulated for discussion purposes and the Task Force has included specific questions for PEEC regarding certain items below.

#### ***1.295.xxx Staff Augmentation Arrangements***

**.01** When a member or member's firm has a staff augmentation arrangement with an attest client, self-review and management participation threats to the member's compliance with the "Independence Rule" [1.200.001] may exist.

**.02** Threats to compliance with the "Independence Rule" [1.200.001] would be at an acceptable level, and independence would not be impaired, provided that, in addition to the General Requirements of the "Nonattest Services" interpretation [1.295.000], all of the following safeguards are met:

- a. The member is satisfied that client management designates an individual or individuals who possess suitable skill, knowledge, and experience, preferably within senior management, to be responsible for:
  - i. determining the nature and scope of the activities to be performed;
  - ii. supervising and overseeing the activities performed; and
  - iii. evaluating the adequacy of the activities performed and the findings resulting from the activities.
- b. The activities do not result in the performance of management responsibilities;
- c. The augmented staff only performs activities that would otherwise be permitted by the "Nonattest Services" interpretation [1.295.000] of the "Independence Rule" [1.200.001];
- d. The duration of the arrangement is short term and temporary in nature; and
- e. The activities performed by augmented staff under the arrangement are discrete and non-recurring in nature.

**.03** In all circumstances, the member should consider whether the staff augmentation arrangement creates the appearance of prohibited simultaneous employment or association with the attest client that is addressed by the "Simultaneous Employment or Association With an Attest Client" interpretation [1.275.005] of the "Independence Rule" [1.200.001]. For example, the member should not be listed as an employee in the attest client's directories or other attest client publications, referred to by title or description as supervising or being in charge of any business function of the attest client, or use the attest client's email, letterhead, or internal correspondence forms in communications.

**.04** The significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards may include:

- a. Conduct an additional review of the work performed by the augmented staff;
- b. Have attest procedures which are related to the activity that the staff performed during the augmented staff arrangement performed by another member of the attest engagement team; or
- c. Separate the augmented staff members and the attest engagement team.

**Questions for PEEC:**

**Paragraph .01: Which threats should be specifically identified?**

**Paragraph .02: Does PEEC agree with the following:**

- The requirement in .02a that the client assign an individual with suitable skills, knowledge, and experience to oversee the activities.
- The requirement of .02a(i) regarding scope, which is intended to safeguard against “scope creep.”
- The requirements of .02a(ii-iii) regarding supervision and evaluation of the activities.
- The specific mention of management responsibilities in .02b;
- The requirement in .02d that the arrangement be short-term and temporary in nature.
- The use of the terms “discrete and non-recurring” in .02e the guidance.

**Paragraph .03: The Task Force requests feedback on this paragraph and the factors that are presented as being indicative of simultaneous employment.**

**Paragraph .04: Does PEEC agree that safeguards should be included? Is the proposed safeguard in .04a practical for staff augmentation arrangements? Are there any other critical safeguards that PEEC thinks should be recommended?**

**Effective Date**

N/A

**Action Needed**

The Task Force requests that PEEC provide feedback on the issues noted and recommend the inclusion or exclusion of any major concepts to consider in its future deliberations.

**Communications Plan**

A report of the Task Force’s progress will be provided to PEEC at the May 2018 PEEC meeting.

**Materials Presented**

**Agenda Item 5B** – AICPA Code Sections

**Agenda Item 5C** – Draft for Discussion

## AICPA Code Sections

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

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

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

.03 However, *threats* will be at an *acceptable level* and *independence* will not be *impaired* when either of the following situations exists:

- a. A *partner* or professional employee of a *firm* serves as an adjunct faculty member of an educational institution that is an *attest client* of the *firm*, and the *partner* or professional employee meets all of the following *safeguards*:
  - i. Does not hold a *key position* at the educational institution
  - ii. Does not participate on the *attest engagement team*
  - iii. Is not an *individual in a position to influence the attest engagement*
  - iv. Is employed by the educational institution on a part-time and non-tenure basis
  - v. Does not participate in any employee benefit plans sponsored by the educational institution, unless participation is required
  - vi. Does not assume any management responsibilities or set policies for the educational institution

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

- b. A *member* in a government audit organization performs an *attest engagement* with respect to the government entity and the head of the government audit organization meets at least one of the following:
  - i. Is directly elected by voters of the government entity with respect to which *attest engagements* are performed
  - ii. Is appointed by a legislative body and is subject to removal by a legislative body

- iii. Is appointed by someone other than the legislative body, as long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body

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

#### **Effective Date**

.05 [Paragraph .04](#) of this interpretation is effective December 15, 2014.

A nonauthoritative question and answer regarding independent contractors retained by the firm who are simultaneously employed or associated with an attest client is available at [www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf](http://www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf).

#### **1.295.150 Internal Audit**

.01 For purposes of this interpretation, internal audit services involve assisting the *attest 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 client*, self-review and management participation *threats* to the *covered member’s* compliance with the “[Independence Rule](#)” [1.200.001] may exist.

.02 The *attest 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 client* outsources the internal audit function to the member, whereby the member, in effect, manages the *attest client’s* internal audit activities.

.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 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

- a. designates an individual or individuals who possess suitable skill, knowledge, and experience, preferably within senior management, to be responsible for the internal audit function.
- b. determines the scope, risk, and frequency of internal audit activities, including those the member will perform in providing the services.
- c. evaluates the findings and results arising from the internal audit activities, including those the member will perform in providing the services.
- d. evaluates the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures.

.04 For example, if the member applies the *safeguards* in [paragraph .03](#), the member may assess whether performance is in compliance with management's policies and procedures, identify opportunities for improvement, and recommend improvement or further action for management consideration and decision making.

.05 The member may assist the individual responsible for the internal audit function in performing preliminary audit risk assessments, preparing audit plans, and recommending audit priorities. The member should also be satisfied that *those charged with governance* are informed about the member's and management's respective roles and responsibilities in connection with the engagement. Such information should provide *those charged with governance* a basis for developing guidelines for management and the member to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

.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 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 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 client's* business process.
- c. has *attest client* management rely on the member's work as the primary basis for the *attest 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 client* as an employee or in any capacity equivalent to a member of management (for example, being listed as an employee in the *attest client*'s directories or other *attest client* publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the *attest client*'s internal audit function, or using the *attest client*'s letterhead or internal correspondence forms in communications).

.07 *Monitoring activities.* Designing, implementing, or maintaining the *attest 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 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 client* would be considered to be accepting responsibility for maintaining the *attest 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*.

.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 client*'s business process, separate evaluations generally do not create a significant management participation *threat* to *independence*.

.09 Members should refer to the Committee of Sponsoring Organizations of the Treadway Commission's (COSO's) *Internal Control—Integrated Framework*, for

additional guidance on monitoring activities and distinguishing between ongoing and separate evaluations.

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

.11 *Attest-related services*. Services considered extensions of the member's audit scope applied in the audit of the *attest client's financial statements*, such as confirming accounts receivable and analyzing fluctuations in account balances, are not considered internal audit services and would not 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*.

.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 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]

### **1.295.135 Executive or Employee Recruiting**

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

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

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

**Draft for Discussion – Staff Augmentation Arrangements****1.295.xxx Staff Augmentation Arrangements**

**.01** When a member or member's firm has a staff augmentation arrangement with an attest client, self-review and management participation threats to the member's compliance with the "Independence Rule" [1.200.001] may exist.

**.02** Threats to compliance with the "Independence Rule" [1.200.001] would be at an acceptable level, and independence would not be impaired, provided that, in addition to the General Requirements of the "Nonattest Services" interpretation [1.295.000], all of the following safeguards are met:

- a. The member is satisfied that client management designates an individual or individuals who possess suitable skill, knowledge, and experience, preferably within senior management, to be responsible for:
  - i. determining the nature and scope of the activities to be performed;
  - ii. supervising and overseeing the activities performed; and
  - iii. evaluating the adequacy of the activities performed and the findings resulting from the activities.
- b. The activities do not result in the performance of management responsibilities;
- c. The augmented staff only performs activities that would otherwise be permitted by the "Nonattest Services" interpretation [1.295.000] of the "Independence Rule" [1.200.001];
- d. The duration of the arrangement is short term and temporary in nature; and
- e. The activities performed by augmented staff under the arrangement are discrete and non-recurring in nature.

**.03** In all circumstances, the member should consider whether the staff augmentation arrangement creates the appearance of prohibited simultaneous employment or association with the attest client that is addressed by the "Simultaneous Employment or Association With an Attest Client" interpretation [1.275.005] of the "Independence Rule" [1.200.001]. For example, the member should not be listed as an employee in the attest client's directories or other attest client publications, referred to by title or description as supervising or being in charge of any business function of the attest client, or use the attest client's email, letterhead, or internal correspondence forms in communications.

**.04** The significance of any threat shall be evaluated and safeguards applied when necessary to eliminate the threat or reduce it to an acceptable level. Examples of such safeguards may include:

- a. Conduct an additional review of the work performed by the augmented staff;

- b. Have attest procedures which are relate to the activity that the staff performed during the augmented staff arrangement performed by another member of the attest engagement team; or
- c. Separate the augmented staff members and the attest engagement team.

## AICPA Independence Standards Applicable to SSAE Engagements

### 1.297 Independence Standards for Engagements Performed in Accordance With Statements on Standards for Attestation Engagements

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

.01 The “[Independence Rule](#)” [1.200.001] and its *interpretations* apply to all *attest engagements*. However, when performing engagements to issue reports in accordance with Statements on Standards for Attestation Engagements (SSAEs), when *independence* is required or when the *member’s* compilation report does not disclose a lack of *independence*, the *covered member* needs to be independent with respect to the responsible party(ies), as defined in the SSAEs.

.02 If the individual or entity that engages the *covered member* (engaging entity) is not the responsible party, the *covered member* need not be *independent* of that engaging entity. However, because *threats* to the *member’s* compliance with the “[Integrity and Objectivity Rule](#)” [1.100.001] and the “[Conflicts of Interest](#)” interpretation [1.110.010] may still exist with respect to the engaging entity, *members* should comply with this rule and interpretation.

.03 In addition, application of the “[Independence Rule](#)” [1.200.001] is further modified as set forth in the “[Agreed-Upon Procedures Engagements in Accordance With SSAEs](#)” interpretation [1.297.020] and the “[Engagements, Other Than AUPs, Performed in Accordance With SSAEs](#)” interpretation [1.297.030] of the “Independence Rule.” [Prior reference: paragraph .13 of ET section 101]

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

#### 1.297.020 *Agreed-Upon Procedure Engagements Performed in Accordance With SSAEs*

.01 For purposes of this interpretation, subject matter is as defined in the SSAEs.

.02 When performing agreed-upon procedures (AUP) engagements in accordance with the SSAEs, the application of the “[Independence Rule](#)” [1.200.001] is modified, as described in the “[Application of the Independence Rule to Engagements Performed in Accordance With Statements on Standards for Attestation Engagements](#)” interpretation [1.297.010] of the “Independence Rule” and this interpretation.

.03 When providing nonattest services that would otherwise *impair independence* under the *interpretations* of the “[Nonattest Services](#)” subtopic [1.295] under the “Independence Rule” [1.200.001], *threats* would be at an *acceptable level* and *independence* would not be *impaired*, provided that the nonattest services do not relate to the specific subject matter of the SSAE engagement. *Threats* would be at an *acceptable level* and *independence* would also not be *impaired* if the “[General Requirements for Performing Nonattest Services](#)”

interpretation [1.295.040] of the “Independence Rule” were not applied when providing the nonattest services, provided that the nonattest services do not relate to the specific subject matter of the AUP engagement.

.04 In addition, when performing an AUP engagement under the SSAEs, *threats* would be at an *acceptable level* and *independence* would not be *impaired*, if the following *covered members* and their *immediate families* are independent of the responsible party(ies):

- a. Individuals participating on the AUP engagement team
- b. Individuals who directly supervise or manage the AUP engagement *partner* or *partner equivalent*
- c. Individuals who consult with the *attest engagement team* regarding technical or industry-related issues specific to the AUP engagement

.05 Furthermore, *threats* to compliance with the “[Independence Rule](#)” [1.200.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*, if the *firm* had a material financial relationship with the responsible party(ies) that was covered by any of the following interpretations of the “[Independence Rule](#)”:

- a. [Paragraph .02](#) of “Overview of Financial Interests” [1.240.010]
- b. “[Trustee or Executor](#)” [1.245.010]
- c. “[Joint Closely Held Investments](#)” [1.265.020]
- d. “[Loans](#)” [1.260.010] [Prior reference: paragraph .13 of ET section 101]

### **Effective Date**

.06 The addition of *partner equivalents* to paragraph .04 is effective for engagements covering periods beginning on or after December 15, 2014.

### **1.297.030 Engagements, Other Than AUPs, Performed in Accordance With SSAEs**

.01 For purposes of this interpretation, subject matter is as defined in the SSAEs.

.02 When performing an engagement, other than an AUP, in accordance with the SSAEs, the application of the “[Independence Rule](#)” [1.200.001] is modified, as described in the “[Application of the Independence Rule to Engagements Performed in Accordance With Statements on Standards for Attestation Engagements](#)” interpretation [1.297.010] of the “Independence Rule” and this interpretation.

.03 When providing nonattest services that would otherwise *impair independence* under the *interpretations* of the “[Nonattest Services](#)” subtopic [1.295], *threats* would be at an *acceptable level* and *independence* would not be *impaired* if the following safeguards are met:

- a. Nonattest services do not relate to the specific subject matter of the SSAE engagement.

- b. The “[General Requirements for Performing Nonattest Services](#)” interpretation [1.295.040] of the “Independence Rule” [1.200.001] are met when providing the nonattest service. [Prior reference: paragraph .13 of ET section 101]

**AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**  
**DIVISION OF PROFESSIONAL ETHICS**  
**PROFESSIONAL ETHICS EXECUTIVE COMMITTEE**  
**OPEN MEETING MINUTES**  
**November 28, 2017**

The Professional Ethics Executive Committee (Committee) held a duly called meeting on November 28, 2017. The meeting convened 11:00 a.m. and concluded at 2:30 p.m. on November 28, 2017.

<p><b><u>Attendance:</u></b>  Samuel L. Burke, Chair  Coalter Baker  Carlos Barrera  Stanley Berman  Michael Brand  Chris Cahill  Tom Campbell  Robert E. Denham  Anna Dourdourekas  Brian S. Lynch</p>	<p>William Darrol Mann  William McKeown  Andrew Mintzer  Steven Reed  James Smolinski  Laurie Tish  Shelly Van Dyne  Lisa Snyder</p> <p><b><u>Not In Attendance:</u></b>  Janice Gray  Greg Guin</p>
<p><b><u>Staff:</u></b>  James Brackens, VP - Ethics &amp; Practice Quality  Toni Lee-Andrews, Director  Ellen Gorla, Associate Director  Shelley Truman, Ethics Specialist  Brandon Mercer, Senior Manager</p>	<p>April Sherman, Manager  Shannon Ziemba, Manager  James West, Manager  Michele Craig, Manager  Liese Faircloth, Manager  Kristie Illuzi, Senior Manager  Carl Peterson, VP – Small Firms Practice Section  Jennifer Kappler, Manager  Jennifer Clayton, Senior Manager  Summer Young, Manager  John Wiley, Manager</p>
<p><b><u>Guests:</u></b>  Jeff Lewis, Chair, Independence/Behavioral Standards Subcommittee  Ian Benjamin, Chair, Technical Standards Subcommittee  Kelly Hnatt, External Counsel  Nancy Miller, KPMG  Dan Dustin, VP State Board Relations, NASBA  Catherine Allen, Audit Conduct  Sonia Araujo, PwC  George Dietz, PwC  Vince DiBlanda, Deloitte  Barbara Rommer, PwC  Jennifer Kary, Crowe Horwath</p>	

### 1. **Welcome and Introductions**

Mr. Burke welcomed the Committee and expressed appreciation for their efforts in joining the meeting.

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

Ms. VanDyne provided the Committee with an overview of the proposed revisions the Task Force recommends be made to the [\*Information Systems Design, Implementation, or Integration\*](#) interpretation. In addition to providing the Task Force with some clarifying editorial revisions, the Committee requested the Task Force:

- Discuss the proposed definition of “financial information system”.
- Incorporate more examples of maintenance issues members may encounter into paragraph .20.
- Discuss if the example “monitors the attest client’s network on a routine or continual basis” in paragraph .20 would include cybersecurity monitoring as a second level of security.
- Make some specific editorial revisions to the proposed revised interpretation.

### 3. **Long Association**

Ms. Dourdourekas explained that the comment letters indicated that Long Association is more troubling to smaller firms. The Task Force initially thought that in order to converge with IESBA, it needed to issue an interpretation. Mr. Burke asked if there was anything we needed to do to report to IESBA, and staff indicated that there is an annual reporting that is done to IESBA.

One PEEC member asked whether members would evaluate using the conceptual framework if there is not an interpretation, and whether doing otherwise would be in the best interests of the public. Other members inquired whether staff should add guidance to the *Plain English Guide to Independence* or in the Conceptual Framework Toolkit. Mr. Brand noted that firms reading the Code will follow the conceptual framework.

The PEEC took a straw poll regarding the next steps for the Task Force, with the Committee determining that members should rely on the conceptual framework approach in the extant Code, but that PEEC should supplement that with nonauthoritative guidance. The Task Force was instructed to formulate such guidance for consideration at the next PEEC meeting.

### 4. **IESBA Update**

Ms. Gorla provided an update on IESBA activities, including the Inducements Exposure Draft.

### 5. **NOCLAR Update**

Mr. Denham noted that NASBA does not think the guidance should exist in the Code, but should be in the UAA. Pursuant to this, the UAA committee will undertake a joint project. The Task Force agrees that there needs to be whistle protection and that PEEC and NASBA should go down the same road at the same time. The Task Force has invited UAA members and NASBA staff to observe the task force.

**6. Committee Project Agenda**

This item was on the agenda for informational purposes only.

**7. Minutes of the Professional Ethics Executive Committee Open Meeting**

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