



PROFESSIONAL ETHICS EXECUTIVE COMMITTEE

Open Meeting Agenda

May 15, 2019
Seattle, WA



**AICPA Professional Ethics Executive Committee
Open Agenda
May 15, 2019
Seattle, WA (Pacific Daylight Time)**

Open meeting: Phone access: +1 669 900 6833 (US Toll) or +1 646 876 9923 (US Toll) Meeting ID: 803 435 701 Web access: https://aicpa.zoom.us/j/803435701 International numbers available: https://zoom.us/u/aVZsUQ9Xt		
<i>May 15th</i>	<i>Open meeting begins</i>	
9:00 a.m. – 10:15 a.m.	State and local government Ms. Miller and Ms. Gorla seek adoption of revised interpretation. Ms. Kappler and Ms. Powell seek feedback on draft implementation guide, checklist, and communication plan. ❖ External link — January 2019 exposure draft ❖ External link — Comment letters	Agenda Item 1A Agenda Item 1B Agenda Item 1C Agenda Item 1D Agenda Item 1E Agenda Item 1F
10:15 a.m. – 10:30 a.m.	Selected procedures engagements Mr. Hunter seeks feedback on the draft non-authoritative FAQs.	Agenda Item 2A Agenda Item 2B
10:30 a.m. – 10:45 a.m.	<i>Break</i>	
10:45 a.m. – 12:15 p.m.	Information technology and cloud services Ms. VanDyne and Ms. Gorla seek adoption of the revised interpretation. ❖ External link: Information Systems Services exposure draft ❖ External Link: Comment letters	Agenda Item 3A Agenda Item 3B Agenda Item 3C Agenda Item 3D
12:15 p.m. – 1:00 p.m.	<i>Lunch</i>	
1:00 pm. – 2:00 p.m.	Staff augmentation Ms. Snyder seeks adoption of proposed new interpretation and feedback on draft non-authoritative FAQs. ❖ External link: Staff Augmentation exposure draft ❖ External link: Comment letters	Agenda Item 4A Agenda Item 4B Agenda Item 4C Agenda Item 4D Agenda Item 4E Agenda Item 4F
2:00 p.m. – 2:50 p.m.	PEEC 2019 Strategy and Work Plan Ms. Lee-Andrews and Ms. Klepcha seek feedback on topics, subtopics, and timing of the projects. to include in the committee’s strategy and work plan.	Agenda Item 5A Agenda Item 5B Agenda Item 5C
2:50 p.m. – 3:05 p.m.	External directors Mr. McKeown will explain the task force's recommendation to terminate this project.	
3:05 p.m. – 3:25 p.m.	<i>Break</i>	

3:25 p.m. – 3:45 p.m.	<p>IESBA update Mr. Mintzer and Ms. Gorla will update the committee on the activities from the March meeting and Ms. Gorla seeks input for the committee's comment letter on the IESBA's part B alignment to ISEA 3000.</p> <p>❖ External link: Exposure Draft- Proposed Revisions to Part 4B to Reflect Terms and Concepts Used in ISAE 3000 (Revised)</p>	
3:45 p.m. – 4:00 p.m.	<p>Inducements Ms. Dourdourekas and Ms. Craig will present the Convergence Task Force's recommendations regarding what convergence efforts are needed.</p> <p>❖ External link: Final pronouncement – Offering and Accepting Inducements</p>	<p>Agenda Item 6A Agenda Item 6B</p>
4:00 p.m. – 4:15 p.m.	<p>Transfer of files and return of client records in sale, transfer, discontinuance, or acquisition of a practice Ms. Sherman seeks feedback on the FAQ that clarifies a member's responsibility for files when merging with or acquiring a firm that is not owned by a member.</p>	<p>Agenda Item 7A Agenda Item 7B</p>
4:15 p.m. – 4:30 p.m.	<p>NOCLAR Mr. Denham will update the committee on the task force's progress.</p>	
4:30 p.m. – 4:40 p.m.	<p>Statements on Standards for Tax Services Task Force Ms. Saunders will provide the committee with a status report on this project.</p>	
4:40 p.m. – 4:45 p.m.	<p>Minutes of the PEEC open meeting The committee is asked to approve the minutes from the February 2019 open meeting.</p>	<p>Agenda Item 8</p>
	<p><i>Open meeting concludes</i></p>	
	<p>Next in-person meeting date</p> <ul style="list-style-type: none"> • November 6th–7th, 2019; Durham, NC 	

State and Local Government Task Force**Task Force Members**

Nancy Miller (Chair), James Curry, John Good, Lee Klumpp, George Dietz, Flo Ostrum, Anna Dourdourekas, Jack Dailey, Randy Roberts, Reem Samra, Barbara Romer (Observer), K. Chamberlin (Observer), E. Gorla (Staff), J. Kappler (Staff), M. Powell (Staff)

Task Force Charge

Consider incorporating the threats and safeguards approach into the Entities Included in State and Local Government Financial Statements interpretation [1.224.020] and determine if a conceptual framework assessment could be utilized to determine when a member needs to be independent of state and local governmental entities for which he or she is not providing financial statement attest services. The Task Force will also clarify who at the firm and which immediate family members the interpretation should extend to and if the interpretation should contain any exceptions. The Task Force will also determine if the final guidance could be extended to the federal government environment.

Reason for Agenda Item

The Committee is asked to adopt the proposal with the Task Force's recommended revisions found in **Agenda Item 1B**.

The Task Force is in the process of developing two *very draft* practice aids which can be found in **Agenda Item 1D** and **Agenda Item 1E**. These draft practice aids are still being worked on by the Task Force and have not been through the Association's editorial or graphic design teams. Accordingly, the Committee's thoughts on the structure and flow of these documents would be appreciated as the content itself will be subject to additional modifications and then will be reviewed by the editorial team. The visuals will be created by the graphic design team, so readability and formatting issues will be addressed then. A few additional notes to consider as you **scan Agenda Item 1D**:

- Some "fake links" to certain sections of the proposed revised interpretation are included since the actual links cannot be added until the new interpretation is added to the Code. These fake links appear in red typeface and are underlined
- Internal hyperlinks between sections of the document are included. However, graphic design will need to develop these hyperlinks within the graphics and so are not currently included.
- Graphic Design will add in a note to step 4A on page 5 that that that there is a rebuttable presumption that the financial statement attest client has more than minimal influence over funds and blended component units.

Summary of Issues

All but one comment letter ([CL 12](#)) was supportive of the proposal. [CL 12](#) believes that PEEC should consider whether to just issue targeted Q&As that address specific fact patterns rather than issuing an Interpretation and offered to assist.

Not Supportive of Conclusion

In support of their position that the proposal should not be adopted, [CL 12](#) explains that they believe the proposal is harder to follow than the first exposure draft because the guidance is more piecemeal than as originally presented, which could result in confusion in practice as certain terms

are no longer as clearly defined as they were in the first draft (e.g., nonaffiliates). [CL 12](#) also noted that when examples are used, it can create the possibility of a “checklist” mentality (i.e. the need for the member to check whether these items are present in this entity, or the alternative, these items are not present and therefore no additional work is necessary). [CL 12](#) is also concerned with the “creates threats” language in paragraph .06. The commenter believes that the language should not be as strong (and suggested this language be replaced with “could create threats”) so that the examples are not automatically determined to give rise to threats (especially example g.).

Task Force Recommendation

The Task Force recommends the Committee adopt an updated interpretation instead of just issuing targeted FAQs. The Task Force believes that paragraph .06¹ as drafted, allows for an appropriate amount of judgement and notes that staff could always use the interpretation to draft FAQs to address common questions received.

Compliance Increases Cost of Audit

CL 11 is concerned that many states require local governments to have their annual financial statements audited by an independent auditor. The requirement for audited financial statement typically excludes only the smallest local government. This is problematic for members who audit local governments in rural areas where there may be only one firm or only one firm performing audits of local governments. These circumstances might result in the local government having to engage two or more auditors which would increase the cost of the audit as well as negatively impact audit efficiency in total.

Task Force Recommendation

The Task Force believes the cost of compliance was considered throughout the process and that the noted challenge faced by very small governments would exist under the extant interpretation. The Task Force notes that the communication plan developed for this project does include outreach to GFOA and the SLG committees of the state CPA societies and believes the practice aids under development will provide additional clarity and that additional nonauthoritative guidance can be issued if further questions are received.

Examples of When the Conceptual Framework May Need to be Consulted – Question 1

The exposure draft asked for feedback regarding whether the examples of circumstances or relationships with nonaffiliates that could result in the member consulting the “[Conceptual Framework for Independence](#)” helpful to assessing when the conceptual framework may be applicable.

[CL 1](#), [2](#), [3](#), [4](#), [5](#), [7](#), [8](#), [9](#), [11](#) and [14](#) find the examples helpful or don’t have any other examples to add. [CL 9](#) recommends an example be added related to a situation where a covered member is involved in employment negotiations with a nonaffiliate. [CL 6](#) and [CL 12](#) do not believe the examples should be included.

¹ [Members](#) may encounter circumstances or relationships with nonaffiliates that create [threats to independence](#) that could result in the *member* consulting the “[Conceptual Framework for Independence](#)” (ET sec. 1.210.010).

[CL 3](#) and [CL 6](#) recommends that paragraph .06 remain in the interpretation without the examples. [CL 3](#) recommends the examples be moved to the implementation guide. [CL 3](#) and [CL 6](#) are concerned that by including this level of specificity in the interpretation itself, members may consider it to be an absolute or complete list of situations where application of the conceptual framework is appropriate. [CL 3](#) is concerned that this could diminish the member's thoughtful consideration of facts and circumstances unique to their attest client and its nonaffiliates including scenarios similar to the examples provided (and other situations not included on the list that would be appropriate to analyze under the conceptual framework).

[CL 6](#), [CL 9](#) and [CL 10](#) believe it is unclear when the user is required to look upstream beyond the examples provided. [CL 10](#) believes the proposed interpretation no longer makes clear that there is any requirement to consider upstream affiliate relationships, nor does it provide a framework of criteria or factors to be considered to assist the member in exercising sound judgment during the assessment. [CL 10](#) does not believe a list of examples of potential independence threats is sufficient to allow members to adequately and consistently infer the degree of upstream analysis PEEC is expecting. If PEEC intends to require members to consider upstream relationships, [CL 10](#) recommends PEEC convey that requirement more explicitly and provide additional guidance to facilitate an adequate assessment.

[CL 12](#) and [CL 13](#) recommend the example contained in paragraph .06 f. be deleted. [CL 13](#) believes this because: (1) this circumstance relates to the financial statement attest client itself and not a nonaffiliate and (2) this situation does not create a threat, as defeasances of debt (by definition) are removed from the face of the financial statements when they meet certain criteria, including the criteria of essentially risk-free assets that have been set aside in trust by the financial statement attest client to repay the debt, which includes payments to any covered member(s) who owns such debt.

[CL 12](#) believes that example g. made more sense when PEEC had included upstream entities in the discussion.

Task Force Recommendation

The Task Force recommends that the examples remain in paragraph .06. The Task Force notes that examples f. and g. were included as examples of relationships that are not addressed by the Code and would result in these relationships being evaluated under the Conceptual Framework for Independence if the member believed threats existed. Accordingly, the Task Force recommends the phrase "with nonaffiliates" be removed from the lead in of paragraph .06 since the defeased and conduit debt examples discussed in items f. and g. are actually situations where the financial statement attest client is involved (and not a nonaffiliate).

The Task Force believes the Implementation Guide addresses many of these concerns. Pages 5 and 6 of the Implementation Guide contains decision trees that make it clear that there are downstream nonaffiliates while page 11 includes a discussion about the conceptual framework approach that clarifies it is PEEC's expectation that the circumstance or relationships not requiring the use of the decision trees are also considered nonaffiliates. Page 11 also goes on to bring the situations from paragraph .06 to life through the use of fact patterns while reminding users that there is a Conceptual Framework for Independence toolkit available to assist with applying the framework.

Clear Which Entities are Affiliates – Question 2

[CL 1](#), [2](#), [3](#), [4](#), [5](#), [11](#), and [14](#) believe the guidance is clear or at least clearer than the first exposure draft. [CL 6](#) believes investments should not be included as an affiliate as it will cause confusion. [CL 6](#)'s recommendation on how to fix is described in the discussion under the section "Investments – Question 3". [CL 11](#) proposes a different definition for affiliate. This commenter suggests that affiliates be defined as (1) opinion units which would be government activities, business type activities, major funds, and non-major funds in the aggregate and (2) discreetly presented component units. Blended component units are reflected in the opinion unit and would not therefore need to be identified as an affiliate under the proposal.

Task Force Recommendation

The Task Force does not recommend that the revisions proposed by [CL 6](#) or [CL 11](#) be made because then the SLG interpretation would not be consistent with the commercial affiliate guidance. The Task Force does recommend the following clarifications be made to the description of investments that should be considered affiliates under .03 a. iv.

- iv. The **investor, which includes the financial statement attest client** or an affiliate **as defined in** ~~under~~ item *i.* of this definition, (~~investor~~) has an investment **in an investee when the investor** that either
 - a. **Controls the investee; unless the investment in the investee** is not trivial and clearly inconsequential to the **financial statement attest client's** ~~investor's financial statements as a whole and gives the investor control over the investment or~~ investor's financial statements as a whole and gives the investor control over the investment or
 - b. **Has significant influence over the investee and the investment in the investee** is material to the **financial statement attest client's** ~~investor's financial statements as a whole and gives the investor significant influence over the investment.~~ investor's financial statements as a whole and gives the investor significant influence over the investment.

Nonaffiliate and Related Organizations

[CL 3](#), [4](#), [6](#), [9](#), and [12](#) recommend the Task Force consider defining a Nonaffiliate and [CL 4](#) notes that without a definition the reader is forced to interpret this to mean all entities other than an affiliate. [CL 4](#) also seeks clarification regarding whether a government's "related organizations" are affiliates or Nonaffiliates. [CL 12](#) believes there may be unintended consequences due to the lack of definition of Nonaffiliates so that firms will be forced to perform unnecessary research to identify entities that potentially could be Nonaffiliates despite the fact that this has little impact on the reporting entity.

[CL 12](#) believes the proposal is harder to follow than the first exposure draft because the guidance is more piecemeal than as originally presented, which could result in confusion in practice. A good example is that the term "nonaffiliate" is no longer defined anywhere in the revised draft and if not defined will create practice issues.

Task Force Recommendation

The Task Force does not recommend a non-affiliate be defined since: (1) it isn't defined for commercial entities; (2) a non-affiliate only exists when a member becomes aware of a situation with an entity that is not an affiliate that gives rise to threats to independence; and (3) because

the Implementation Guide addresses many of these concerns as described above in the Task Force's recommendation related to Question 1.

With respect to the request to defined "related organizations" the Task Force recommends that the staff wait to see what specific questions are posed and develop guidance in the form of FAQs if necessary.

Entity

[CL 11](#) believes the definition of "entity" in paragraph .03 b. it is too broad and will add undue costs with little benefit to the quality of the audit.

Task Force Recommendation

The Task Force does not believe the definition should be revised as it is just describing what entities would be considered a financial statement attest client or an affiliate of a financial statement attest client.

Materially Excluded Entity

[CL 2](#) recommends an example of when a material entity might be excluded be added.

Task Force Recommendation

The Task Force believes that the Casino Board example included in the Implementation Guide addresses this comment.

How Far Down Does the Affiliate Guidance Go

[CL 1](#) believes it would be helpful to clarify how far down a member should continue to go when determining whether an entity is an affiliate. An example was added to the Implementation Guide. The example begins at the bottom of page 13 and continues on the top of page 14.

Task Force Recommendation

The Task Force believes the Implementation Guide addresses these concerns. For affiliates other than investments, the Task Force believes the decision trees and examples make it clear that a member would continue to look down until one of the criteria is no longer met. For investments that are affiliates, the Task Force believes the examples provided under the investment scenarios control pathway example and a significant influence pathway example make it clear there is no need not look any further. The Task Force directs the Committee to the following pages in the Implementation Guide:

- Page 9 explains that member only need to look at the investments of the FSAC and .03 a. i. affiliates – "For purposes of the SLG interpretation, an investor includes the financial statement attest client or an Affiliate .03 a. i. of the SLG financial statement attest client. Accordingly, only an investment in an investee held by an investor will require evaluation to determine whether the investee is an affiliate of the SLG financial statement attest client. "
- Just below Exhibit D3.1 on page 16 - "Given the conclusion that DEF Company is an Affiliate .03 a. iv. of XYZ State, Firm A understands it should apply the independence rule and related interpretations to DEF Company. As an Affiliate .03 a. iv. of XYZ State, DEF Company is not considered an investor for purposes of the SLG interpretation, so the member is not required to look at investments held by DEF Company when evaluating affiliates of XYZ State."

- Just below Exhibit D 3.2 on page 17 – “Given the conclusion that RST Company is an Affiliate .03 a. iv. of XYZ State, Firm A understands it should apply the independence rule and related interpretations to RST Company. As an Affiliate .03 a. iv. of XYZ State, RST Company is not considered an investor for purposes of the SLG interpretation, so the member is not required to look at investments held by RST Company when evaluating affiliates of XYZ State.”

More Than Minimal Influence Over the Accounting and Financial Reporting

[CL 8](#) recommends the interpretation be more explicit in how discretely presented component units are evaluated.

Task Force Recommendation

The Task Force believes that the Inclusion and Exclusion Pathways discussions in the Implementation Guide on page 8 that states that “A rebuttable presumption does not exist for discretely presented component units.” In addition, the XYZ State example includes two discretely presented component units, the Public University (page 13) and the Casino Board (page 14) which should assist members with understanding how discretely presented component units should be evaluated.

Investments – Question 3

[CL 3](#), [4](#), [8](#), [11](#) and [14](#) believe the guidance is clear. [CL 9](#) recommends that .03 c. iv. be deleted or clarified because it refers to the term entity as broadly defined by paragraph 3.b, instead of a specific type of entity described in paragraph 3.a. and is uncertain as to what it is attempting to further explain for investments.

Task Force Recommendation

The Task Force does not recommend this be deleted. Rather, the Task Force believes it is clear that all we were trying to say is that interests in funds, component units, departments, agencies, programs, organizational units, fiduciary activities, custodial activities, employee benefit plans, and sub organizational units of the preceding entities are not investments.

[CL 6](#) recommends that the affiliate definition not include investments, rather that the investment affiliate guidance be moved to the definition of investments and then paragraphs .05 and .08 be revised to apply to affiliates and investments.

Task Force Recommendation

The Task Force does believe this change should be made because this treatment is consistent with the general affiliates interpretation which defines investments as affiliates.

[CL 2](#) recommends the following clarification: “An investment is a security or other asset that the *financial statement attest client* or an affiliate, **as defined in Terminology, par. 03(a)(i) under item a.i. of this paragraph**, holds primarily for the...”

Task Force Recommendation

The Task Force recommends the following revisions be made to the definition of an investment:

An investment is a security or other asset that **an investor, which includes** the *financial statement attest client* or an affiliate, **as defined in** ~~under~~ item a.i. of this

paragraph, holds primarily for the purpose of income or profit and has a present service capacity based solely on its ability to generate cash or to be sold to generate cash. This includes investments and ownership of an equity interest in common stock accounted for using the equity method of accounting as provided for in GASB Codification Section 150. The following interests are not considered investments for purposes of this interpretation:

- i. Interests obtained by **an investor** ~~a financial statement attest client or an affiliate under item a.i. of this paragraph~~ as a result of an action by a third party, such as through a bequest or a grant, and that the entity does not intend to retain (temporary investments).
- ii. Equity interests in joint ventures, partnerships, LLCs, or other types of entities in which the intent of the **investor** ~~financial statement attest client or an affiliate under item a.i. of this paragraph~~ is to directly enhance its ability to provide governmental services.
- iii. Equity interests in component units in which the intent ~~of the investor the financial statement attest client or an affiliate under item a.i. of this paragraph~~ is to directly enhance its ability to provide governmental service
- iv. Interests that would otherwise be considered an entity as defined in item *b* of this paragraph.

Trivial and Clearly Inconsequential

[CL 8](#) recommends changing the word “and” to “or” in item a.iv.1 of paragraph .03: “...is not trivial or clearly inconsequential to the investor’s financial statements...”. [CL 9](#) notes that “trivial and clearly inconsequential” is not the exact term found in AU-C 450. AU-C 450 uses and defines the term “clearly trivial” for evaluating misstatements, and the term “clearly inconsequential” to further define the term “clearly trivial.” Therefore, to be consistent with AU-C 450, recommend PEEC reword paragraph .03.a.iv.1. to read, “is not clearly trivial and clearly inconsequential to the investor’s financial statements as a whole...”

Task Force Recommendation

The Task Force does not recommend these revisions be made.

Implementation Tools – Question 4

[CL 12](#) recommends the interpretation not be issued and instead the Task Force develop FAQs Don’t issue a standard, rather issue FAQs. They also offered to review the tools developed should the project proceed. [CL 14](#) recommends before developing implementation guidance, the interpretation be implemented by members and feedback be collected in order to fully understand what guidance would be helpful.

[CL 7](#) believes the judgmental nature of the decision of “more than minimal influence” introduces a risk that two auditors could look at the same situation and reach a different conclusion when evaluating “more than minimal influence” since the evaluation of “more than minimal influence” under the proposed interpretation is solely a qualitative analysis. The Task Force notes that this is always a potential when issuing principle-based standards. While, paragraph .10 of the proposed interpretation noted that some factors may be weighed differently depending on the circumstances and the subject matter of any potential impairment, there is no application guidance on how to weigh the existing factors. As such, [CL 7](#) recommends PEEC consider providing examples or illustrations that would assist members with this evaluation.

[CL 1](#) recommends the implementation tools provide examples of nonaffiliates (such as, nonaffiliates a. or e.) in the implementation guidance.

Guidance that clarifies the purposes and application and provides visual displays such as flow charts for different scenarios were recommended by [CL 2](#), [6](#), [7](#), [9](#), and [11](#). Similar recommendations were also made by a number of other commenters. These include:

- ✓ [CL 3](#) recommends the use of an implementation guide with decision tree and illustrative examples
- ✓ [CL 4](#) and [9](#) recommend real world examples expressed in Q&A format and use of decision trees and flowcharts.
- ✓ [CL 8](#) recommends practical examples of affiliates and nonaffiliates in the implementation guidance
- ✓ [CL 8](#) and [9](#) recommend certain visuals from the initial exposure draft
- ✓ [CL 5](#) recommends visual presentations of typical state and local structures and which entities would likely be affiliates

[CL 7](#), [11](#) also recommend implementation guidance including online training (e.g., webcast and self-study)

Best Efforts: [CL 8](#) recommends clarification be provided along with examples of situations where a member maybe unable obtain information necessary to identify affiliates. The Task Force does not recommend this be done since the best efforts provision is used in the commercial affiliate interpretation.

Materiality: [CL 7](#) recommends that the that the implementation guidance provides examples or illustrations on determining materiality in a state and local government environment, including, but not limited to, an example for pensions funds. The Task Force does not recommend the Committee weigh in on audit concepts.

Task Force Recommendation

The Task Force considered these recommendations and believes that the two proposed practice aids, the Implementation Guide and the Checklist, addresses the substance of these concerns and that before making developing any further non-authoritative guidance that these materials be issued and feedback be obtained regarding what the issues remain.

Editorial Comments

Editorial Comment Related to Best Efforts: [CL 9](#) suggest paragraph .08 c. be edited to add in that the financial statement attest client that should be giving the written assurance is “those charged with governance”. The Task Force believes that this recommendation was likely made because item a. in paragraph .08 refers to “those charged with governance”. Since it was the Task Force’s intent for the “Best Efforts” paragraph to align with the equivalent “Client Affiliates” interpretation provision, the Task Force recommends conforming edits to paragraph .08.

Editorial Comment Related to Materiality Task Force Recommends Making: [CL 2](#) and [13](#) recommend clarifications be made to the application of materiality in paragraph .11. The Task Force recommends the following clarifications be made:

Determination of materiality is a matter of professional judgment. [Members](#) should consider both quantitative and qualitative factors when determining whether an entity or investment is material to a [financial statement attest client's](#) financial **statements as a whole reporting entity**. For purposes of this interpretation, materiality is intended to be applied at the *financial statement attest client's* financial **statements reporting entity** as a whole, rather than individual opinion units in circumstances in which there may be more than one opinion unit.

General Editorial Comments Task Force Recommends Making:

- Editorial Comment: Financial Reporting Entity: [CL 2](#) and [CL 13](#) recommend the term “financial reporting entity” in paragraph .09 be clarified. The Task Force agrees and recommends the following edits to paragraph.09:

.09 “The overall facts and circumstances should be considered when evaluating the level of influence the [financial statement attest client](#) has over the accounting or financial reporting process of an entity in the **financial statement attest client's financial statements** ~~financial reporting entity~~. The targeted analysis is applied solely to the accounting and financial reporting process of the entity as opposed to the analysis of what entities are included in the **financial statement attest client's financial statements** ~~financial reporting entity~~. Factors such as the following may assist [members](#) with this evaluation.”
- Editorial Comment: State and Local Government Entity: The Task Force supports the following recommended edits to the definition of a state and local government entity (item d) suggested by [CL 6, 9](#):

State and local government entities are entities whose generally accepted accounting principles standard setter is GASB. Examples of state and local government entities include general-purpose governments **and special-purpose governments. Examples of general-purpose governments include** ~~such as~~ states, counties, cities, towns, **and** villages, ~~and special purpose governments that perform limited activities~~. Examples of special-purpose governments include cemetery districts, school districts, universities and colleges, utilities, hospitals or other health care organizations, public airports, public housing authorities, financing authorities, public transportation systems, public employee retirement systems (PERSs), post-employment benefit plans, pension plans, public entity risk pools, external investment pools, Indian tribes, state tuition programs, and other special districts.
- Editorial Comment: Financial Statement Attest Client That is a State or Local Government Entity: The Task Force supports [CL 7](#) recommendations that the references to “state or local government entity” be removed from paragraph .03a, .04 and .05.
- Editorial Comment: Immediate Family Member: The Task Force supports [CL 7](#) recommendation that the term “member” be added after the phrase “immediate family” in paragraph .06a to be consistent with other references to these individuals in the code.

Action Needed

The Committee is asked to approve the proposed interpretation with the Task Force's recommended revisions found in **Agenda Item 1B**. The Task Force also seeks feedback on the structure and flow of the two preliminary draft practice aids found in **Agenda Item 1D** and **Agenda Item 1E**.

Effective Date

Only two comment letters provided input on the effective date. [CL 8](#) recommends that the effective date of the proposed interpretation be two years after adoption. A two-year time frame would provide entities sufficient time to prepare the necessary documentation required by auditors or to prepare for a potential change in auditors. [CL 8](#) notes that there are two significant accounting standards that state and local governments are in the process of implementing over the next two years, Governmental Accounting Standards Board (GASB) Statement No. 84, Fiduciary Activities, and GASB Statement No. 87, Leases. In addition, there are new Government Auditing Standards that will become effective in the next year. In situations where threats to independence cannot be lowered to an acceptable level, entities would need to procure new independent auditors. A one-year time period may not be achievable for some entities. Another consideration is that there are entities, such as component units, that have different fiscal years than the primary government. Depending on when the proposed interpretation is effective, an entity may not be able to procure a new independent audit firm, if necessary, in a timely manner.

[CL 12](#) believes that PEEC should allow adequate time for firms to prepare for the adoption of this guidance, and the Interpretation should not be effective for at least one CPE cycle, and any implementation tools and resources also should be made available prior to the effective date.

Assuming the interpretation is adopted at the May meeting, the Task Force recommends that the revised interpretation be effective for years beginning after December 15, 2020.

Communications Plan

The Task Force believes a robust communication plan is needed for this project. The plan under development includes not only email communications from the division, GAQC and internal and external stakeholders but articles, web events, conferences and training materials. While Task Force believes it is important for these communications to continue between May 2019 through December 2021, it does believe there are several key points during that time frame where particular emphasis will occur. **Agenda Item 1F** is the Communication Plan Graphic which provides an overview of the types of planned communications by distribution channel and timing of communications. A detailed draft of the communication plan is available to PEEC upon request.

Materials Presented

Agenda Item 1B:	Revised Interpretation
Agenda Item 1C:	Comment Letter Summary
Agenda Item 1D:	Draft Implementation Guide
Agenda Item 1E:	Draft Affiliate Checklist
Agenda Item 1F	Communication Plan Graphic

Text of Proposed Interpretation “State and Local Government Entities”

(Formerly “Entities Included in State and Local Government Financial Statements;” revisions to this title appear in strikethrough.)

Revisions Task Force recommends be made appear in yellow highlight.

1.224 Affiliates, Including State and Local Government Affiliates ~~Governmental Units~~

1.224.020 ~~Entities Included in State and Local Government Client Affiliates Financial Statements~~

Applicability

- .01 This interpretation applies to state and local government entities (as defined in item *d.* of paragraph .03 of this interpretation) that are financial statement attest clients.
- .02 When an interpretation of the “Independence Rule” (ET sec. 1.200.001) is applied in a state or local government environment and the *interpretation* uses terminology that is not applicable in this environment, the member should use professional judgement to determine if there is an equivalent term. For example, certain *interpretations* use the phrase “officer, director, or owner of the attest client.” In some state or local government environments, it may be necessary for the *member* to extend these *interpretations* to officials of the financial statement attest client when the **official individual** has governance responsibilities or control over financial reporting.

Terminology

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

- a. An affiliate of a **state or local government** financial statement attest client exists in all of the following situations.
 - i. The entity is included in the *financial statement attest client’s* financial statements, and the member or member’s firm does not make reference to another auditor’s report on the entity.
 - ii. The entity is included in the *financial statement attest client’s* *financial statements*, and the *member* or *member’s firm* makes reference to another auditor’s report on the entity, and
 - 1. the entity is material to the *financial statement attest client’s* *financial statements* as a whole, and
 - 2. the *financial statement attest client* has more than minimal influence over the accounting or financial reporting process over the entity. There is a rebuttable presumption that the *financial statement attest client* has more than minimal influence over the accounting or financial reporting process of funds and blended component units.

- iii. The entity is a material excluded entity, and the *financial statement attest client* has more than minimal influence over the entity's accounting or financial reporting process. A material excluded entity is an entity that is required under the applicable financial reporting framework to be included in the *financial statements* of the *financial statement attest client* but is, nevertheless, excluded by the *financial statement attest client* and is material to the *financial statement attest client's financial statements* as a whole. There is a rebuttable presumption that the *financial statement attest client* has more than minimal influence over the accounting or financial reporting process of funds and blended component units.
- iv. The **investor, which includes the** *financial statement attest client* or an affiliate **as defined in** under item *i.* of this definition, ~~(investor)~~ has an investment **in an investee when the investor** that either
 - 1. **Controls the investee; unless the investment in the investee** is ~~not~~ trivial and clearly inconsequential to the **financial statement attest client's** investor's *financial statements* as a whole ~~and gives the investor control over the investment~~ or
 - 2. **Has significant influence over the investee and the investment in the investee** is material to the **financial statement attest client's** investor's *financial statements* as a whole ~~and gives the investor significant influence over the investment.~~
- b. An entity is intended to be broadly defined and can include funds, component units, departments, agencies, programs, organizational units, fiduciary activities, custodial activities, employee benefit plans, and sub organizational units of the preceding entities.
- c. An investment is a security or other asset that **an investor, which includes** the *financial statement attest client* or an affiliate, **as defined in** under item *a.i.* of this paragraph, holds primarily for the purpose of income or profit and has a present service capacity based solely on its ability to generate cash or to be sold to generate cash. This includes investments and ownership of an equity interest in common stock accounted for using the equity method of accounting as provided for in GASB Codification Section 150. The following interests are not considered investments for purposes of this interpretation:
 - i. Interests obtained by **an investor** ~~a financial statement attest client or an affiliate under item a.i. of this paragraph~~ as a result of an action by a third party, such as through a bequest or a grant, and that the entity does not intend to retain (temporary investments).
 - ii. Equity interests in joint ventures, partnerships, LLCs, or other types of entities in which the intent of the **investor** ~~financial statement attest client or an affiliate under item a.i. of this paragraph~~ is to directly enhance its ability to provide governmental services.
 - iii. Equity interests in component units in which the intent **of the investor** ~~the financial statement attest client or an affiliate under item a.i. of this paragraph~~ is to directly enhance its ability to provide governmental service

- iv. Interests that would otherwise be considered an entity as defined in item *b* of this paragraph.
- d. State and local government entities are entities whose generally accepted accounting principles standard setter is GASB. Examples of state and local government entities include general-purpose governments **and special-purpose governments. Examples of general-purpose governments include** such as states, counties, cities, towns, **and** villages, ~~and special purpose governments that perform limited activities.~~ Examples of special-purpose governments include cemetery districts, school districts, universities and colleges, utilities, hospitals or other health care organizations, public airports, public housing authorities, financing authorities, public transportation systems, public employee retirement systems (PERSs), post-employment benefit plans, pension plans, public entity risk pools, external investment pools, Indian tribes, state tuition programs, and other special districts.

Interpretation

- .04 Financial interests in, and other relationships with, affiliates of a financial statement attest client ~~that is a state or local government entity~~ may create threats to a member's compliance with the "Independence Rule."
- .05 Members should apply the "Independence Rule" and related interpretations applicable to a ~~state or local government~~ financial statement attest client to their affiliates except as provided for in paragraph .07 of this interpretation.
- .06 Members may encounter circumstances or relationships ~~with nonaffiliates~~ that create threats to independence that could result in the *member* consulting the "Conceptual Framework for Independence" (ET sec. 1.210.010). Examples of such circumstances or relationships **could** include the following:
 - a. A covered member's immediate family member is in a key position with a nonaffiliate that includes the financial statement attest client in its financial statements, and the nonaffiliate provides accounting staff, shares financial information systems, or establishes internal controls over financial reporting for the *financial statement attest client*.
 - b. The *member* **or member's firm** is considering providing financial information system design services to a nonaffiliate in which the same financial information system would also be used by the *financial statement attest client*.
 - c. A *covered member* has a *financial interest* in a nonaffiliate that includes the *financial statement attest client* in its *financial statements*, and the nonaffiliate prepares the *financial statements* for the *financial statement attest client*.
 - d. The *financial statement attest client* participates in a public private partnership or joint venture that does not meet the definition of an *investment* in item *c.* of paragraph .03 of this interpretation. A *covered member* has a *financial interest* in an organization that is also involved with the public private partnership or joint venture.
 - e. A *covered member* owns utility bonds issued by a nonaffiliate, and the *financial statement attest client* is responsible for payment of the utility bond debt service.

- f. A *covered member* owns defeased debt issued by the *financial statement attest client*. The defeased debt is not accounted for on the *financial statements* of the *financial statement attest client*, and the *financial statement attest client* has funded the debt service to be paid from a bank trust account.
- g. A *covered member* owns conduit debt issued by the *financial statement attest client* on behalf of a nonaffiliate. The conduit debt is not accounted for on the *financial statements* of the *financial statement attest client*, and the debt service is paid by the nonaffiliate.

Exception

.07 The *member* and *member's firm* may provide prohibited nonattest services to entities described under items a.ii. and a.iii. of paragraph .03 during the *period of the professional engagement* or during the period covered by the *financial statements*, provided that it is reasonable to conclude that the services do not create a self-review *threat* with respect to the *financial statement attest client* because the results of the nonattest services will not be subject to the *covered member's financial statement* attest procedures. For any other *threats* that are created by the provision of the nonattest services that are not at an *acceptable level* (in particular, those relating to management participation), the *member* should apply *safeguards* to eliminate or reduce the *threats* to an *acceptable level*.

Best Efforts

.08 A *member* must expend best efforts to obtain the information necessary to identify affiliates of a *financial statement attest client*. If, after expending best efforts, a *member* is unable to obtain the information to determine which entities are affiliates of a *financial statement attest client*, *threats* would be at an *acceptable level* and *independence* would not be *impaired* if the *member* **does all of the following**:

- a. Discusses the matter, including the potential impact on *independence*, with *those charged with governance* **at the *financial statement attest client***
- b. Documents the results of that discussion and the efforts taken to obtain the information;**
and
- c. Obtains written assurance from the *financial statement attest client* that it is unable to provide the *member* with the information necessary to identify the affiliates of the *financial statement attest client*.

More Than Minimal Influence Over Accounting and Financial Reporting Process

.09 The overall facts and circumstances should be considered when evaluating the level of influence the *financial statement attest client* has over the accounting or financial reporting process of an entity in the ***financial statement attest client's financial statements* financial reporting entity**. The targeted analysis is applied solely to the accounting and financial reporting process of the entity as opposed to the analysis of what entities are included in the ***financial statement attest client's financial statements* financial reporting entity**. Factors such as the following may assist *members* with this evaluation.

- a. The extent of involvement the *financial statement attest client* has in preparing the *financial statements* of an entity.

- b. The extent of operational control the *financial statement attest client* has over an entity.
 - c. The extent to which both the *financial statement attest client* and an entity have the same
 - i. accounting or finance staff
 - ii. accounting systems
 - iii. internal control over financial reporting systems
 - d. The extent to which the *financial statement attest client*
 - i. is able to direct the behaviors or actions of the governing board of the entity
 - ii. has the ability to add or remove members of the governing board of the fund or component unit
 - iii. issues or pays for the entity's debt
 - iv. finances the entity's deficits
 - v. uses or takes the entity's financial resources
- .10 Whereas some factors may indicate influence, others may indicate little to no influence. Some factors may be weighted differently depending on the circumstances and the subject matter of any potential impairment. [Members](#) should take a substantive approach to evaluating the factors (for example, the **financial statement attest client entity** exercises a right), rather than merely considering form (for example, the *financial statement attest client* has a right that is not exercised). The consideration of these factors will require the *member* to exercise professional judgement when reaching the determination of whether more than minimal influence exists.

Material to the Financial Statement Attest Client's Financial Statements as a Whole

- .11 Determination of materiality is a matter of professional judgment. [Members](#) should consider both quantitative and qualitative factors when determining whether an entity or investment is material to a [financial statement attest client's](#) financial **statements as a whole reporting entity**. For purposes of this interpretation, materiality is intended to be applied at the *financial statement attest client's* financial **statements reporting entity**, rather than individual opinion units in circumstances in which there may be more than one opinion unit.

COMMENT SUMMARY
Proposed Revised Interpretation “State and Local Government Client Affiliates” (formerly Entities Included in State and Local Government Financial Statements)

Comment Letter	Feedback Highlights
<p>CL1 Tennessee Department of Audit, Division of State Audit</p> <p>Support with Recommendations</p>	<p>Examples of when the conceptual framework may need to be consulted Examples help identify when the Conceptual Framework for Independence might be consulted. However, illustrations like those in the initial ED would be helpful for ¶6a and ¶6c to differentiate among the financial attest client, an affiliate, and the non-affiliate. We suggest PEEC consider adding a decision tree flowchart as an exhibit rather than including the narrative only.</p> <p><i>How far down does the affiliate guidance go</i> In ¶3a.i how would the affiliate/non-affiliate definition apply to a State government (primary government) and its discretely presented component unit university (also its own primary government) and its discretely presented component unit foundation? Material foundations for our universities, as well as the universities themselves, are separate legal entities, and the schools generally do not have more than minimal influence over the accounting process or financial reporting at each stand-alone entity level but would have that influence at the financial reporting entity level. Thus, at what level is the affiliate definition applicable for the foundation, university, and State government, since all the criteria must be present? The criterion in ¶3a.ii.2 might need to clarify at which level the influence resides (i.e., reporting entity only or all levels of the financial reporting process – stand-alone and consolidation, respectfully).</p>
<p>CL 2 NASBA Support with Recommendations</p>	<p>Examples of when the conceptual framework may need to be consulted Find the examples helpful.</p> <p>Affiliates <i>Materially Excluded Entity</i> Provide an example of when this might occur.</p> <p>Investments Recommended the following clarification:</p>

Comment Letter	Feedback Highlights
	<p>“An investment is a security or other asset that the <i>financial statement attest client</i> or an affiliate, as defined in Terminology, par. 03(a)(i) under item <i>a.i.</i> of this paragraph, holds primarily for the...”</p> <p>Implementation Tools Guidance that clarifies the purposes and application and provides visual displays such as flow charts for different scenarios.</p> <p>Editorial Comment: Financial Reporting Entity Recommend the term “financial reporting entity” in paragraph .09 be clarified.</p> <p>Other Comment: Materiality Recommend further clarification be made to the application of materiality in paragraph .11 Determination of materiality is a matter of professional judgment. <i>Members</i> should consider both quantitative and qualitative factors when determining whether an entity or investment is material to the financial statements a financial statement attest client’s financial reporting entity. For purposes of paragraphs .03 a. ii and .03 a. iii this interpretation, materiality is intended to be applied at the <i>financial statement attest client’s</i> financial statements reporting entity as a whole, rather than individual opinion units in circumstances in which there may be more than one opinion unit. For purposes of paragraph 03a.iv., materiality is intended to be applied to the investor’s financial statements as a whole rather than individual opinion units in circumstances in which there may be more than one opinion unit.</p>
<p>CL 3</p> <p>Baker Tilly Virchow Krause, LLP Support with Recommendations</p>	<p>Examples of when the conceptual framework may need to be consulted CL 3 recommends that paragraph .06 remain in the interpretation but that the examples be moved to the implementation guide. CL 3 is concerned that by including this level of specificity in the interpretation itself, members may consider it to be an absolute or complete list of situations where application of the conceptual framework is appropriate. CL 3 is concerned that this could diminish the member’s thoughtful consideration of facts and circumstances unique to their attest client and its nonaffiliates including scenarios like the examples provided (and other situations not included on the list that would be appropriate to analyze under the conceptual framework).</p> <p>Affiliate Recommend the Task Force consider defining a nonaffiliate.</p> <p>Investments</p>

Comment Letter	Feedback Highlights
	<p>Guidance is clear.</p> <p>Implementation Tools Implementation guide with decision tree and illustrative examples.</p>
<p>CL 4 Michigan Office of the Auditor General Support with Recommendations</p>	<p>Examples of when the conceptual framework may need to be consulted Believe it is helpful.</p> <p>Affiliate Recommend the Task Force consider defining a nonaffiliate and notes that without a definition the reader is forced to interpret this to mean all entities other than an affiliate. Also seeks clarification regarding whether a government’s “related organizations” are affiliates or nonaffiliates.</p> <p>Investments Believe guidance is clear.</p> <p>Implementation tools Real world examples expressed in Q&A format and use of decision trees and flowcharts.</p>
<p>CL 5 Crowe Support</p>	<p>Examples of when the conceptual framework may need to be consulted No other examples provided.</p> <p>Affiliates Guidance is clear.</p> <p>Investments Believe guidance is clear.</p> <p>Implementation tools Visual presentations of typical state and local structures and which entities would likely be affiliates.</p>
<p>CL6 VA Auditor of Public Accounts Support with</p>	<p>Examples of when the conceptual framework may need to be consulted Examples should not be included in the interpretation, but clarification needed regarding when an upstream entity is an affiliate. Should define nonaffiliate.</p> <p>Affiliates Believe including investments in the definition of an affiliate is confusing and should be moved.</p>

Comment Letter	Feedback Highlights
<p>Recommendations</p>	<p>Investments Recommends that the affiliate definition not include investments, rather that the investment affiliate guidance be moved to the definition of investments and then paragraphs .05 and .08 be revised to apply to affiliates and investments.</p> <p>Implementation tools Guidance that clarifies the purposes and application and provides visual displays such as flow charts for different scenarios.</p> <p>Editorial Comment: State and local government entities Recommend some edits to the definition of a state and local government entity found in .03 d.</p>
<p>CL 7</p> <p>Grant Thornton Support with Recommendations</p>	<p>Examples of when the conceptual framework may need to be consulted Helpful.</p> <p>Affiliates Guidance is clear.</p> <p>Investments Believe guidance is clear.</p> <p>Implementation tools Implementation guidance including online training (e.g., webcast and self-study) examples and illustrations and FAQs. Additional application guidance for “more than minimal influence.</p> <p>Editorial Comment: General CL 7 recommends that the following text in bold italic be added to the end of paragraph .01 so that paragraph .05 can be deleted. “...financial statement attest clients <i>and their affiliates, as further defined below, except as provided for in paragraph .07 of this interpretation.</i>”</p> <p>Editorial Comment: Financial Statement Attest Client That is a State or Local Government Entity CL 7 notes that many of the references to the term “financial statement attest client” do not repeat that the financial statement attest client is a state or local government entity since this is clarified in paragraph .01. As</p>

Comment Letter	Feedback Highlights
	<p>such, CL 7 recommends the references to “state or local government entity” be removed from paragraph .03a, .04 and .05.</p> <p>Editorial Comments: Immediate Family CL 7 recommends the term “member” be added after the phrase “immediate family” in paragraph .06a to be consistent with other references to these individuals in the code.</p> <p>Editorial Comments: Materiality CL 7 recommends that the that the implementation guidance provides examples or illustrations on determining materiality in a state and local government environment, including, but not limited to, an example for pensions funds.</p>
<p>CL 8</p> <p><u>Government Finance Officers Association's Committee on Accounting, Auditing, and Financial Reporting Support with Recommendations</u></p>	<p>Examples of when the conceptual framework may need to be consulted Helpful and encourage more practical examples.</p> <p>Affiliates <i>More Than Minimal Influence Over the Accounting and Financial Reporting</i> CL8 recommends the interpretation be more explicit in how discreetly presented component units are evaluated.</p> <p>Investments <i>Trivial and Clearly Inconsequential</i> Believe guidance is clear. CL 8 recommends changing the word “and” to “or” item a.iv.1 of paragraph .03: “...is not trivial or clearly inconsequential to the investor’s financial statements...”.</p> <p>Implementation tools Practical examples of affiliates and nonaffiliates in the implementation guidance. Also, recommend flowcharts and tables included in the initial exposure draft be added.</p> <p>Editorial Comment: Best Efforts Recommends clarification be provided along with examples of situations where a member maybe unable obtain information necessary to identify affiliates.</p> <p>Effective Date Recommends that the effective date of the proposed interpretation be two years after adoption. A two-year time frame would provide entities enough time to prepare the necessary documentation required by auditors or to</p>

Comment Letter	Feedback Highlights
	<p>prepare for a potential change in auditors. CL 8 notes that there are two significant accounting standards that state and local governments are in the process of implementing over the next two years, Governmental Accounting Standards Board (GASB) Statement No. 84, Fiduciary Activities, and GASB Statement No. 87, Leases. In addition, there are new Government Auditing Standards that will become effective in the next year. In situations where threats to independence cannot be lowered to an acceptable level, entities would need to procure new independent auditors. A one-year period may not be achievable for some entities. Another consideration is that there are entities, such as component units, that have different fiscal years than the primary government. Depending on when the proposed interpretation is effective, an entity may not be able to procure a new independent audit firm, if necessary, in a timely manner.</p>
<p>CL 9</p> <p>National State Auditors Association</p> <p>Support with Recommendations</p>	<p>Examples of when the conceptual framework may need to be consulted</p> <ul style="list-style-type: none"> • Helpful. • Recommend an additional example be added to address a covered member involved in employment negotiations with a nonaffiliate. • Make it clearer that the examples are just that, examples by adding that the list of examples are not all inclusive. • It is unclear when the user is required to look upstream beyond the examples provided. <p>Affiliates</p> <p>Clarify in paragraph .03 whether entities disclosed in notes to the financial statements but not included in the financial reporting entity are affiliates or nonaffiliates.</p> <p>Investments</p> <p>Recommends that .03 c. iv. be deleted or clarified because it refers to the term entity as broadly defined by paragraph 3.b, instead of a specific type of entity described in paragraph 3.a. Paragraph .03.c.iv was added after the 2017 exposure draft, but we are uncertain as to what it is attempting to further explain for investments.</p> <p><i>Trivial and Clearly Inconsequential</i></p> <p>CL 9 notes that “trivial and clearly inconsequential” is not the exact term found in AU-C 450. AU-C 450 uses and defines the term “clearly trivial” for evaluating misstatements, and the term “clearly inconsequential” to further define the term “clearly trivial.” Therefore, to be consistent with AU-C 450, recommend PEEC reword paragraph .03.a.iv.1. to read, “is not clearly trivial and clearly inconsequential to the investor’s financial statements as a whole...”</p>

Comment Letter	Feedback Highlights
	<p>Implementation tools Suggest the PEEC include visual aids (such as those from the original exposure draft). In addition, real world examples, expressed in a Q&A format or flowchart format would be helpful. We have the following specific suggestions for implementation guidance:</p> <ul style="list-style-type: none"> • Add illustrations like those in the initial ED for paragraph .06.a and .06.c to differentiate among the financial attest client, an affiliate, and the nonaffiliate. • Add illustrations that describe the different investment scenarios (such as table C from the original exposure draft). <p>Editorial Comment: State and local government entities Recommend some edits to the definition of a state and local government entity found in .03 d.</p> <p>Editorial Comment: Member Paragraph .06.b uses the term “member” instead of the term “covered member” like the other examples in paragraph .06. We suggest the PEEC reevaluate whether “member” is the appropriate term in paragraph .06.b.</p>
<p>CL 10 Virginia Society of CPAs Accounting & Auditing Advisory Committee Support with Recommendations</p>	<p>Examples of when the conceptual framework may need to be consulted Believe it is unclear when the user is required to look upstream beyond the examples provided. Also believes the proposed interpretation no longer makes clear that there is any requirement to consider upstream affiliate relationships, nor does it provide a framework of criteria or factors to be considered to assist the member in exercising sound judgment during the assessment. The Committee does not believe a list of examples of potential independence threats is enough to allow members to adequately and consistently infer the degree of upstream analysis the Division is expecting. If the Division intends to require members to consider upstream relationships, the Committee recommends it convey that requirement more explicitly and provide additional guidance to facilitate an adequate assessment.</p>
<p>CL 11 FICPA Support with Recommendations</p>	<p>Examples of when the conceptual framework may need to be consulted Helpful.</p> <p>Affiliates Clear but:</p>

Comment Letter	Feedback Highlights
	<ul style="list-style-type: none"> Do not agree with the definition of “entity” in .03 d. Believe it is too broad and will add undue costs with little benefit to the quality of the audit. Believe affiliates should be defined as (1) opinion units which would be government activities, business type activities, major funds, and non-major funds in the aggregate and (2) discreetly presented component units. Blended component units are reflected in the opinion unit and would not therefore need to be identified as an affiliate under the proposal. <p>Investments Clear.</p> <p>Implementation tools There should be training on the final interpretation which should be made available to members serving government clients. This training could be in multiple formats and of varying lengths. In addition, such training could be offered to firms who are members of the Government Audit Quality Center and advertised often in the CPA Letter as well as the Journal of Accountancy. The training could also be developed and disseminated by partnering with state auditors and other member organizations serving state and local governments and their auditors.</p> <p>Overall Conclusion: Compliance Increases Cost of Audit CL 11 Concerned that many states require local governments to have their annual financial statements audited by an independent auditor. The requirement for audited financial statement typically excludes only the smallest local government. This is problematic for members who audit local governments in rural areas where there may be only one firm or only one firm performing audits of local governments. These circumstances might result in the local government having to engage two or more auditors which would increase the cost of the audit as well as negatively impact audit efficiency in total.</p>
<p>CL 12 PCPS Technical Issues Committee Not Supportive of Proposal</p>	<p>Overall Conclusion: Not Supportive of Proposal CL 12 believes the proposal is harder to follow than the first exposure draft because the guidance is more piecemeal than as originally presented, which could result in confusion in practice as certain terms are no longer as clearly defined as they were in the first draft. CL 12 believes that PEEC should consider whether to just issue targeted Q&As that address specific fact patterns rather than issuing an Interpretation.</p> <p>Examples of when the conceptual framework may need to be consulted Recommend the examples contained in paragraph .06f and .06g be deleted.</p>

Comment Letter	Feedback Highlights
	<p>Clear Which Entities are Affiliates – Question 2 <i>Nonaffiliate and Related Organizations</i> Recommend the Task Force consider defining a nonaffiliate and believes there may be unintended consequences due to the lack of definition of nonaffiliates so that firms will be forced to perform unnecessary research to identify entities that potentially could be nonaffiliates even though this has little impact on the reporting entity. Believes the proposal is harder to follow than the first exposure draft because the guidance is more piecemeal than as originally presented, which could result in confusion in practice. A good example is that the term “nonaffiliate” is no longer defined anywhere in the revised draft. Feel strongly that definitions (including a definition of nonaffiliate) should be authoritative and that the Interpretation should be clear as to the intent of which entities should be included or excluded.</p> <p>Investments – Question 3 Clear.</p> <p>Implementation tools – Question 4 TIC believes that rather than issuing this Interpretation, PEEC should consider addressing specific fact patterns in a series of Q&As. TIC would be happy to work with the Ethics staff in developing some of this guidance. If this ED is issued as drafted, TIC understands that the Ethics staff will be working on some additional implementation guidance and tools to assist practitioners with implementation of this guidance. TIC would be happy to assist in reviews of these tools and, perhaps, be part of the task force or test groups that run different real-life scenarios through these tools to ensure the outcome is as expected.</p> <p>Effective Date Believes that PEEC should allow adequate time for firms to prepare for the adoption of this guidance, and the Interpretation should not be effective for at least one CPE cycle, and any implementation tools and resources also should be made available prior to the effective date.</p>
<p>CL 13 Deloitte Support with Recommendations</p>	<p>Examples of when the conceptual framework may need to be consulted Paragraph .06f, related to defeased debt issued by the financial statement attest client, should be deleted from the Proposed Interpretation, as (1) this circumstance relates to the financial statement attest client itself and not a nonaffiliate and (2) this situation does not create a threat, as defeasances of debt (by definition) are removed from the face of the financial statements when they meet certain criteria, including the criteria of essentially risk-free assets that have been set aside in trust by the financial statement attest client to repay the debt, which includes payments to any covered member(s) who owns such debt.</p>

Comment Letter	Feedback Highlights
	<p>Editorial Comment: Financial Reporting Entity Recommend the term “financial reporting entity” in paragraph .09 be clarified and recommends the following edits to the paragraph: The overall facts and circumstances should be considered when evaluating the level of influence the <i>financial statement attest client</i> has over the accounting or financial reporting process of an entity in the financial statement attest client’s financial statements financial reporting entity. The targeted analysis is applied solely to the accounting and financial reporting process of the entity as opposed to the analysis of what entities are included in the financial statement attest client’s financial statements financial reporting entity. Factors such as the following may assist <i>members</i> with this evaluation.</p> <p>Editorial Comments: Materiality Recommend the following clarifications be made to the application of materiality in paragraph .11 Determination of materiality is a matter of professional judgment. <i>Members</i> should consider both quantitative and qualitative factors when determining whether an entity or investment is material to the financial statements a financial statement attest client’s financial reporting entity. For purposes of paragraphs .03 a. ii and .03 a. iii of this interpretation, materiality is intended to be applied at the <i>financial statement attest client’s</i> financial statements reporting entity as a whole, rather than individual opinion units in circumstances in which there may be more than one opinion unit. For purposes of paragraph 03a.iv. of this interpretation, materiality is intended to be applied to the investor’s financial statements as a whole rather than individual opinion units in circumstances in which there may be more than one opinion unit.</p>
<p>CL 13 BDO Support with Recommendations</p>	<p>Examples of when the conceptual framework may need to be consulted Helpful. Affiliates Clear. Investments Clear. Implementation tools Allow the interpretation to be implemented by members and collect feedback to fully understand what guidance would be helpful.</p>



IMPLEMENTATION GUIDE

State and Local Government Client Affiliates

TBD 2019

DRAFT

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Introduction to Implementation Guide

The [State and Local Government Client Affiliates](#) interpretation (ET sec. 1.224.020)¹ (SLG affiliates interpretation) provides that *members* should be independent of certain entities that are required to be included in a state or local government (SLG) *financial statement attest client's financial statements*. The interpretation defines the entities requiring [independence](#) as affiliates.

This nonauthoritative implementation guide is designed to assist *members* with implementing the SLG affiliates interpretation by understanding which entities are affiliates, and which *independence* requirements are extended to these affiliates. This implementation guide does not provide authoritative guidance and should be used in conjunction with the SLG affiliates interpretation. Specifically, this implementation guide includes the following:

- ▶ Decision trees that provide an overview of the pathways to identify affiliates of a SLG [financial statement attest client](#).
- ▶ Description of the pathways in which an entity or investment would be considered an affiliate of a SLG *financial statement attest client*.
- ▶ Exhibits that illustrate the decision points along these pathways.
- ▶ Examples of circumstances or relationships that may require a *member* to consult the "[Conceptual Framework for Independence](#)".
- ▶ Description of the nonattest service exception within the SLG affiliates interpretation.
- ▶ Example of how these pathways could be applied to XYZ State.

Practice Aid: State and Local Government Affiliates Checklist

A separate practice aid is available, in the form of a checklist, to assist with evaluations.

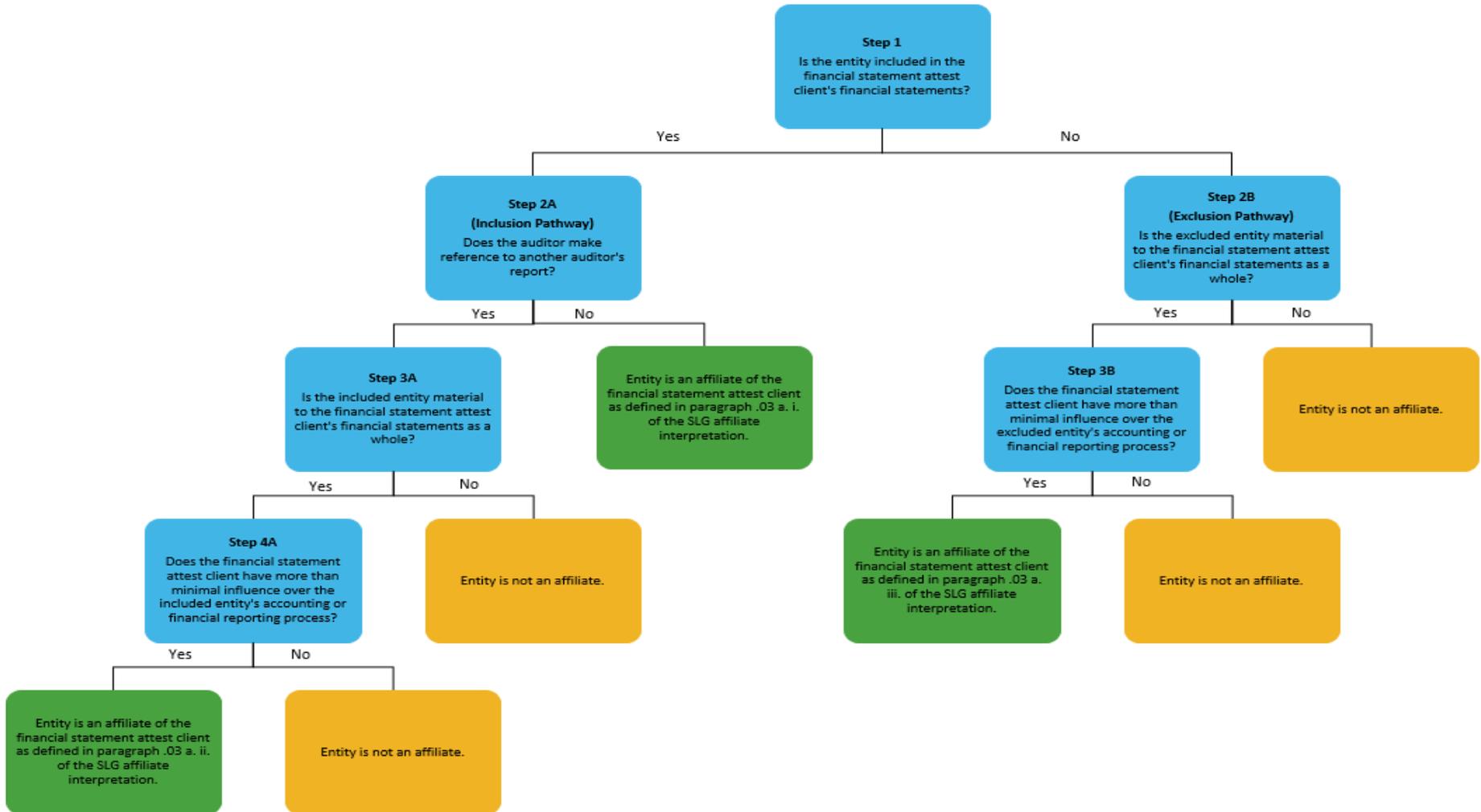
Terms that are defined in the Code of Professional Conduct appear in italic. The first time a defined term or citation to the Code of Professional Conduct appears in this implementation guide, it will be hyperlinked.

¹ ET sections referenced throughout this implementation guide can be found in AICPA *Professional Standards*.

Affiliate Decision Trees

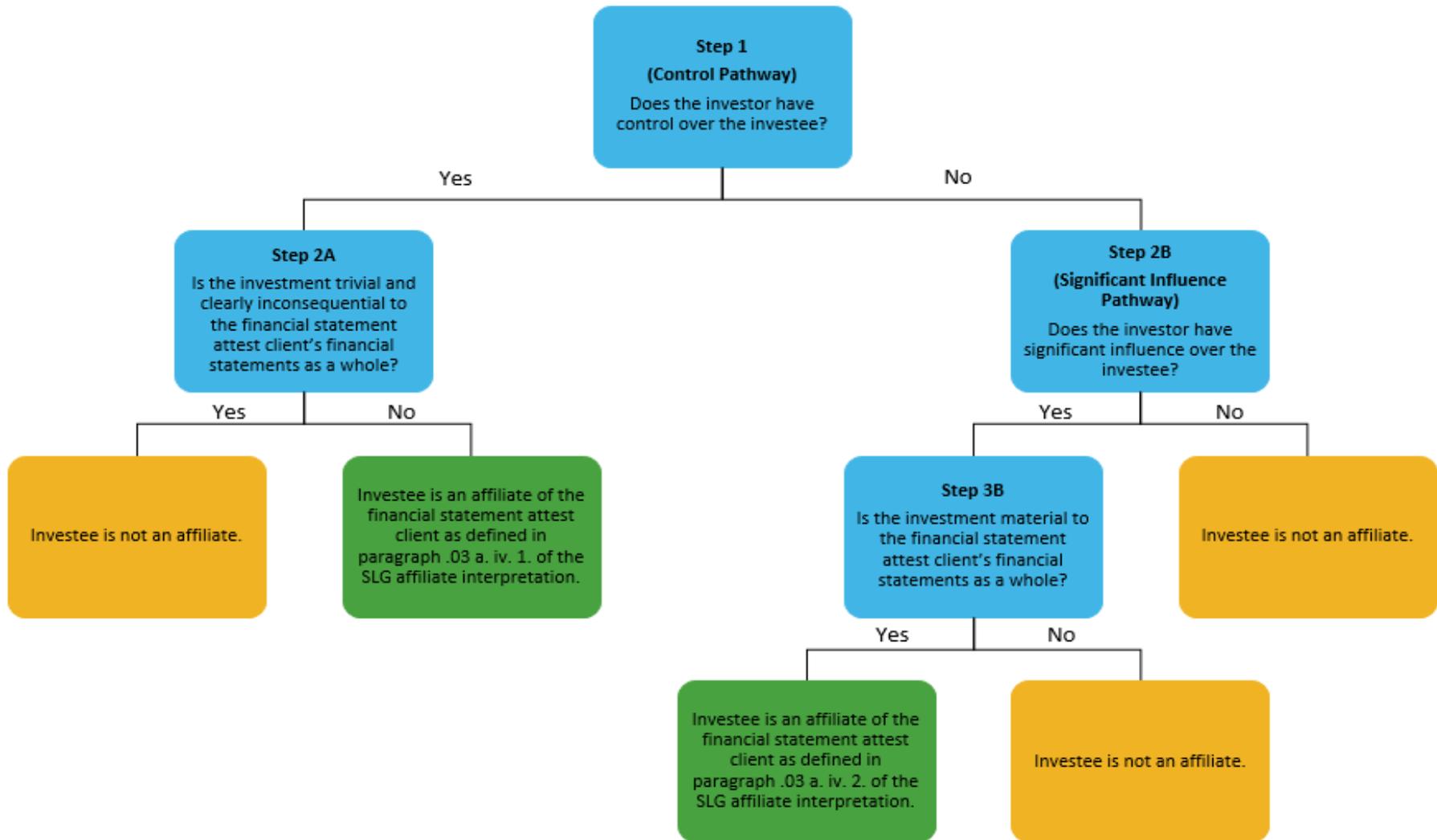
I. Decision Tree for Entities Required Under the Applicable Financial Reporting Framework to be Included in the Financial Statements of the SLG Financial Statement Attest Client

The following decision tree provides a framework for determining affiliates as defined in paragraphs .03 a. i.-iii. of the SLG affiliates interpretation.



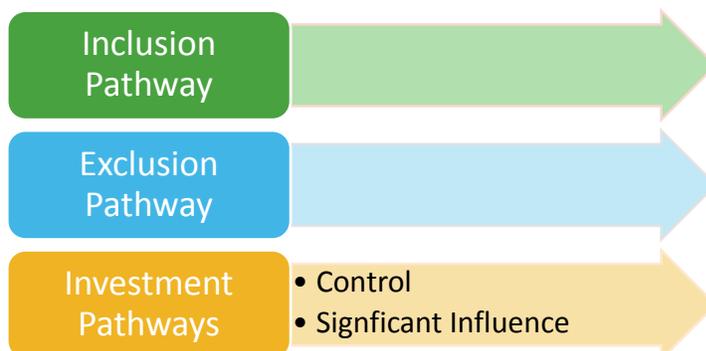
II. Decision Tree for Investments Held by an Investor

The following decision tree provides a framework for determining affiliates as defined in paragraph .03 a. iv. of the SLG affiliates interpretation. For purposes of the SLG affiliates interpretation, an investor includes the *financial statement attest client* or an affiliate of the *financial statement attest client* that meets the definition of affiliate under paragraph .03 a. i. of the SLG affiliates interpretation.



Pathways

The SLG affiliates interpretation specifies three categories of pathways where an affiliate relationship may exist. For purposes of the implementation guide, these pathways are referred to as:



Inclusion Pathway

In the inclusion pathway, two situations exist where an included entity will be considered an affiliate of the SLG *financial statement attest client* and as a result, the *member* will need to be independent of these included entities in addition to being *independent* of the *financial statement attest client*.

An included entity is an entity that is included in the *financial statements* (“included entity”) of the *financial statement attest client*. For entities that are required under the applicable financial reporting framework to be included in the *financial statements* of the SLG *financial statement attest client* but are excluded from the *financial statements* of the *financial statement attest client*, refer to the [exclusion pathway](#).

Member’s audit report does not reference another auditor

When the included entity is reported on by the *member* or *member’s firm* as part of the *financial statement attest client*, the included entity is considered an affiliate as defined in [paragraph .03 a. i.](#) of the SLG affiliates interpretation. As a result, the “Independence Rule” and related interpretations should be applied to the included entity.

Member’s audit report references another auditor

An entity will be considered an affiliate as defined in [paragraph .03 a. ii.](#) of the SLG affiliates interpretation when the *member* or *member’s firm* makes reference to another auditor’s report on the included entity and

- the included entity is material to the *financial statement attest client’s financial statements* as a whole; and
- the *financial statement attest client* has more than minimal influence over the accounting or financial reporting process of the included entity.

Accordingly, the “Independence Rule” and related interpretations should be applied to the included entity with one exception related to the provision of nonattest services (see discussion below under [“Nonattest Services Exception”](#)).

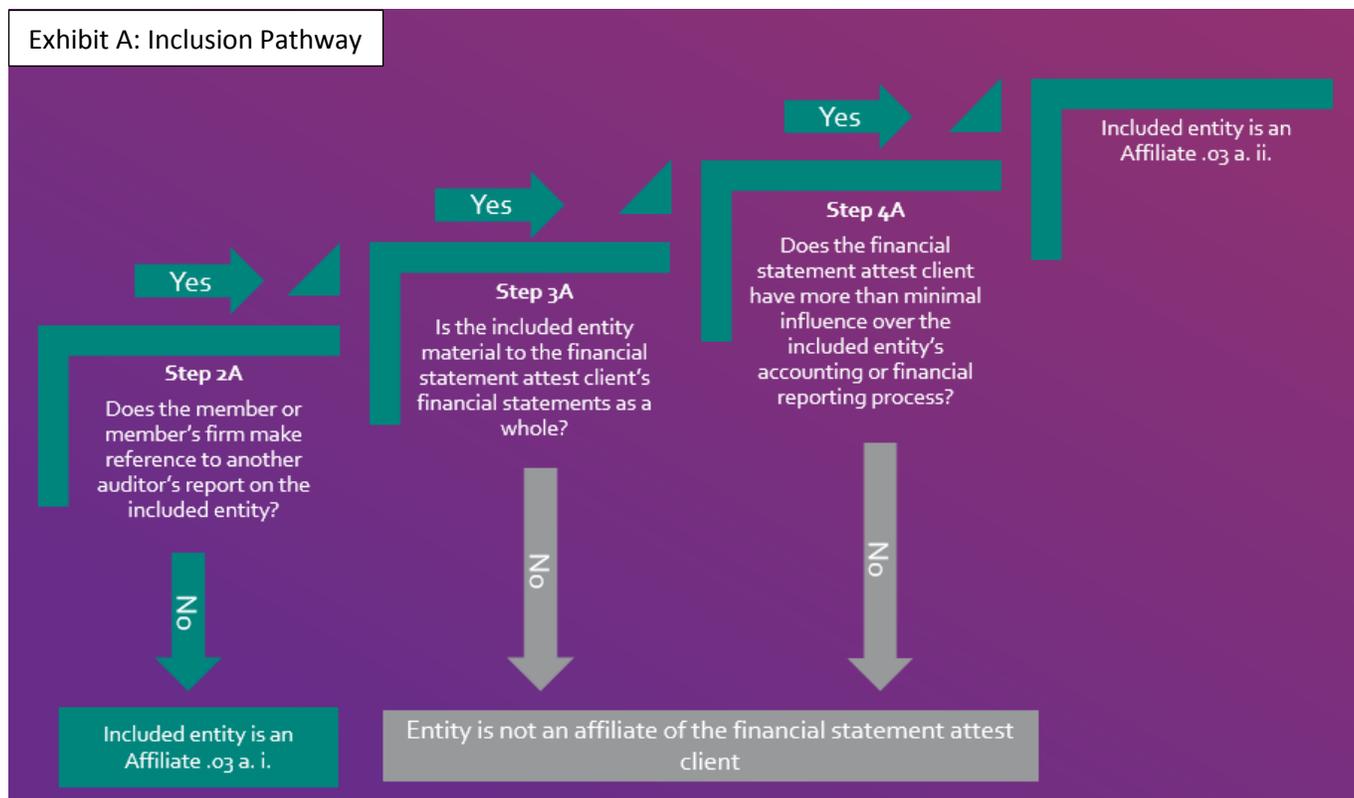
More than minimal influence

If the included entity is a fund or blended component unit, there is a rebuttable presumption that the *financial statement attest client* has more than minimal influence over the accounting or financial reporting process of such an included entity. While a rebuttable presumption does not exist for discretely presented

component units, *members* should perform the evaluation by considering the factors in [paragraph .09](#) of the SLG affiliates interpretation.

Inclusion pathway illustration

The following exhibit illustrates the steps in determining whether an included entity would be considered an Affiliate .03 a. i. or an Affiliate .03 a. ii. of the SLG *financial statement attest client*.



Exclusion Pathway

In the exclusion pathway, an entity that is excluded from the SLG *financial statement attest client's financial statements* will be considered an affiliate as defined in [paragraph .03 a. iii.](#) of the SLG affiliates interpretation when:

- the excluded entity is material to the *financial statement attest client's financial statements* as a whole; and
- the *financial statement attest client* has more than minimal influence over the accounting or financial reporting process of the included entity.

Accordingly, the "Independence Rule" and related interpretations should be applied to the excluded entity with one exception related to the provision of nonattest services (see discussion below under "[Nonattest Services Exception](#)").

An excluded entity is an entity that is required under the applicable financial reporting framework to be included in the *financial statements* of the SLG *financial statement attest client* but is, nevertheless, excluded (i.e. GAAP departure).

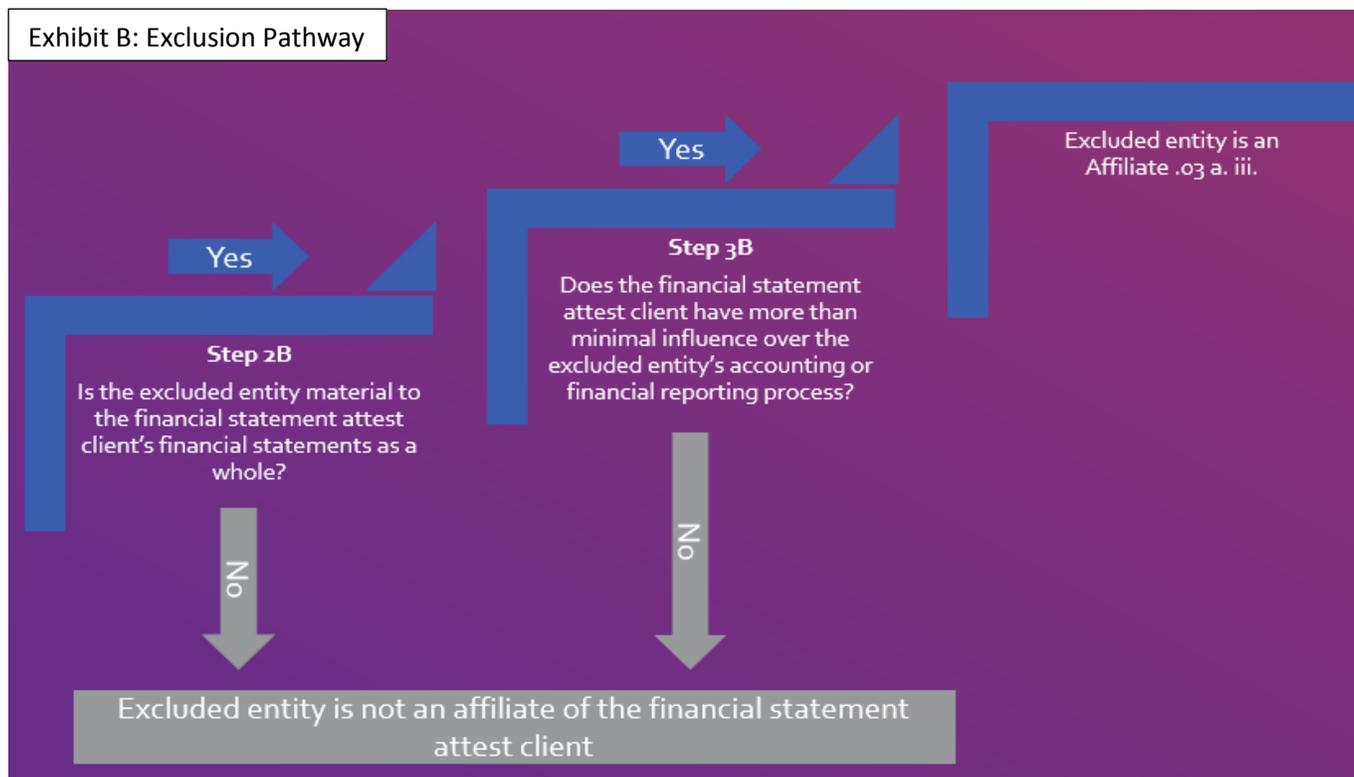
More than minimal influence

If the excluded entity is a fund or blended component unit, there is a rebuttable presumption that the *financial statement attest client* has more than minimal influence over the accounting or financial reporting

process of such an included entity. While a rebuttable presumption does not exist for discretely presented component units, *members* should perform the evaluation by considering the factors in [paragraph .09](#) of the SLG affiliates interpretation.

Exclusion pathway illustration

The following exhibit illustrates the steps in determining whether an excluded entity would be considered an Affiliate .03 a. iii. of a SLG *financial statement attest client*.



Investment Pathways

For purposes of the SLG affiliates interpretation, an investor includes the *financial statement attest client* or an Affiliate .03 a. i. of the SLG *financial statement attest client*. Accordingly, only an investment in an investee held by an investor will require evaluation to determine whether the investee is an affiliate of the SLG *financial statement attest client*.

When an investment in an investee meets the criteria under either of the following pathways, the investee will be considered an affiliate under [paragraph .03 a. iv.](#) of the SLG affiliates interpretation:

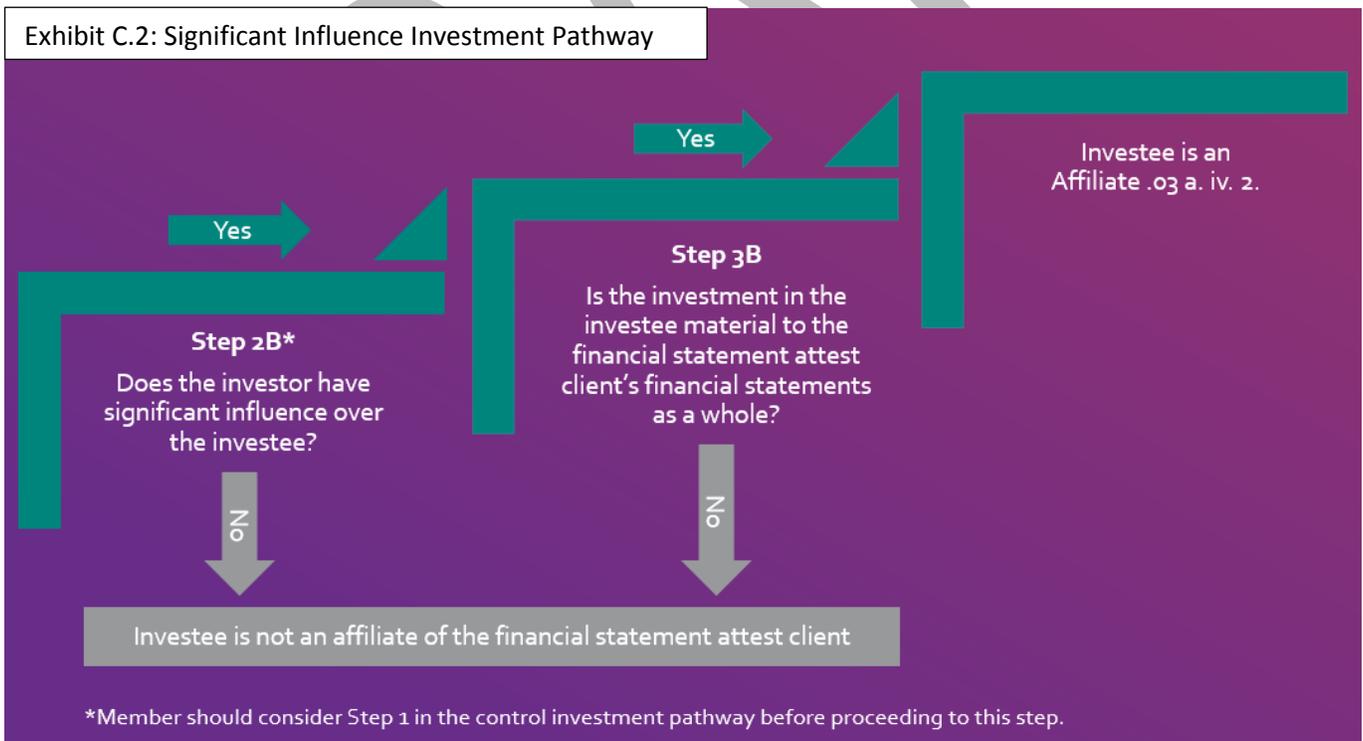
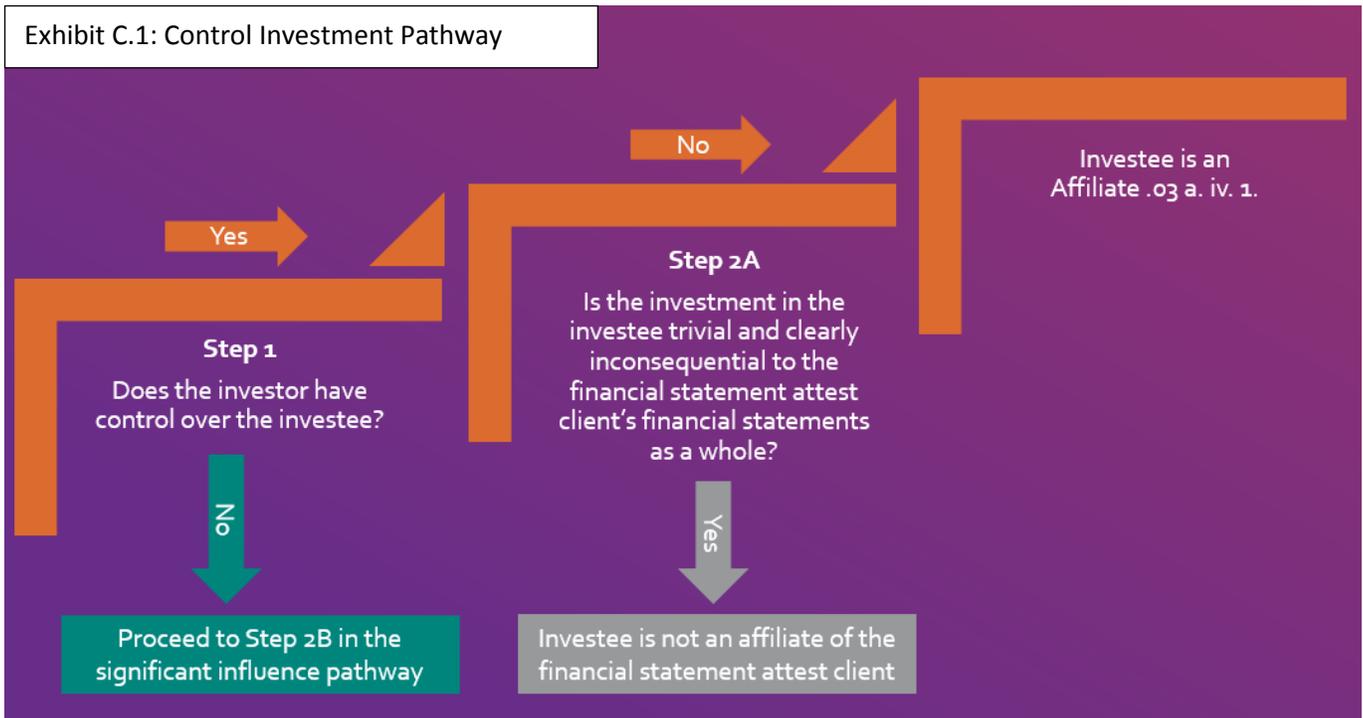
There are two pathways that should be considered in determining whether an investee is an affiliate:

- **Control Investment Pathway:** The investor has *control* over the investee unless the investment in the investee is trivial and clearly inconsequential to the *financial statement attest client's* financial statements as a whole.
- **Significant Influence Investment Pathway:** The investor has *significant influence* over the investee and the investment in the investee is material to the *financial statement attest client's* financial statements as a whole.

Accordingly, the “Independence Rule” and related interpretations should be applied to the investee.

Investment pathways illustration

The following exhibits illustrate the steps that would result in an investee being considered an Affiliate .03 a. iv. of a SLG financial statement attest client.



Conceptual Framework for Independence

Other circumstances or relationships that do not meet the criteria of the affiliate relationships described in paragraph .03 of the SLG affiliates interpretation may create *threats* to *independence* that could necessitate consulting the “[Conceptual Framework for Independence](#)” (ET sec. 1.210.010). Examples of such circumstances or relationships are described in [paragraph .06](#) of the SLG affiliates interpretation. The examples presented are not intended to be all inclusive.

Practice Aid: [Conceptual Framework Toolkit for Independence](#)

A toolkit is available to assist with evaluations.

Examples of Circumstances or Relationships That May Require a Member to Consult the Conceptual Framework for Independence

The following information is applicable for the examples illustrated:

- CPA, LLC is proposing to audit Wet Water District, a blended component unit of Wonderful City.
- Wonderful City is audited by another audit firm
- Frank Smith and Joe Banks are partners in CPA, LLC
- Joe Banks will be the audit partner on Wet Water District

Employment relationships

Frank’s wife Pam Smith is the Financial Reporting Manager for Wonderful City. Her responsibilities include preparation of the City’s comprehensive annual financial report (“CAFR”) and overseeing certain members of her team that are responsible for the accounting functions for Wet Water District.

The *firm* consulted the “Conceptual Framework for Independence” to consider whether Pam’s position would create significant *threats* to the firm’s *independence* related to the audit of Wet Water District. The firm considered the following factors:

- Pam is a *covered member’s immediate family* member with respect to the Wet Water District Audit;
- Her responsibilities include oversight of accounting functions at Wet Water District

The *firm* should consider *threats* to *independence* and, if *threats* were determined to be significant, the firm will be required to apply *safeguards* sufficient to eliminate *threats* or reduce them to an *acceptable level*. If the firm was unable to apply *safeguards* to sufficiently mitigate any significant *threats*, the CPA, LLC’s *independence* would be *impaired* if CPA, LLC accepted the proposed audit for Wet Water District.

Using the “Conceptual Framework for Independence,” the *firm* determined that Pam’s role creates management participation, familiarity, and self-interest *threats* to Frank’s compliance with the “Independence Rule” as it related to the audit of Wet Water District. After reviewing Pam’s role further, the *firm* discovered that Pam does not prepare the financial statements for Wet Water District. Those financial statements are prepared by the accounting manager within Pam’s department and then reviewed by the executive director of the Wet Water District. Pam reviews those financial statements only in respect to preparing the City’s CAFR. The *firm* also assigned a partner from another office within the firm to perform the concurring review on the audit. After considering the *safeguards* at Wet Water District and at the *firm*, the *firm* determined that *threats* were reduced to an *acceptable level* and accepted the proposed audit for Wet Water District.

Nonattest services

CPA, LLC is engaged to perform the audit of Wet Water District for fiscal year 20XX. The following year, Wonderful City inquires whether CPA, LLC can provide financial reporting design services for Wonderful City's new ERP system. The financial reporting module will also be used by Wet Water District.

CPA, LLC consulted the "Conceptual Framework for Independence" to consider whether the proposed nonattest services create significant *threats* to the firm's *independence* related to the audit of Wet Water District. The *firm* considered the following factors:

- The nonattest service may be a prohibited service if performed directly for an audit client.
- The nonattest service will be subject to the audit of Wet Water District

The firm should consider *threats* to *independence* and, if *threats* were determined to be significant, the firm will be required to apply *safeguards* sufficient to eliminate *threats* or reduce them to an *acceptable level*. If the firm was unable to apply *safeguards* to sufficiently mitigate any significant *threats*, the CPA, LLC's *independence* would be *impaired* if CPA, LLC accepted the proposed nonattest service for Wonderful City.

Using the "Conceptual Framework for Independence," the *firm* determined that self-review and management participation *threats* would exist if the firm performed the design services and that the threats would be significant. Even though the firm would not be engaged to perform the design services by Wet Water District directly, Wet Water District would be using the financial reporting module that the firm would be designing. Considering this, the firm determined that the *threats* could not be reduced to an *acceptable level* by the application of *safeguards*, so *independence* would be *impaired*. Accordingly, the *firm* did not pursue the design services engagement with Wonderful City.

Financial interests

Joe Banks is proposing on the audit for Wet Water District. Frank owns municipal bonds issued by Wonderful City.

CPA, LLC consulted the "Conceptual Framework for Independence" to consider whether the municipal bonds owned by Frank create significant *threats* to the firm's *independence* related to the audit of Wet Water District. The firm considered the following factors:

- Wonderful City provides accounting services for Wet Water District
- Frank is not on the audit engagement team for Wet Water District
- Frank is a *covered member* as he works in the same office as Joe Banks, the audit partner on Wet Water District

The firm should consider *threats* to *independence* and, if *threats* were determined to be significant, the firm will be required to apply *safeguards* sufficient to eliminate *threats* or reduce them to an *acceptable level*. If the firm was unable to apply *safeguards* to sufficiently mitigate any significant *threats*, the CPA, LLC's *independence* would be *impaired* if CPA, LLC accepted the proposed audit service for Wet Water District.

Other circumstances that may result in the firm consulting the "Conceptual Framework for Independence" may include the following situations where Frank owns bonds or debt securities in

- Municipal bonds issued by Delight County, who participates in a joint venture with Wet Water District;
- Utility bonds issued by Wonderful City where Wet Water District is responsible for the debt service payments;
- Defeased debt securities issued by Wet Water District; or

- Conduit revenue bonds issued by Wet Water District for purposes of funding the construction of a pollution control facility for a private entity.

Nonattest Services Exception

When an entity is an affiliate of a *financial statement attest client*, the SLG interpretation requires that the “Independence Rule” and related interpretations that are applicable to the *financial statement attest client* be applied to the affiliate. However, [paragraph .07](#) of the SLG affiliates interpretation provides an exception for prohibited nonattest services (that is, services that would *impair independence* under the “[Nonattest Services](#)” subtopic of the “Independence Rules”) for affiliates defined in [paragraph .03 a. ii.](#) and [paragraph .03 a. iii.](#) of the SLG affiliates interpretation. For purposes of this implementation guide, this exception is referred to as the Nonattest Services Exception.

Under the Nonattest Services Exception, *members* would not be prohibited from providing these services to Affiliates .03 a. ii. or Affiliates .03 a. iii. of the SLG *financial statement attest client* when:

- it is reasonable to conclude that the prohibited nonattest service does not create a self-review *threat* because the results of the nonattest service will not be subject to financial statement attest procedures; and
- any other *threats* that are created by the provision of the nonattest service (for example, management participation *threats*) that are not at an *acceptable level* are eliminated or reduced to an *acceptable level* by the application of *safeguards*.

Examples of Nonattest Services Exception

The following information is applicable for the examples illustrated:

- Firm Z audits ABC County
- Firm Z determined that County Housing Authority is an Affiliate .03 a. ii. of ABC County
- Firm Z determined that NFP Company is an Affiliate .03 a. iii. of ABC County

Included entity example

Firm Z was asked by County Housing Authority to provide back-up services for County Housing Authority’s books and records. Although providing back-up services impairs independence under the “Hosting Services” interpretation, since Firm Z concluded that County Housing Authority is an Affiliate .03 a. ii., Firm Z may evaluate whether the back-up services would meet the requirements of the nonattest services exception. If Firm Z concludes that the back-up services will not be subject to financial statement attest procedures and any other threats are at an acceptable level, then Firm Z could provide the services to the County Housing Authority if the County Housing Authority also agrees to

- Assume all management responsibilities;
- Designate an individual who possesses suitable skill, knowledge, and experience to oversee the back-up services;
- Evaluate the adequacy and results of the back-up services performed by the firm; and
- Accept responsibility for the results of the back-up services.

Excluded entity example

Firm Z was asked by NFP Company to perform financial information system design services for NFP Company. Although providing system design services impairs independence, since Firm Z concluded that NFP Company is an Affiliate .03 a. iii., Firm Z may evaluate whether the system design services would meet the requirements of the nonattest services exception. If Firm Z concludes that the system design services will not be subject to financial statement attest procedures and any other threats are at an acceptable level, then Firm Z could provide the services to the NFP Company if the NFP Company also agrees to:

- Assume all management responsibilities;
- Designate an individual who possesses suitable skill, knowledge, and experience to oversee the system design services;
- Evaluate the adequacy and results of the system design services performed by the firm; and
- Accept responsibility for the results of the system design services.

Example Affiliate Determinations

The following examples illustrate affiliate determinations under the SLG affiliates interpretation using the information below.

Firm A audits XYZ State. XYZ State has numerous funds and component units. Firm A is determining which entities meet the affiliate definition and as such, require application of the “Independence Rule” and related interpretations. Firm A is evaluating the following entities to determine whether they are affiliates:

- Highway Fund, a fund included in XYZ State’s financial statements
- Public University, a discretely presented component unit included in XYZ State’s financial statements
- University Foundation, a blended component unit included in Public University’s financial statements
- Utility Fund, required to be included in XYZ State’s financial statements but excluded (GAAP departure)
- Investments of the Public Pension Trust Fund

Affiliate .03 a. i. - Highway Fund

The Highway Fund is included in XYZ State’s financial statements. Firm B audits the Highway Fund. Firm A does not make reference to Firm B’s audit of the Highway Fund.

The Highway Fund is an affiliate of XYZ State as defined in paragraph .03 a. i. of the SLG affiliates interpretation because Firm A does not reference Firm B’s audit of the fund.

Firm A will apply the “Independence Rule” and related interpretations to the Highway Fund.

In addition, Firm A:

- Will need to evaluate investments in investees, if any are held by the Highway Fund, to determine if there are any investments in investees that are also affiliates as defined in [paragraph .03 a. iv.](#) of the SLG affiliates interpretation; and
- May not use the [Nonattest Services Exception](#).

The same conclusion would be reached if Firm A audited the Highway Fund.

Since Firm B’s *financial statement attest client* is the Highway Fund, Firm B will evaluate entities required to be included in the Highway Fund under the applicable financial reporting framework and investments, held by the Highway Fund and affiliates of the Highway Fund as defined in paragraph .03 a. i. of the SLG affiliates interpretation, to determine the affiliates of the Highway Fund.

Affiliate .03 a. ii. - Public University

The Public University is included in XYZ State’s financial statements as a material discretely presented component unit. Firm C audits the Public University. Firm A references Firm C’s audit report in Firm A’s audit report on XYZ State’s financial statements. XYZ state has more than minimal influence over the Public University’s accounting and financial reporting process.

The Public University is an affiliate of XYZ State as defined in [paragraph .03 a. ii.](#) of the SLG affiliates interpretation because the Public University is material to XYZ State’s financial statements as a whole and XYZ State has more than minimal influence over the Public University’s accounting and financial reporting process.

Firm A will apply the “Independence Rule” and related interpretations to the Public University.

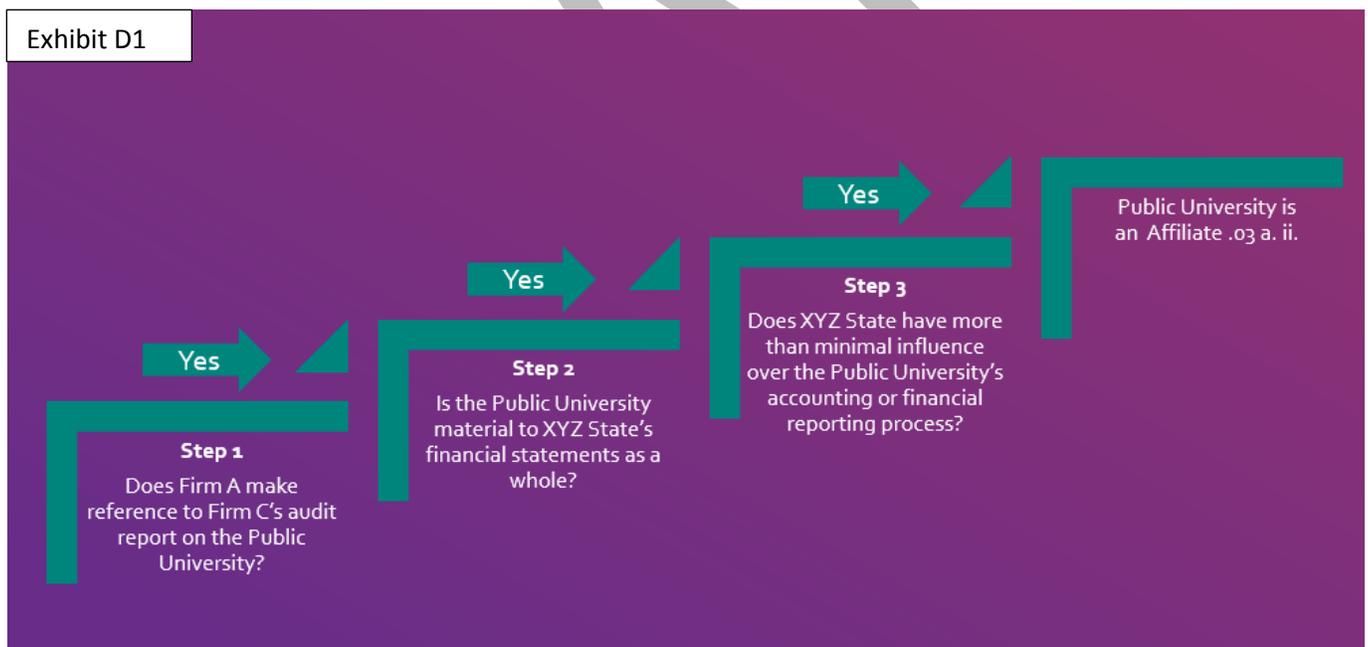
In addition, Firm A:

- Will not need to evaluate investments in investees held by the Public University for *independence* purposes; and
- May use the [Nonattest Services Exception](#).

If the Public University was not material to XYZ’s financial statements as a whole, then the Public University would not be an affiliate of XYZ State as defined in [paragraph .03 a. ii.](#) of the SLG affiliates interpretation. Similarly, if XYZ State did not have more than minimal influence over the Public University’s accounting and financial reporting process, the Public University would not be an affiliate of XYZ State.

Since Firm C’s *financial statement attest client* is the Public University, Firm C will evaluate entities required to be included in the Public University under the applicable financial reporting framework and investments, held by the Public University and affiliates of the Public University as defined in paragraph .03 a. i. of the SLG affiliates interpretation, to determine the affiliates of the Public University.

Exhibit D1 provides a visual of the conclusion that the Public University is an Affiliate .03 a. ii. of XYZ State.



Affiliate .03 a. ii. – University Foundation

The University Foundation is a blended component unit included in the Public University’s financial statements. As previously discussed, the Public University is a discretely presented component of XYZ State. The University Foundation is also included in XYZ State’s financial statements and is material to XYZ State. Firm C audits the University Foundation. Firm A references Firm C’s audit report in Firm A’s audit report on XYZ State’s financial statements. XYZ State has more than minimal influence over the University Foundation’s accounting and financial reporting process.

The University Foundation is an affiliate of XYZ State as defined in [paragraph .03 a. ii.](#) of the SLG affiliates interpretation because the University Foundation is material to XYZ State’s financial statements as a whole and XYZ State has more than minimal influence over the University Foundation’s accounting and financial reporting process.

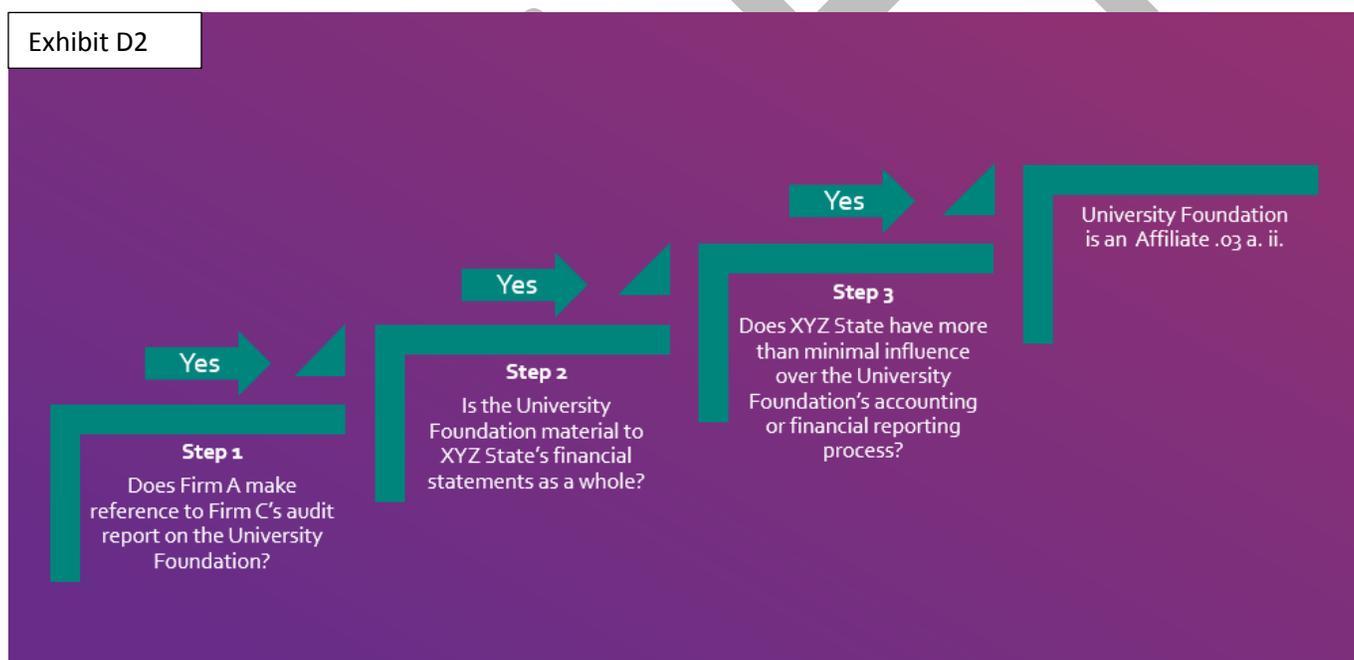
Firm A will apply the “Independence Rule” and related interpretations to the University Foundation.

In addition, Firm A:

- Will not need to evaluate investments in investees held by the University Foundation for *independence* purposes; and
- May use the [Nonattest Services Exception](#).

If the University Foundation was not material to XYZ’s financial statements as a whole, then the University Foundation would not be an affiliate of XYZ State as defined in [paragraph .03 a. ii.](#) of the SLG affiliates interpretation. Similarly, if XYZ State did not have more than minimal influence over the University Foundation’s accounting and financial reporting process, the University Foundation would not be an affiliate of XYZ State.

Exhibit D2 provides a visual of the conclusion that the University Foundation is an Affiliate .03 a. ii. of XYZ State.



Affiliate .03 a. iii. – Utility Fund

The Utility Fund is a discretely presented component unit of XYZ State under the applicable financial reporting framework and is material to XYZ State. Although XYZ State is required to include the Utility Fund in its financial statements, XYZ State chooses to exclude the Utility Fund from its financial statements (i.e., GAAP departure) because the Utility Fund does not have current audited financial statements available. XYZ State has more than minimal influence over the Utility Fund’s accounting and financial reporting process.

The Utility Fund is an affiliate of XYZ State as defined in [paragraph .03 a. iii.](#) of the SLG affiliates interpretation because the Utility Fund is material to XYZ State’s financial statements as a whole, and XYZ State has more than minimal influence over the Utility Fund’s accounting and financial reporting process.

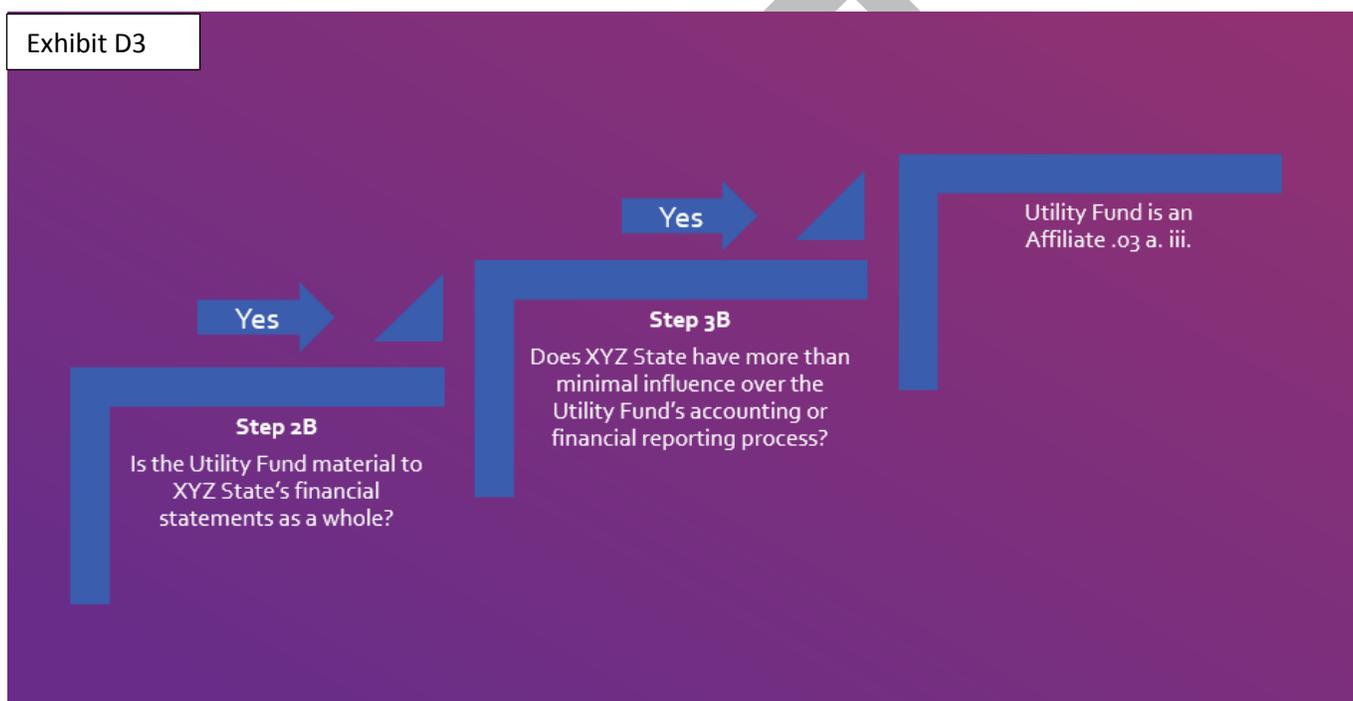
Firm A will apply the “Independence Rule” and related interpretations to the Utility Fund.

In addition, Firm A:

- Will not need to evaluate investments in investees held by the Utility Fund for *independence* purposes; and
- May use the [Nonattest Services Exception](#).

If the Utility Fund was not material to XYZ’s financial statements as a whole, then the Utility Fund would not be an affiliate of XYZ State as defined in [paragraph .03 a. iii.](#) of the SLG affiliates interpretation. Similarly, if XYZ State did not have more than minimal influence over the Utility Fund’s accounting and financial reporting process, the Utility Fund would not be an affiliate of XYZ State.

Exhibit D3 provides a visual of the conclusion that the Utility Fund is an Affiliate .03 a. iii. of XYZ State.



Affiliate .03 a. iv. – Investments of the Public Pension Trust Fund

XYZ State includes a Public Pension Trust Fund in its financial statements that is reported as a fiduciary fund. Firm A determined that the Public Pension Trust Fund is an affiliate of XYZ State as defined in [paragraph .03 a. i.](#) of the SLG affiliates interpretation. As a result, Firm A will need to evaluate the Public Pension Trust Fund’s investments in investees to determine if there are any investments in investees that are also affiliates as defined in [paragraph .03 a. iv.](#) of the SLG affiliates interpretation.

Firm A will evaluate two investments in investees of the Public Pension Trust Fund to determine if either of the investments would be affiliates of XYZ State.

- Investment in DEF Company
- Investment in RST Company

While this example relates to investments held by a single Affiliate .03 a. i. of XYZ State, the *member* should consider investments held by the *financial statement attest client* itself and as a whole. For example, the Public Pension Trust Fund could be the *member’s financial statement attest client* or XYZ State may have an investment that is allocated to several funds within its financial statements, in which each may be

considered an affiliate under [paragraph .03 a. i.](#) of the SLG interpretation. In this circumstance, it is important for the *member* to consider the investment held by the *financial statement attest client* as a whole, rather than the individual allocated portions of the investment within each Affiliate .03 a. i. of the *financial statement attest client*.

Investment in DEF Company

The Public Pension Trust Fund is considered an [investor](#) as defined in the SLG affiliates interpretation because the Public Pension Trust Fund is an affiliate of XYZ State as defined in [paragraph .03 a. i.](#) the SLG affiliates interpretation. The Public Pension Trust Fund has a *controlling* interest in DEF Company and the Trust Fund’s investment in DEF Company is more than trivial and clearly inconsequential to the XYZ State’s financial statements as a whole.

DEF Company is an affiliate of XYZ State as defined in [paragraph .03 a. iv. 1.](#) of the SLG affiliates interpretation because the Public Pension Trust Fund’s ownership interest in DEF Company gives it *control* over DEF Company and the Public Pension Trust Fund’s investment in DEF Company is more than trivial and clearly inconsequential to XYZ State’s financial statements as a whole.

Firm A will apply the “Independence Rule” and related interpretations to DEF Company.

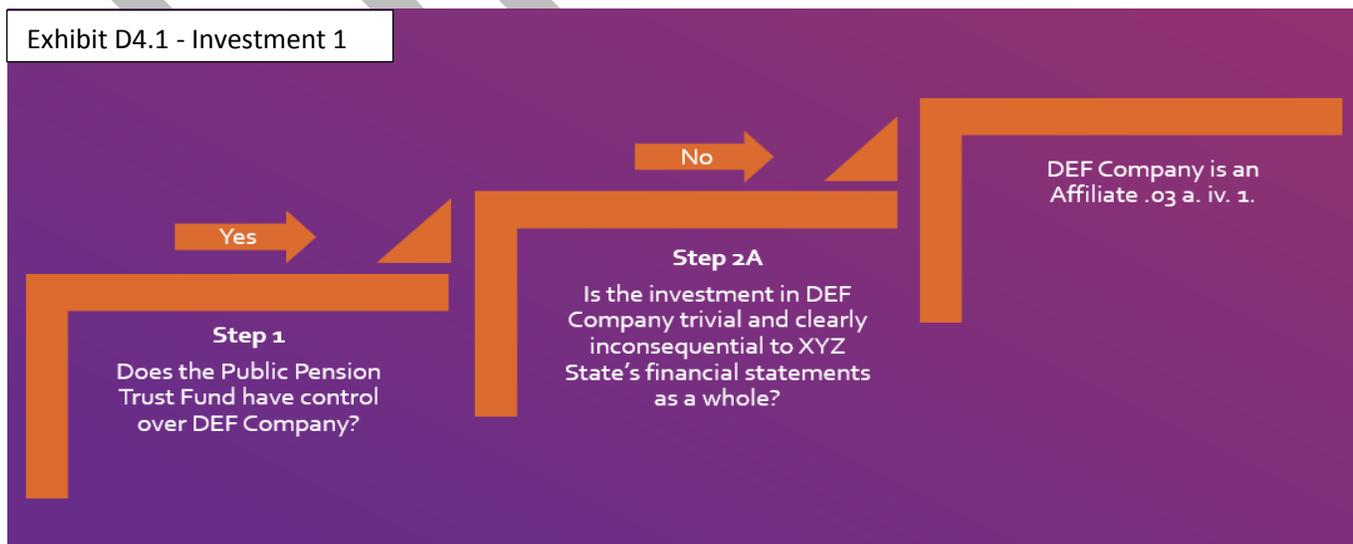
In addition, Firm A:

- Will not need to evaluate investments in investees held by DEF Company for *independence* purposes; and
- May not use the [Nonattest Services Exception](#).

If the Public Pension Trust Fund’s investment in DEF Company was trivial and clearly inconsequential to XYZ State’s financial statements as a whole, DEF Company would not be an affiliate of XYZ State.

If, however, the Public Pension Trust Fund’s investment in DEF Company was more than trivial and clearly inconsequential to XYZ State’s financial statements as a whole but the Public Pension Trust Fund did not have *control* over DEF Company, Firm A would need to evaluate whether DEF Company is an affiliate using the significant influence investment pathway. The significant influence investment pathway is demonstrated using the Investment in RST Company.

Exhibit D4.1 provides a visual of the conclusion that DEF Company is an Affiliate .03 a. iv. 1. of XYZ State.



Investment in RST Company

As previously discussed, the Public Pension Trust Fund is considered an investor as defined in the SLG affiliates interpretation. The Public Pension Trust Fund also has an interest in RST Company that gives the Trust Fund *significant influence* over RST Company. The investment in RST Company is material to XYZ State's financial statements as a whole.

RST Company is an affiliate of XYZ State as defined in [paragraph .03 a. iv. 2.](#) of the SLG affiliates interpretation because the Public Pension Trust Fund's ownership interest in RST Company gives it *significant influence* over RST Company and the Public Pension Trust Fund's investment in RST Company is material to XYZ State's financial statements as a whole.

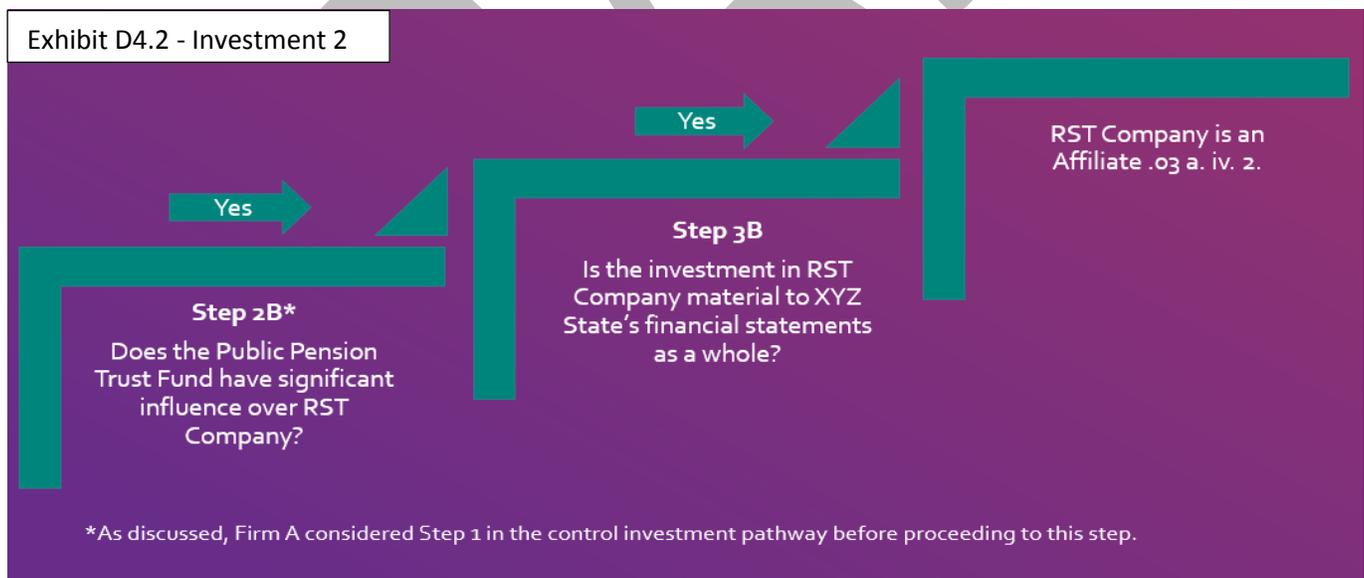
Firm A will apply the "Independence Rule" and related interpretations to RST Company.

In addition, Firm A:

- Will not need to evaluate investments in investees held by RST Company for *independence* purposes; and
- May not use the [Nonattest Services Exception](#).

If the Public Pension Trust Fund's investment in RST Company did not give the Public Pension Trust Fund at least *significant influence* over RST Company, or if the Public Pension Trust Fund's investment RST Company was not material to the XYZ State's financial statements as a whole, RST Company would not be an affiliate of XYZ State.

Exhibit D4.2 provides a visual of this conclusion that RST Company is an Affiliate .03 a. iv. 2. of XYZ State.





Step 1

Is the Entity Included in the Financial Statement Attest Client's Financial Statements?
If Yes, Then Follow the Included Entities Section of the Checklist Below; if No, Follow the Excluded Entities Section.

Name of the Entity Required Under the Applicable Financial Reporting Framework to be Included in the Financial Statements of the SLG Financial Statement Attest Client	Included Entities [Entities Required Under the Applicable Financial Reporting Framework to be Included in the Financial Statements of the SLG Financial Statement Attest Client, and are Included]				Excluded Entities [Entities Required Under the Applicable Financial Reporting Framework to be Included in the Financial Statements of the SLG Financial Statement Attest Client, and are Excluded]			Notes
	Step 2A	Step 3A	Step 4A	Result	Step 2B	Step 3B	Result	
	Does the auditor make reference to another auditor's report?	Is the included entity material to the financial statement attest client's financial statements as a whole?	Does the financial statement attest client have more than minimal influence over the included entity's accounting or financial reporting process?		Is the excluded entity material to the financial statement attest client's financial statements as a whole?	Does the financial statement attest client have more than minimal influence over the excluded entity's accounting or financial reporting process?		
Highway Fund - Example	No	Yes	No	Affiliate .03 a. i.; Must evaluate investments				
Public University - Example	Yes	Yes	Yes	Affiliate .03 a. ii.; May apply paragraph .07 exception				
Casino Board - Example					Yes	Yes	Affiliate .03 a. iii.; May apply paragraph .07 exception	

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Investment Evaluation

Name of the investment held by the investor (Affiliate .03 a. i.)	Control Evaluation			Significant Influence Evaluation			Notes
	Step 1	Step 2A	Result	Step 2B	Step 3B	Result	
	Does the investor have control over the investee?	Is the investment trivial and clearly inconsequential to the financial statement attest client's financial statements as a whole?		Does the investor have significant influence over the investee?	Is the investment material to the financial statement attest client's financial statements as a whole?		
Investment 1 - Example	Yes	No	Affiliate .03 a. iv.; Stop Here				
Investment 2 - Example	No	No	Proceed to Step 2B	Yes	Yes	Affiliate .03 a. iv.	

DRAFT

Selected Procedures Engagements Task Force

Task Force Members

Kelly Hunter (Chair), Brian Lynch, Nancy Miller, Sharon Jensen, Jim Smolinski, Anna Dourdourekas. Staff: Liese Faircloth, CPA, Ellen Gorla, CPA (NY) and Mike Glynn, CPA CGMA

Task Force Charge

The original charge of the task force was to recommend to PEEC whether the independence modifications currently allowed for engagements performed under the SSAEs (including examinations of pro-forma or prospective financial information) could be extended to compilation engagements for either pro-forma financial information or prospective financial information since these engagements are performed under the SSARs and not the SSAEs. In addition, the task force was to provide preliminary feedback to the Audit and Attest Standards staff on whether a previously proposed service referred to as “Selected Procedures Engagements” would likely qualify for modified independence. The proposed “Selected Procedures Engagements” was exposed for comment by the Accounting and Review Services Committee (ARSC) in September 2017 but the project is currently not active as it has been subsumed within a subsequent exposure draft issued by the Auditing Standards Board (ASB).

PEEC is now being asked whether any potential independence concerns exist as a result of proposed revisions under consideration by the ASB that would a) no longer require the practitioner to request a written assertion from the responsible party when the practitioner is reporting directly on the subject matter and b) revise AT-C section 215, *Agreed-Upon Procedures Engagements* to no longer require that all parties to the engagement (the engaging party, the responsible party (where applicable), and users of the practitioner’s report) to agree to the procedures to be performed and take responsibility for their sufficiency and to allow the practitioner to issue a general use agreed-upon procedures report.

Reason for Agenda Item

The Committee’s input on the FAQs included in **Agenda Item 2B**.

Summary of Issues

February 2019 PEEC Conclusions

During the February 2019 meeting, the Committee agreed that Staff should draft FAQs that provide guidance that

1. Independence would not be impaired in an engagement where there is not a requirement for a written assertion from the responsible party when the practitioner is reporting directly on the subject matter, provided the client (or responsible party) takes responsibility for the subject matter (or underlying subject matter as the terms are synonymous).
2. That the use of the ISAE terminology (subject matter information) to reference the outcome of the procedures or the assertion (if one exists) does not create any confusion or concerns in applying the “Independence Rule” to the engagement.

3. There is no significant impact to threats when the engaging party acknowledges the “appropriateness” of the procedures rather than the “sufficiency” of the procedures in an agreed-upon procedures engagement.
4. The “Independence Rule” does not prohibit members from being involved in the design of the procedures applied to the subject matter of an AUP engagement, and that the member’s involvement in the design of procedures applied to the subject matter should not impact the significance of threats to independence.
5. There are no concerns with allowing the practitioner to issue a general use agreed-upon procedures report, unless the procedures are prescribed, and the practitioner is precluded from designing or performing additional procedures, the criteria are not available to users, or the criteria are suitable only for a limited number of users.

The FAQs found in **Agenda Item 2B** convey these conclusions.

Effective Date

The FAQs will be released after the SSAE is adopted by the ASB.

Action Needed

Does the Committee have any suggested revisions to the FAQs included in **Agenda Item 2B**?

Communications Plan

These FAQs would be added to the [General FAQs](#) document and the following reference would be added after each interpretation “Independence Standards for Engagements Performed in Accordance with Statements on Standards for Attestation Engagements” subtopic upon the effective date of revised SSAE XX.

Nonauthoritative questions and answers regarding the independence considerations related to SSAE XX are available at www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf.

Staff would share this information with the Accounting and Auditing team and will work with that team to develop and appropriate communications.

Materials Presented

Agenda Item 2B: Draft FAQs

Statements on Standards for Attestation Engagements XX – Independence Considerations

Question 1: When performing an attestation engagement in accordance with SSAE No. XX, would independence be impaired if only the *member* performs the measurement or evaluation of the subject matter in accordance with (or based on) the criteria?

Answer 1: No, provided: (1) the measurement or evaluation is performed at the same time as the attestation engagement; and (2) the responsible party is a party other than the practitioner and takes responsibility for the subject matter.

Question 2: When performing an attestation engagement in accordance with SSAE XX, is a threat to independence created when the *member* both develops criteria and measures whether subject matter is in accordance with (or based on) the criteria when the engaging party agrees to the criteria recommended or developed by the *member*?

Answer 2: No, provided a party other than the *member* takes responsibility for (1) the criteria for the measurement, evaluation, or disclosure of the subject matter; and (2) determining that such criteria are suitable and will be available to the intended users.

Question 3: When performing an agreed-upon procedures engagement in accordance with SSAE XX are there any independence threats created by requiring only the engaging party to acknowledge that the procedures performed are *appropriate* for the purpose of the engagement instead of specified parties being required to accept responsibility that such procedures are *sufficient*?

Answer 3: No threats to independence are created by requiring only the engaging party to take responsibility for the *appropriateness* of the procedures.

Question 4: In an agreed-upon procedures engagement performed in accordance with SSAE XX the practitioner is explicitly allowed to develop, or assist in developing, the procedures for the engagement. Are any significant threats to independence created by permitting the *member* to develop, or assist in developing, the procedures?

Answer 4: No threats to independence are created by permitting the *member* to develop, or assist in developing, the procedures because the design of procedures to be performed is part of the agreed-upon procedures service and is not a separate nonattest service.

Question 5: In an agreed-upon procedures engagement performed in accordance with SSAE XX are threats to independence created by allowing the *member*, in addition to the engaging party, to take responsibility for the *appropriateness* of the procedures performed?

Answer 5: No threats to independence are created by allowing both the member and the engaging party to take responsibility for the *appropriateness* of the procedures.

Information Technology and Cloud Services Task Force**Task Force Members**

Shelly VanDyne (Chair), Cathy Allen, Katie Jaeb, Anna Dourdourekas, Dan O'Daly, John Ford, Nancy Miller, Danielle Cheek, Jonathan Pike (Observer). Staff: Ellen Gorla, Michele Craig

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

The Task Force is seeking adoption of the Information System Services interpretation.

Information System Services

The Committee discussed the comments received on the Information System Services exposure draft at the November 2018 and February 2019 meetings. The comments and conclusions to date can be found in **Agenda Item 3C**. Each comment in **Agenda Item 3C** is given a row number and references to these rows in this agenda item are to assist the Committee with locating the comment(s).

The Task Force is seeking adoption of the revised interpretation found in **Agenda Item 3B** after discussing the following matters.

Paragraph .02 (Rows 2 and 59)

During the November 2018 meeting the Task Force recommended that clarification be added to address systems that don't aggregate source data underlying the subject matter of the attest engagement or generate information that is significant to the subject matter of the attest engagement to address how to apply this guidance when the attest engagement does not involve the financial statements. At the November 2018 meeting, the PEEC recommended this issue be considered by the planning committee to see if a broader project should be undertaken as part of the Division's strategy and work plan (SWP). Since the SWP is currently under development, the Task Force recommends the Committee consider adding the following statement to the introduction of the interpretation:

This interpretation applies to all attest engagements, including those in which the subject matter of the engagement is not financial statements. In these cases, the member should define a financial information system as any information system that is subject to the member's attest procedures considering the relevant factors in paragraph .03 a.

Paragraphs .03 a. and .05 (Rows 42 and 43) and Paragraphs .06 and .22

During the February 2019 meeting, the Committee requested the Task Force (1) provide more clarification regarding what constitutes "discrete"; and (2) whether the level of significance should also be included as a safeguard. With respect to clarifying what "discrete" means, the Task Force was asked to consider the concepts "routine and mechanical".

When discussing the Committee's feedback, the Task Force noted that some could interpret the provision in paragraph .05 to mean that the member could design or develop a significant FIS that

performs a discrete calculation. The Task Force's use of the term "discrete" to describe the tool was intended to explain why the tool would not be considered an FIS.

Accordingly, the Task Force recommends: (1) moving the discussion about a tool from paragraph .05 to item a. of paragraph .03 (the definition of an FIS) and (2) moving the discussion about factors to consider when determining whether a nonattest service is related to an FIS, from item a. of paragraph .03 to its own paragraph .06. The Task Force believes these revisions will more clearly outline when a tool would be considered an FIS and will help members understand and apply the interpretation more consistently.

The Task Force's recommended revisions to paragraphs .03 a. and .05 appear in orange text below. New paragraph .06 does not appear in orange text since the location of the text was moved but the content remained the same.

.03 a. Financial information system (**FIS**) is a system that aggregates source data underlying the financial statements or generates information that is significant to **either** the *financial statements* or financial processes as a whole. **An FIS includes a tool that calculates results unless the**

- i. tool performs a discrete noncomplex calculation;**
- ii. attest client evaluates and accepts responsibly for the input and assumptions; and**
- iii. attest client could recalculate (for example, the formulas may be viewed) the results.**

.05 When a member designs or develops an attest client's FIS financial information system, threats to compliance with the "Independence Rule" would not be at an acceptable level and could not be reduced to an acceptable level by the application of safeguards 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 a financial 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".~~

.06 To determine whether a nonattest service is related to an **FIS** financial information system, members should ~~may~~ consider **all relevant** factors, such as whether the nonattest service will affect the following:

- a. System controls or system output that will be subject to attest procedures
- b. A system that generates data that are used as an input to the *financial statements*, **including data or information that is either reflected in or used in determining amounts and disclosures included in the financial statements**
- c. A system that gathers data that **is used in** assist management's **decision** ~~in~~ making **about matters that could significantly** decisions that directly impacting financial reporting, **such as an analytical or reporting tool**
- d. A system that is part of the attest client's internal controls over financial reporting, **including information systems used to effect internal controls over financial reporting, for example, a system used to ensure that information produced for the financial statements is accurate. However, information systems used only**

in connection with controlling the efficiency and effectiveness of operations are considered to be unrelated to the financial statements and accounting records.

When drafting the above revision, the Task Force noted that paragraph .22 also uses the term “discrete” to explain why certain maintenance, support or monitoring services do not impair independence. The Task Force recommends replacing “discrete” with “individually separate, distinct and nonrecurring” to describe the types of engagements that would not impair independence. The Task Force believes this revision will add clarity and drive more consistent application. The Task Force’s recommended revisions to paragraph .22 follow in orange text:

Independence will not be *impaired*, provided all the requirements of the “Nonattest Services” subtopic of the “Independence Rule” are met and the maintenance, support, ~~and/or~~ monitoring services are *discrete individually separate, distinct and* nonrecurring engagements ~~in~~ which the *attest client* has not outsourced a function, process, or activity to the *member* that ~~in-effect~~ would result in the *member* assuming a management responsibility. Examples of ~~such~~ services that ~~would~~ *not impair independence* may include ~~being engaged for a discrete project to do~~ *performing* any of the following *services*:

- a. Analyze a network and provide observations or recommendations
- 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 the design or operating effectiveness of an *attest client’s* security over information technology systems
- f. Assess the *attest client’s* information technology security policies or practices

New Paragraph .06 [Exposed Paragraph .03 a. iv] (Row 20)

During the February 2019 meeting, the Committee asked the Task Force to add an example of a system that is used only in connection with controlling the efficiency and effectiveness of operations but could never be used as a financial information system. The Task Force discussed this request at length and was not able to identify an example. The Task Force recommends an example not be added and instead address questions as they are posed so that the specific facts and circumstances can be considered.

Paragraph .09 (Rows 52 and 53)

During the February 2019 meeting the Task Force recommended replacing the phrase “computer, normally onto a customer’s server” with the phrase “designated hosting site”. The Committee supported this revision and added as an example that the client’s designated hosting site could include a cloud-based server. The Task Force recommends that the example of a cloud-based server as a client’s designated hosting site not be added and instead suggest the statement be left broad, so the example does not become obsolete as the technology changes.

Paragraph .11 (Rows 56 and 57)

The Task Force recommends the last sentence in paragraph .11 be revised to clarify why designing or developing new software code or features that modify or alter the functionality of a COTS software solution in ways not pre-defined by the third-party vendor, would not constitute configuring a COTS FIS. The Task Force’s recommended revisions to paragraph .11 follow in orange text:

To configure a COTS FIS financial information system software solution means selecting **inputting the client selected** the software features, functionality options, and settings **within the third-party vendor's software** provided by the **third-party vendor**, that **which** will determine **s** 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, However, the member should not configuring a COTS financial information system software solution does not involve design or developing~~ new software code or features to modify or alter the functionality of the COTS software solution in ways not pre-defined by the **third-party vendor, as this would be considered designing or developing activities described in paragraph .03 b. and c.**

Paragraph .13

The Task Force recommends revisions to paragraph .13 that eliminate duplication. The Task Force's recommended revisions to paragraph .13 follow in orange text:

To customize a COTS FIS software solution means modifying or enhancing the features and functions that go beyond the options provided by the third-party vendor when configuring the COTS software solution. ~~To customize a COTS FIS financial information system software solution means modifying or enhancing~~ altering or adding to the features and functions provided for by the **third-party vendor**, that go beyond all options available when configuring the COTS software solution. ~~For purposes of this interpretation, customizing can involve both modification and enhancements~~ **are defined as:**

- a. Modification involves altering the COTS software solution code to change or add to the functionality provided by the **third-party vendor**.
- b. Enhancements involve developing new code, external to the COTS software solution, that works in concert with the COTS software solution to provide altered or additional functionality

Information Technology Services FAQs

The Task Force recommends that the extant Information Technology Services FAQs found in **Agenda Item 3D** be deleted, and that new FAQs be developed as questions are received. While the Task Force believes its proposed revisions to the definition of an FIS will allow members to determine whether a tool they use would rise to the level of an FIS, the Task Force acknowledges that it could be helpful to develop FAQs that demonstrate the range of possibility that tax provision and lease accounting tools may have.

Effective Date (Rows 124-126)

Thirteen commenters believe the proposed one year delayed effective date is appropriate while one commenter doesn't believe an extended period is necessary and 4 commenters believe more than a year is needed. The Task Force believes that additional time should be provided for members to implement this guidance even though in substance there is little that is more restrictive than the extant. However, since the Task Force is seeking adoption at the May 2019 meeting, it is recommending the period be just slightly over a year and be effective as of January 1, 2021 with early implementation allowed.

Questions for the Committee

1. Does the Committee support the recommended revisions to the proposed revised interpretation that appear in **Agenda Item 3B** in orange?

2. Does the Committee want to discuss any other comments in **Agenda Item 3C**?
3. Does the Committee agree with the Task Force's recommendations related to the existing FAQs?
4. Does the Committee support the recommended effective date of January 1, 2021 with early implementation allowed?
5. Does the Committee approve the revised interpretation for adoption?

Action Needed

The Committee's adoption of the revised Information System Services interpretation is requested.

Communications Plan

The Task Force believes a robust communication plan is needed for this project. Some of the ideas Staff plans to discuss with the Task Force includes email communications from the division to internal (i.e. Peer Review) and external stakeholders as well as articles, web events, conference and training materials. The Task Force believes it is be important for these communications to continue between May 2019 through December 2021, with an emphasis on Fall 2019.

Materials Presented

Agenda Item 3B	Revised Interpretation
Agenda Item 3C	Comment Letter Summary
Agenda Item 3D	Extant FAQs

Text of Proposed Interpretation “Information Systems Services”

(Formerly “Information Systems Design, Implementation, or Integration.”)

NOTE TO PEEC

- ***Text in black bold italic and strikethrough represent revisions agreed to by PEEC prior to the February 2019 meeting.***
- ***Green text are revisions made by the PEEC during the February 2019 meeting.***
- ***Orange text are revisions made by the Task Force since the February 2019 meeting.***

1.295.145 Information Systems Services ~~Design, Implementation, or Integration~~

Introduction

- .01 Self-review and management participation *threats* to the *member's* compliance with the “Independence Rule” [1.200.001] may exist when a *member* provides ***nonattest*** services related to an *attest client's* information systems.
- .02 ***This interpretation applies to all attest engagements, including those in which the subject matter of the engagement is not financial statements. In these cases, the member should define a financial information system as any information system that is subject to the member's attest procedures considering the relevant factors in paragraph .03 a.***

Terminology

- .03 The following terms are defined solely for the purpose of applying this interpretation:
- a. Financial information system (***FIS***) is a system that aggregates source data underlying the *financial statements* or generates information that is significant to ***either*** the *financial statements* or financial processes as a whole. ***An FIS includes a tool that calculates results unless the***~~To determine whether a nonattest service is related to an *FIS* financial information system, members *should* may consider *all relevant* factors, such as whether the nonattest service will affect the following:~~
- tool performs a discrete noncomplex calculation;***
 - attest client evaluates and accepts responsibly for the input and assumptions; and***
 - attest client could recalculate (for example, the formulas may be viewed) the results.***
- ~~i.—System controls or system output that will be subject to attest procedures~~
- ~~ii.—A system that generates data that are used as an input to the financial statements, including data or information that is either reflected in or used in determining amounts and disclosures included in the financial statements~~

- iii. ~~A system that gathers data that is used in assist management's decision in making about matters that could significantly decisions that directly impacting financial reporting, such as an analytical or reporting tool~~
 - iv. ~~A system that is part of the attest client's internal controls over financial reporting, including information systems used to effect internal controls over financial reporting, for example, a system used to ensure that information produced for the financial statements is accurate. However, information systems used only in connection with controlling the efficiency and effectiveness of operations are considered to be unrelated to the financial statements and accounting records.~~
- 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) refers to a software package developed, distributed, maintained and supported by **an entity or entities that are not the member or member's firm** (a third-party vendor), sometimes simply referred to as an "off the shelf" package or solution. COTS solutions have generally referred to traditional on-premise software that runs on a customer's own computers or on a **third-party** vendor's "cloud" infrastructure. COTS solutions range from software packages that require only installation on a computer and are ready to run to large scale, complex enterprise applications.

Design, Development, or Implementation Services Not Related to a Financial Information System

- .04 When performing design, development, or implementation services described in this interpretation for an *attest client* that are not related to a **FIS** financial information system, *threats* to compliance with the "Independence Rule" [1.200.001] would be at an *acceptable level* provided all the requirements of the "Nonattest Services" subtopic [1.295] of the "Independence Rule" are met, including that the *attest client* has not outsourced a function, process, or activity to the *member*, which ~~in-effect~~ would result in the *member* assuming a management responsibility.

Designs or Develops a Financial Information System

- .05 When a *member* designs or develops an *attest client's FIS* financial information system, *threats* to compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* 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 a financial 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".~~

.06 To determine whether a nonattest service is related to a **FIS** financial information system, **members should** may consider **all relevant** factors, such as whether the nonattest service will affect the following:

- a. System controls or system output that will be subject to attest procedures
- b. A system that generates data that are used as an input to the *financial statements*, **including data or information that is either reflected in or used in determining amounts and disclosures included in the financial statements**
- c. A system that gathers data that **is used in** assist management's **decision** in making **about matters that could significantly** decisions that directly impacting financial reporting, **such as an analytical or reporting tool**
- d. A system that is part of the *attest client's* internal controls over financial reporting, **including information systems used to effect internal controls over financial reporting, for example, a system used to ensure that information produced for the financial statements is accurate. However, information systems used only in connection with controlling the efficiency and effectiveness of operations are considered to be unrelated to the financial statements and accounting records.**

Implementation of a COTS Financial Information System Software Solution

.07 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, and data translation. Services that are performed post-implementation, such as the maintenance, support, and monitoring of the system, are not **considered to be** implementation services.

.08 **Threats** created by certain COTS implementation services related to the *attest client's FIS* financial information system may be reduced to an *acceptable level* by the application of *safeguards*; however, in other situations *threats* to compliance with the "Independence Rule" would be significant and could not be reduced to an *acceptable level* by the application of *safeguards*. **These situations are addressed in paragraphs .087 through .198 of this interpretation.**

Install a COTS Financial Information System Software Solution

.09 To install a COTS **FIS** financial information system software solution means the initial loading of software on a **the client's designated hosting site such as the client's cloud-based server** computer, normally onto a customer's server. Software configuration, integration, and conversion activities may follow installation.

.10 When a *member* installs a COTS **FIS** 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 of the "Independence Rule" are met.

Configure a COTS Financial Information System Software Solution

.11 To configure a COTS **FIS** financial information system software solution means selecting **inputting the client selected** the software features, functionality options, and settings **within the third-party vendor's software provided by the third-party vendor, that which will**

determines 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, However, the member should not~~ configuring a COTS financial information system software solution does ~~not involve design or~~ developing new software code or features to modify or alter the functionality of the COTS software solution in ways not pre-defined by the **third-party** vendor, **as this would be considered designing or developing activities described in paragraph .03 b. and c.**

- .12 When a **member** configures a COTS financial information system software solution **based on the client selected features, functionality options and settings within the third-party vendor's software**, **threats** to compliance with the "Independence Rule" would be at an **acceptable level**, provided all the requirements of the "Nonattest Services" subtopic of the "Independence Rule" are met.

Customize a COTS Financial Information System Software Solution

- .13 **To customize a COTS FIS software solution means modifying or enhancing the features and functions that go beyond the options provided by the third-party vendor when configuring the COTS software solution.** ~~To customize a COTS FIS financial information system software solution means~~ **modifying or enhancing** altering or adding to the features and functions provided for by the **third-party** vendor, that go beyond all options available when configuring the COTS software solution. ~~For purposes of this interpretation, customizing can involve both modification and enhancements~~ **are defined as:**
- Modification involves altering the COTS software solution code to change or add to the functionality provided by the **third-party** vendor.
 - Enhancements involve developing new code, external to the COTS software solution, that works in concert with the COTS software solution to provide altered or additional functionality.

- .14 If a **member** customizes an **attest client's** COTS **FIS** financial information system software solution, **threats** to compliance with the "Independence Rule" would not be at an **acceptable level** and could not be reduced to an **acceptable level** by the application of **safeguards**, and **independence** would be **impaired**.

Interface a COTS Financial Information System Software Solution

- .15 Providing interface services for a COTS **FIS** 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.
- .16 If a **member** provides interface services for a COTS **FIS** financial information system software solution, **threats** to compliance with the "Independence Rule" would not be at an **acceptable level** and could not be reduced to an **acceptable level** by the application of **safeguards**; **independence** would be **impaired** except as provided for in paragraph .165.
- .17 If a **member** uses an **third-party vendor's** application program interface (API) ~~that is developed by a third party~~ to interface legacy or **third-party** COTS **FIS** financial information

system software solutions, **such as an application programming interface (API)**, *threats* to *independence* would be at an *acceptable level*, provided the *member* will not be designing or developing code ~~thus altering how the COTS FIS functions, processes data or produce results for that enables~~ the **interface application API** to work, and all the requirements of the "Nonattest Services" subtopic of the "Independence Rule" are met.

Data Translation Services Related to a COTS Financial Information System Software Solution

- .18 Performing data translation services for a COTS **FIS** 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.
- .19 If a *member* performs data translation services for a COTS **FIS** financial information system software solution, *threats* to compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* and *independence* would be *impaired* except as provided for in paragraph .198.
- .20 If a *member* uses an **third-party vendor's API interface application** developed by a third party to perform data translation services for a COTS **FIS** financial information system software solution, **such as an API**, *threats* to *independence* would be at an *acceptable level*, provided the *member* will not be designing or developing code ~~thus altering how the COTS FIS functions, processes data or produce results for that enables~~ the **interface application API** to work, and all the requirements of the "Nonattest Services" subtopic of the "Independence Rule" are met.

System and Network Maintenance, Support, and Monitoring

- .21 Maintenance, support, and monitoring services are activities that are provided after a financial or nonfinancial system or network is implemented. If post-implementation services involve the *attest client* outsourcing an ongoing function, process, or activity to the *member* that *in-effect* would result in the *member* assuming a management responsibility, compliance with the "Independence Rule" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired*. Examples of ~~such~~ services that involve an ongoing function, process, or activity that *in-effect* would result in the *member* assuming a management responsibility ~~would~~ include **services in which a service whereby the member** directly or indirectly ~~does any of the following~~:
 - 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. Has responsibility for monitoring or maintaining the *attest client's* network performance
 - d. Operates or manages the *attest client's* information technology 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. Has responsibility for maintaining the security of the *attest client's* networks and systems

- .22 *Independence* will not be *impaired*, provided all the requirements of the "Nonattest Services" subtopic of the "Independence Rule" are met and the maintenance, support, ~~and~~ monitoring services are *discrete individually separate, distinct and* nonrecurring engagements ~~in~~ for which the *attest client* has not outsourced a function, process, or activity to the *member* that ~~in effect~~ would result in the *member* assuming a management responsibility. Examples of ~~such~~ services that ~~would~~ *not impair independence* may include ~~being engaged for a discrete project to do~~ *performing* any of the following *services*:
- a. Analyze a network and provide observations or recommendations
 - 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 the design or operating effectiveness of an *attest client's* security over information technology systems
 - f. Assess the *attest client's* information technology security policies or practices

Effective Date

- .23 This interpretation will be effective **January 1, 2021** ~~one year after it appears in the *Journal of Accountancy*~~. Early implementation is allowed.

~~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.~~

Comments on Exposure Draft-Overview

As of May 1, 2019

NOTE: The paragraph numbers referenced in the **dark purple rows** are the paragraph numbers from the exposure draft, not the paragraph numbers for the proposed revised interpretation.
 Rows in **red highlight** are comments the Task Force included in the May 2019 PEEC agenda materials.

Comments	Comment Letter	Recommendation	Open Item	Conclusion
Introduction (paragraph .01)				
<p>1. Clarify that the interpretation only applies when a member is performing a separate IT engagement and does not apply when procedures described in the interpretation are performed as part of an attest engagement (i.e., when engagements incorporate the installation of oversight software or programs, that would be used by auditors or auditor’s API system to provide continuous monitoring and audit processing on a continuous basis.</p>	CL12	<p>To clarify that the software covered by this interpretation is not software that would be used to perform aspects of the audit, the term “nonattest” was added to paragraph .01 “... may exist when a member provides nonattest services related to an attest client’s information systems.”</p> <p>During the February 2019 meeting, the Committee was asked if there any broader issues that the Committee believes should be addressed related to the use of oversight technology on the audit engagement? During the February 2019 meeting the Committee did not present any additional issues for the Task Force to consider.</p>		<p>To clarify that the software covered by this interpretation is not software that would be used to perform aspects of the audit, the term “nonattest” was added to paragraph .01 “... may exist when a member provides nonattest services related to an attest client’s information systems.”</p>
<p>2. Without a specific scope limitation, concerned the proposal will prohibit innovation in the assurance space and derail audit of the future. They are actively growing our service offerings and working on various ways to improve audit</p>	CL18	<p>Initially the Task Force proposed adding a statement to paragraph .03 that clarifies that when performing these nonattest services, for an attest client that is not a financial statement attest client, the</p>	<p>The PEEC is asked to consider the Task Force’s new recommendation.</p>	

<p>efficiency and effectiveness through innovation and technology and believes the standard would limit this ability.</p>		<p>information system shouldn't aggregate source data underlying the subject matter of the attest engagement or generates information that is significant to the subject matter of the attest engagement.</p> <p>However, during the November 2018 PEEC meeting, the Committee did not recommend that this be added to the interpretation, rather, that the issue be presented to the Planning Committee to see if it believes it is a boarder project that should be addressed by PEEC, possibly in section 1.297.</p> <p>Ms. Miller to present this issue to the PEEC during the 2019 PEEC Strategy and Work Plan discussion that takes place during the February 2019 meeting.</p> <p>Since the Planning Committee has not yet discussed this, the Task Force recommends the PEEC reconsider its initial conclusion and consider adding the following as new paragraph .02 to the proposed interpretation.</p> <p><i>This interpretation applies to all attest engagements, including those in which the subject matter of the engagement is not</i></p>		
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		<i>financial statements. In these cases, the member should define a financial information system as any information system that is subject to the member's attest procedures considering the relevant factors in paragraph .03 a.</i>		
Terminology – General Comments (.02)				
3. Definitions of the terms, interface, application program interface (API) and data translation, not commonly known to CP As, should be added (i.e., relocated from .13, .15 and .16)	CL2	Task Force believes how the interpretation is drafted (i.e., keeping the definitions within the topic) is more user friendly and so does not recommend they be relocated to the terminology section.		
4. Recommends adding definition of financial process like the one found on page 6.	CL7	<p>Page 6 indicates that a financial process "... include broad processes that affect financial reporting, such as information technology general controls."</p> <p>The Task Force recommends not incorporating the information from page 6 as doing so would include examples and the Task Force is concerned that readers would focus on the examples as opposed to broadly thinking about what a "financial process is.</p>		
5. Practitioner "should consider" the four factors when determining nonattest services vs. "may consider" given the critical distinction between financial and other information systems in the proposal.	CL4	The Task Force recommends replacing "may consider" with "should consider" as this would be more in line with the division's drafting conventions. During the		Replaced "may consider" with "should consider"

		February 2019 meeting the Committee did not object to the recommendation.		
6. Suggest that PEEC incorporate as an additional defined term “implementing an information system.”	CL4	Task Force believes how the interpretation is drafted (i.e., keeping the definitions within the topic) is more user friendly and so does not recommend they be relocated to the terminology section.		
(Sub-Theme) Dashboard	CL2,4			
7. Term dashboard reporting should be defined	CL2	Instead of defining a dashboard, the Task Force recommends describing what is intended by adding the phrase “such as an analytical and reporting tool” to the end of iii. in item a. of paragraph .02.		
8. If the term dashboard is included in the standard, it should be replaced by a description that is less likely to fall out of use quickly. Such as “business visual analytic and reporting application tools”.	CL4	<p>A system that gathers data that <i>is used in</i> assist management’s <i>decision</i> in making <i>that could significantly</i> decisions that directly impacting financial reporting <i>matters, such as an analytical or reporting tool.</i></p> <p>During the February 2019 meeting, the Committee believed it was still unclear what the term “significantly” was intended to be measuring. The Committee suggested that it would be clearer that significance was intended to measure the impact on financial reporting matters as</p>		

		<p>opposed to the significance of the management’s decisions if the phrase “about matters” was added after the phrase “decision making”.</p> <p>One Committee member believed that some may not realize that the phrase “such as an analytical or reporting tool” was intended to include “dashboards” and recommended the Task Force consider developing a FAQ to highlight that a dashboard could be an example.</p> <p>During one of the Task Force’s April 2019 calls, it was decided to hold off developing a FAQ to see why specific questions are received</p>		
Terminology – Financial Information System (.02 a.)				
<p>9. During the November 2018 meeting, the Committee asked the Task Force to discuss the placement of the term “significant” in paragraph .02 a. and whether it was clear whether it applies to a system that aggregates source data underling the financial statements or if the first sentence could be drafted more clearly.</p>	<p>PEEC – Nov 2018 Meeting</p>	<p>The Task Force believes the sentence is drafted correctly and since this text was pulled from the SEC literature, is only recommending that the term “either” be added to the sentence to help with the clarification.</p> <p>Financial information system (FIS) is a system that aggregates source data underlying the financial statements or generates information that is significant</p>		<p>During the February 2019 meeting the Committee did not object to the recommendation.</p>

		to either the <i>financial statements</i> or financial processes as a whole.		
(Sub-Theme) Definition is too broad	CL2, 9, 11, 12	The Task Force recommends adding the abbreviation “FIS” will help clarify that the system in question is a financial one. This was presented to the Committee at its November 2018 meeting. The Committee did not object to this addition.		
10. Financial information system definition is too broad, far reaching and imprecise to it would be interpreted to preclude members form assisting clients with the preparation of financial statements. Revise so that it is narrowed considerably to make clear that the practice of importing a client’s unadjusted GL data into a member’s practice aid software is not intended to be covered.	CL2	The Task Force believes that adding the term “nonattest” to paragraph .01 will help make it clear that the intent of the interpretation is not to pull in technology to assist with the attest engagement. This was presented to the Committee at its November 2018 meeting. The Committee did not object to this addition.		
11. Definition of what constitutes a financial information system is flawed and not in tune with the overall concerns of the AICPA in maintaining member relevance in technology	CL9			
12. Criteria of “aggregating source data” to define a financial information system is too broad and should be removed		The Task Force recommends this phrase remain as it was taken from the SEC rules.		
13. Criteria for defining a financial information system of generating information that is significant to the financial statements or financial processes as a whole should be eliminated. Consider limiting it to a “primary” financial information system so		The Task Force does not believe the “primary financial information system” is broad enough.		

<p>that members may assist clients with information system services and ancillary products that do not effectuate journal entries in the primary financial information systems if there is documentation of mitigating factors</p>				
<p>14. PEEC reconsider the concept of using significance or materiality when determining a financial information system because it places an undue burden on the member due to variability of the impact to the f/s that the system can have in future periods (i.e., may not be significant in the year of design but rise to significance later or the volume of transaction processed through system could grow over time)</p>		<p>The Task Force does not agree and believes the language and terminology used is consistent with other standards that are out there already.</p>		
<p>15. Clarify whether the significance test applies to the “discrete” exception as the 2 examples given could have a significant impact on the financial statements.</p>		<p>The Task Force recommends the following edits to item iii. A system that gathers data that <i>is used in assist</i> management’s <i>decision</i> in making <i>that could significantly</i> decisions that directly impact <i>ing</i> financial reporting <i>matters, such as an analytical or reporting tool.</i></p>		<p>All but one Task Force member believes that members have a responsibility to consider not only how the system would be used but how the system could be used. During the February 2019 meeting, the Committee agreed with that both should be considered.</p>
<p>16. Definition is overly broad “systems that gathers information” should be removed</p>	<p>CL11</p>	<p>The Task Force believes that significance should be tied to the impact the data gathered by the system could have on financial reporting matters. One Task Force member did not believe it was appropriate to use of the term “could” significantly impact financial</p>		

		reporting matters because then systems that have multiple uses might result in independence being impaired even when the system is not being used in that manner.		
17. Definition is so broad could include Big Data non-financial data as well	CL12	Task Force does not believe the definition is too broad.		
18. Providing information to management does not automatically mean this will be used to make financial decisions that would have a material impact.		All but one Task Force member does not believe revisions are necessary.		
19. Possible that a system once installed could provide new information to management that they were not previously aware of, or information that was not previously available, but provides significant insight into a company's operations, results, or activities in a nonfinancial way.		The Task Force believes this concern is addressed by the recommended revisions found in rows 15 and 16 of this document.		Same request as rows 15 and 16 of this document
20. During the November 2018 PEEC meeting, the Committee asked the Task Force to consider clarifying that a system that is part of the attest client's internal controls over financial reporting would be a system that is used to ensure what is being produced for the financial statements is accurate.	PEEC – Nov 2018 Meeting	<p>The Task Force added the following clarifications to address the Committee's concerns. It should be noted that that what is being contemplated in this item is a <i>system</i> not a <i>tool</i>.</p> <p>A system that is part of the <u>attest client's</u> internal controls over financial reporting, including information systems used in effecting internal controls over financial reporting. For example, a system that is used to ensure what is being produced for the financial</p>	Ask the Committee if it agrees with the Task Force's recommendation.	

		<p><i>statements is accurate. However, information systems that are used only in connection with controlling the efficiency and effectiveness of operations are considered to be unrelated to the financial statements and accounting records.</i></p> <p>During the February 2019 meeting, the Committee asked the Task Force to add an example of a system that is used only in connection with controlling the efficiency and effectiveness of operations but could never be used as a financial information system.</p> <p>The Task Force discussed this request at length and was not able to identify an example. The Task Force recommends an example not be added and instead address questions as they are posed so that the specific facts and circumstances can be considered</p>		
(Sub-Theme) General Comments on FIS				
<p>21. Appears to confuse the CPA's role in providing information (in the most general sense of the term, information, such as assurance is a type of information) with management decisions made from various sources of information.</p>	CL18	<p>The Task Force believes this concern is addressed by the recommended revisions found in rows 15 and 16 of this document.</p>		<p>Same request as rows 15 and 16 of this document</p>

<p>22. Consider including some examples of systems that would not be considered “financial information systems.” This would be valuable, as, many systems within an attest client may be integrated.</p>	<p>CL24</p>	<p>The Task Force does not recommend adding examples of information systems that would not be financial because (1) the conclusion would be very dependent upon how the system is designed and (2) could provide a false sense of security that these systems could never impair independence.</p>		
<p>23. Elaborate on the term “directly affect (or impact) financial reporting”.</p>	<p>CL27</p>	<p>The Task Force believes this concern is addressed by the recommended revisions found in rows 15 and 16 of this document.</p>		<p>Same request as rows 15 and 16 of this document</p>
<p>24. Provide specific examples of financial information systems that do not aggregate source data and if none can be developed, then eliminate this component from the definition.</p>	<p>CL27</p>	<p>The Task Force does not recommend adding examples of information systems that do not aggregate source data that underlies the financial statements because (1) the conclusion would be very dependent upon how the system is designed and (2) could provide a false sense of security that these systems (e.g., stand along document management system that catalogs information that is not integrated with anything) could never impair independence even if they were designed in such a way so that they would aggregate source data that underlies the financial statements.</p>		
<p>25. Term Significant Should Be Defined. Suggest the guidance included on page 6 that indicates information is significant if it</p>	<p>CL25 (from Question 2)</p>	<p>The Task Force does not believe it is necessary to define significant.</p>		

is probable that it will be material to the financial statements.				
Terminology – Designing an Information System (.02 b.)				
26. Is the definition of “designing” intended to apply to all information systems as drafted or should the focus be on financial information systems?	CL12	The Task Force believes it should apply to all systems.		
27. Clarify if “designing” is intended to include determining the best COTS solution for a client that the client will set up. For example, does it extend to complying of open source information to build a software system for a client or if the client used the member as a subcontractor and oversaw the member’s work related to the design and development of the system.	CL12	<p>The Task Force noted that members can always provide clients with advice and the term “determining” is not intended to mean giving the client recommendations.</p> <p>The Task Force’s preliminary thinking is that open source code is not COTs since developed usually through a community effort and is too theoretical so would be best to address on a case by case basis using the overall guidelines provided in the interpretation.</p> <p>During the February 2019 meeting the Task Force asked the Committee if it agrees with the Task Force’s recommendation to draft a FAQ that will replace the extant FAQ 6 that would explain that members can provide clients with recommendations when the client is trying to determine a COTs system that it could use. Extant FAQ 6 is dated and reads as follows</p>		

		<p>6. Would assisting an attest client with procuring and securing Internet access impair independence?</p> <p>No, provided an individual designated by the <i>attest client</i> to oversee the service has the necessary skill, knowledge, and/or experience and makes all decisions concerning the Internet provider and services to be provided.</p> <p>During the April 2019 Task Force discussion, the Task Force decided to recommend that instead all the FAQs be deleted, and new ones be issued to address questions that come in related to the revised interpretation.</p>		
Terminology – Developing an Information System (.02 c.)				
28. Is the definition of “developing” intended to apply to all information systems as drafted or should the focus be on financial information systems?	CL19 (from question 1)	The Task Force believes it should apply to all systems.		
Terminology – COTS (.02 d.)				
29. Clarify the term COTS in the interpretation or in a FAQ as many in public practice refer to systems as “packaged” or “off the shelf”.	CL14	Task Force does not believe this is necessary.		
30. The term COTS is overused, frequently misused and becoming less relevant, thus	CL25	The Task Force does not agree.		

the concept should be retired, and more precise terms should be used				
31. Could there be a situation where a software package or solution designed and developed by a 3 rd party (not the member) would not be considered a COTS solution?	CL8 (from question 1)	The Task Force believes that there could be multiple vendors or there could be no vendor because it is free (open source). To clarify this, the Task Force made the following revisions to the definition of COTS		
32. Is the term “vendor” needed in the definition of COTS or could it be deleted? If deleted from the definition, would the term need to be replaced throughout the interpretation?	Danielle Cheek	<p><i>Commercial off-the-shelf (COTS) refers to a software package developed, distributed, maintained and supported by an entity or entities that are not the member or member’s firm (a third-party vendor), sometimes simply referred to as an “off the shelf” package or solution. COTS solutions have generally referred to traditional on-premise software that runs on a customer’s own computers or on a third-party vendor’s “cloud” infrastructure. COTS solutions range from software packages that require only installation on a computer and are ready to run to large scale, complex enterprise applications.</i></p> <p>During the February 2019 meeting, the Committee did replace the term “software</p>		

		package” with the term “software” as it believes the term “software” is more reflective of current terminology.		
Design, Development, or Implementation Services Not Related to a Financial Information System (.03)				
(Sub-Theme): Clarify that non-financial systems are permissible as opposed to saying that threats are at an acceptable level.				
33. Rather than characterizing such circumstances as threats that are acceptable, final version of the proposed interpretation should state clearly that they should not be deemed threats at all so that members do not need to perform the documentation required by the conceptual framework.	CL2	The Task Force disagrees because documentation is only required if safeguards need to be applied.		
34. Clarify paragraph .03 to permit a member to configure and customize a COTS non-financial information system as threats to independence would appear to be at an acceptable level, provided all the requirements of a non-attest service are met.	CL7	The Task Force believes this concern is addressed by the recommended revision found in row 2 of this document.		Same request as row 2 of this document
35. Should consider whether AICPA Staff FAQ no. 7 should be incorporated into the interpretation for clarification as to what would be considered unrelated to a financial information system or deleted from the Staff FAQs.	CL24	The Task Force was initially going to recommend that since extant FAQ 7 doesn't conflict with the guidance in the interpretation that adding clarification to the FAQ that such systems will have no significant impact on the financial statements, accounting records or internal controls over financial reporting as follows. However, after further reflection decided to recommend the FAQ be deleted since this guidance is now covered in the interpretation.	Ask the Committee if it agrees with deleting FAQ 7.	

		<p>The Task Force also recommends item ii. in paragraph .03 a. be clarified as follows.</p> <p>ii. A system that generates data that are is used as an input to the <i>financial statements, including data or information that is either reflected in or used in determining amounts and disclosures included in the financial statements</i></p> <p>The Task Force notes that the revisions made in Row 20 to example iv. of paragraph .02 should be read in conjunction with this revision.</p> <p>iv. A system that is part of the <u>attest client's</u> internal controls over financial reporting, including information systems used in effecting internal controls over financial reporting. For example, a system that is used to ensure what is being produced for the financial statements is accurate. However, information systems that are used only in connection with controlling the efficiency</p>		
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		<i>and effectiveness of operations are considered to be unrelated to the financial statements and accounting records.</i>		
Designs or Develops a Financial Information System (. 04)				
36. Term “template” used in paragraph .04 should be clarified...should refer to an Excel spreadsheet	CL7	<p>Task Force recommends replacing “template” with the term “tool”.</p> <p>During the February 2019 meeting, the Committee requested the Task Force:</p> <p>(1) provide more clarification regarding what constitutes “discrete”; and (2) whether the level of significance should be included as a safeguard as well.</p> <p>With respect to clarifying what “discrete” means the Task Force was asked to consider the concepts “routine and mechanical”. The Committee requested the Task Force consider whether this should be done within the interpretation or in a FAQ that points back to the exception in the interpretation and emphasizes that the member will need to apply judgement when determining whether the tool performs a discrete calculation.</p>		<p>During the February 2019 meeting the Committee agreed that the inclusion of a level of significance would contradict the other independence provisions.</p> <p>During the Task Force’s April 1, 2019 call it noted that the “template” exception was included to eliminate simple excel worksheets and since the conclusion of whether the discrete exception would be applicable will require the use of professional judgement given the unique facts and circumstance.</p> <p>Also, the Task Force noted that the prohibitions outlined in the interpretation would not extend to systems that generate information that is <i>not</i> significant to either the <i>financial statements</i> or financial processes as a whole and so there was some “relief” on the front end.</p>

37. Members should be able to design (create the blueprint) for a financial information system without impairing independence if management reviews and approves the design and performs all management responsibilities with respect to development and installation	CL11	The Task Force does not recommend making this change and believe designing is even a bigger concern that creating the code.		
38. Discrete calculation- should include reformatting of information, or calculating standard financial ratios or financial relationships from client provided data, and delivering to client a report that may be used for their financial decision-making process	CL12	The Task Force believes this concern is addressed by the recommended revision found in row 36 of this document.	Same request as row 36 of this document	
39. Inconsistency between paragraphs .04 and .16- allowing performance of discrete calculation vs. not allowing designing and development to convert system data that is compatible (i.e. excel).	CL12	The Task Force doesn't believe that permitting (i.e., independence not impaired) a member to design and develop a tool that performs a discrete calculation (paragraph .04) conflicts with the conclusion that performing data translation services that 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 would impair independence (paragraph .16). The Task Force believes the member can implement safeguards when designing or developing a tool that performs a discrete calculation.		
40. Disagree that a member designs or develops an attest client's financial	CL19	The Task Force does not recommend making this change		

<p>information would impair independence, because only some types design work would impair independence (that is, not all types of design work would impair independence).</p>		<p>and believes designing is even a bigger concern that creating the code.</p>		
<p>41. Suggest adding language that indicates that a spreadsheet is an example of a template to assist members in consistent application and offered up suggested edits.</p>	CL22	<p>The Task Force believes this concern is addressed by the recommended revision found in row 36 of this document.</p>	<p>Same request as row 36 of this document</p>	
<p>42. The two examples provided as exceptions in inherently different applications and including these two examples together may potentially mislead practitioners as to what constitutes a “discrete calculation” and the intention behind the template exception.</p>	CL22	<p>One Task Force member noted that some of the tax provision tools she has seen lately would cause her to conclude that the specific program would not fit the spirit of a discrete calculation because of its sophistication and if we include the example, members might always think that a tax provision software will always meet the exception. The Task Force agreed to remove tax provision tools as an example and instead develop a FAQ using tax provision software as an example that demonstrates the range of possibilities to help determine if a tool is performing a discrete calculation.</p>	<p>Seek the Committee’s feedback on the relocation of the template/tool provision to the definition of an FIS. Seek the Committee’s feedback regarding whether it believes this revision will provide the necessary clarity and wait to see what types of questions come in or whether an FAQ should be developed prior to the effective that shows how a tax provision tool or a lease tool could take on the characteristics of not only a tool that provides a calculation that the client is able to properly evaluate and take responsibility for but could also evolve to a tool that the client could not properly evaluate and take responsibility for.</p>	
<p>43. Suggest providing additional clarification on the application of the term “discrete”, which generally means “individually separate and distinct”.</p>	CL27	<p>During an April 2019 call the Task Force noted that some could interpret the provision in paragraph .05 to mean that a significant FIS that performs a discrete calculation could be designed or developed by a member. The Task Force does not</p>		

		<p>believe that would be appropriate and noted that the discussion in paragraph .05 was just attempting to explain why the template/tool would not be considered an FIS.</p> <p>Accordingly, the Task Force recommends moving the discussion about a template/tool from paragraph .05 to item a. of paragraph .03 (the definition of an FIS). The Task Force believes that moving this provision to the definition of an FIS and explaining why the template/tool will result in an FIS, will result in members understanding the provision better as well as applying the provision more consistently.</p> <p><i>“An FIS includes a tool that calculates results that the attest client is unable to properly evaluate or accept responsibly for.”</i></p> <p>The Task Force also recommends that at least 2 FAQs be drafted (one using tax provision software and another using leasing software as an examples) that demonstrate the range of possibility to help to clarify what tool would be a FIS and what kinds of tools wouldn't be a FIS.</p>		
<p>44. Suggest additional clarification on “the activity” the template would perform that</p>	<p>CL27</p>	<p>The Task Force broke paragraph .04 into multiple thoughts to help clarify. The proposed revisions:</p>		

<p>would impair independence if performed directly by the member.</p>		<p>When a <u>member</u> designs or develops an <u>attest client's FIS</u> financial information system, <u>threats</u> to compliance with the "Independence Rule" would not be at an <u>acceptable level</u> and could not be reduced to an <u>acceptable level</u> by the application of <u>safeguards</u> and <u>independence</u> would be <u>impaired</u>. Designing and developing a template tool does not constitute designing or developing a FIS that if all of the following safeguards are met:</p> <ul style="list-style-type: none"> a. the tool performs a discrete calculation such as a tax provision or a depreciation calculation; and b. does not constitute designing or developing a financial information system and will not impair independence, provided the template the tool does not perform an activity that, if performed directly by the <u>member</u>, would <u>impair independence;</u> and 		
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		<p>c. and the member complies with all the requirements of the "Nonattest Services" subtopic [1.295] of the "Independence Rule".</p> <p>The Committee did not object to this revised formatting.</p>		
<p>45. Suggest that members may be able to implement safeguards to address the threats created when designing. The self-review threat could be mitigated by not relying on the software and performing their own review or testing to see if the information generated by the system is accurate. The management participation threat can be mitigated by ensuring that the individual who oversees the work performed by the member is competent and able to understand and accept responsibility for the it. Also, sometimes the product developed will include certain definitive actions that are required to be taken by management such as signoffs and approvals of transactions, calculations, reports or journal entities.</p>	CL27	<p>The Task Force does not recommend making this change and all Task Force members believe designing is even a bigger concern that creating the code.</p>		
<p>(Sub-Theme): Question 1 Is the terminology used in the proposal consistent with industry practice and will it be readily understood by members who do and do not practice in this arena?</p>				
<p>46. Add a "spreadsheet" as an example of a template</p>	CL8 (from question 1)	<p>Task Force recommends replacing "template" with the term "tool" will help with this concern. Since it may or may not involve design, don't include it as an example since threats and safeguards.</p>		

		<p>During the February 2019 meeting, the Committee was asked for feedback on the development of a FAQ that discusses how a member might use a tool to create a system such as when you use a tool such as Excel or an RPA to create a connection that results in designing a system.</p> <p>Since the Committee did not provide feedback on this recommendation, the Task Force decided not to propose any revisions, rather to address the specific questions as they are received as the conclusion will depend on the specific facts and circumstances.</p>		
(Sub-Theme): Question 2b Is it appropriate to allow members to design and develop a financial information system that is not significant?				
<p>47. Add language that would clarify that design and development services should be looked at from an aggregated perspective as well and if significant then prohibited.</p>	<p>CL4 (from question 2b)</p>	<p>Addressed by the cumulative effect interpretation.</p> <p>Seek the Committee’s feedback on the development of a FAQ that explains that members may design or develop systems that do not generate information or aggregates source data that is significant to the <i>financial statements</i> or financial processes as a whole, and when determining significance, the services should be viewed from an aggregated perspective.</p>		

		<p>The Committee did not provide feedback on this during the February 2019 meeting.</p> <p>During one of the Task Force's April calls it decided not to develop a FAQ, rather to wait and see what specific questions members have.</p>		
48. Recommends documentation of conclusion that FIS is not significant.	CL1 (from question 2b)	Task Force does not believe including a recommendation that members document this conclusion is necessary.	Staff to communicate this to Peer Review when the interpretation is adopted.	
49. Recommends documentation of conclusion that FIS is not significant as well as provide examples in nonauthoritative guidance.	CL14 (from question 2b)	<p>During the February 2019 meeting the Committee's was asked if it had any objections to staff communicating to Peer Review, once the interpretation is adopted that there is not a documentation requirement in the interpretation. The Committee did not object to the Task Force's recommendation.</p>		
50. Scope is consistent with the SEC and IESBA	CL 24 (from question 2b)	The Task Force noted that it was intentional for the proposal to be less restrictive than the SEC's rules and the IESBA rules for public interest entities.		
Implementation of a COTS Financial Information System Software Solution (.05-.06)				
51. During the November 2018 PEEC meeting, the Committee recommended the Task Force add to the end of paragraph .06 clarification that implementation services that impair independence and those that do not impair independence will be discussed in the subsequent paragraphs.	PEEC – Nov 2018	The Task Force does not believe adding this is necessary but provided the following sentence for the Committee's consideration in the event it disagrees with the Task Force. This sentence would be added to the end of paragraph .06.		

		<p><i>These situations are addressed in paragraphs .07 through .18 of this interpretation.</i></p> <p>The Committee did not object to this addition during the February 2019 meeting.</p>		
<p>Install a COTS Financial Information System Software Solution (.07-.08)</p>				
<p>(Sub-Theme) Need to incorporate current technology</p>				
<p>52. Paragraph .07 should also address systems installed in cloud environments.</p>	CL7	<p>During the February 2019 meeting the Task Force recommended replacing the phrase “computer, normally onto a customer’s server” with the phrase “designed hosting site”. The Committee was supportive of this revision and added as an example that the client’s designated hosting site could include a cloud-based server. The Task Force is recommending that that the example of a cloud-based server as a client’s designed hosting site not be added and instead allow the statement to be left broad so as technology changes the example does not be obsolete.</p>	<p>Seek the Committee’s feedback on the Task Force’s recommendation.</p>	
<p>53. Suggests expanding this definition to indicate customer’s “designated hosting site” (i.e. install to cloud vs. server) to allow for more industry changes, including changes in terminology or technology that could happen in the future.</p>	CL12			
<p>54. Develop Q&A that address current technology vs. a standard that would apply to all networks.</p>	CL12	<p>The Task Force recommends that the interpretation be left board as currently drafted and then as questions arise related to how specific technologies might be impacted, develop non-authoritative white papers or thought documents that will provide insight on how</p>		

		specific technologies might be impacted by this interpretation. For example, what services members may be asked to provide under the umbrella of Robotic Process Automation and what the independence challenges maybe associated with providing these services? The means of doing things has often changed and so you can often analogize it (e.g., aspects of blockchain can likely be analogized but could be aspects that can't).		
55. This paragraph should be revised to incorporate modern technology systems, as there are significant concerns that this paragraph does not consider current business practices.	CL19	The Task Force believes this concern is addressed by the recommended revisions found in rows 52 and 53 of this document.	Same request as rows 52 and 53.	
Configure a COTS Financial Information System Software Solution (.09-.10)				
(Sub-Theme) Not easily understood or clear that management makes the selection (2 comments)				
56. "...selecting the predefined format of certain data attributes and the inclusion or exclusion of such attributes." may not be easily understood, paragraphs .09 and .10 should be expanded and at least one example provided.	CL3	The Task Force made the following revisions to the first sentence of paragraph .09: To configure a COTS <i>FIS</i> financial information system software solution means selecting— <i>inputting the client selected</i> the software features, functionality options, and settings <i>within the software</i> provided by the <i>third-party</i> vendor, that <i>which</i> will determine how the software will perform certain transactions and	The Task Force recommends the last sentence in paragraph .10 be revised to clarify why designing or developing new software code or features that modify or alter the functionality of a COTS software solution in ways not pre-defined by the third-party vendor, would not constitute configuring a COTS FIS. <i>However, the member should not</i> configuring a COTS financial information system software solution does not involve <i>design or</i> developing new software code	
57. Do not believe it is clear that management must determine the features and options for the system, and the member may only input management's selection by physically selecting those client-determined settings (rewording provided).	CL22			

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 ~~FIS~~ ~~financial information system~~ software solution does not 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 **third-party** vendor.

The Task Force made the following revisions to paragraph .10

However, the member should not ~~configuring a COTS financial information system software solution does not~~ **involve design or** developing new software code or features to modify or alter the functionality of the COTS software solution in ways not pre-defined by the **third-party** vendor, **as this would be considered designing or developing activities**

or features to modify or alter the functionality of the COTS software solution in ways not pre-defined by the **third-party** vendor, **as this would be considered designing or developing activities described in paragraph .03 b. and c.**

		<i>described in paragraph .03 b. and c.</i>		
Customize a COTS Financial Information System Software Solution (.11-.12)				
(Sub-Theme) Should add guidance related to non-financial reporting				
58. Should provide for a significance evaluation by the member of the nature and extent of a COTS customization service, should not preclude such judgment outright (para.12).	CL2	Task Force discussed if prohibited customization should be limited to other than insignificant modification or enhancements (that is, allow for insignificant modification to a significant FIS). The Task Force initially took it out because it wasn't very helpful guidance since we couldn't define insignificant. The Task Force believes that it should not be added back in.		
59. Unclear whether paragraphs .11 and .12 should apply to customization that is unrelated to financial reporting; definition of "customize" in paragraph .11 should include similar language as paragraph .09's definition of "configuration".	CL7	Same as Row 2.	Same as Row 2	
60. Revise the guidance to address the impact of non-financial modifications/customizations to COTS Financial Information Systems.	CL9	The Task Force discussed whether examples should be added of types of customization that firms could provide that don't affect financial information but recommends that no specific action be taken to address this comment, rather, for questions to be addressed as posed.		
61. Consider updating paragraph .12 to be consistent with the extant interpretation which allows for members to make insignificant modifications to source code underlying an attest client's existing financial information system.	CL14	Same as item 58.		

62. Guidance in first sentence of paragraph is too broad-appears to allow configuration of revenue recognition rules.	CL19	Task force doesn't believe edits are necessary as the paragraphs say what we believe they should say.		
Interface a COTS Financial Information System Software Solution (.13-.15)				
(Sub-Theme) Should include more than API, as this may not be the right term as it is too narrow (6 comments for paragraphs .13-.18 on API)				
63. Suggest clarifying in that API (paragraph .15 and .18) means that the API must be unaltered and auditable in how it is used and how it processes data that is moved through that API protocol through the interpretation or in non-authoritative guidance.	CL7	Task Force believes the following revisions to paragraph .15 will address this concern and seeks feedback on whether the bracketed text is needed: If a member uses an interface application program interface (API) that is developed by a third party to interface legacy or third-party COTS FIS financial information system software solutions, such as an application programming interface (API) , threats to independence would be at an acceptable level , provided the <i>member</i> will not be designing or developing code [thus altering how the COTS FIS functions, processes data or produce results] for the interface application API to work and all the requirements of the "Nonattest Services" subtopic of the		
64. More than just APIs should be scoped out for purposes of paragraphs .13 through .15. Data is not being created when performing these services, rather, just moving data and so safeguards should be able to be put in place. For example, with advances in machine learning, some interfaces could be bot to bot that has machine learning on each side of the application. This would not be considered an API and safeguards should be able to be put in place to reduce threats to independence to an acceptable level.	CL12			
65. Concerned that specifically referencing application programming interfaces (APIs) may be inappropriately narrow and should be revised in the Proposal.	CL17			
66. Proposed interpretation defines "API" as "application program interface," but we understand the "P" is generally understood by practitioners to mean "programming" rather than "program.	CL22			

<p>67. Believe that the subtitle “interface a COTS financial information system software solution” could imply an ongoing relationship suggest removing the subsection on “Interface a COTS Financial Information System Software Solution” in paragraphs .13-.15, and incorporate paragraph .15 behind paragraph .04, as part of “Designs or Develops a Financial Information System” section.</p>	<p>CL22</p>	<p>“Independence Rule” are met.</p> <p>During the February 2019 meeting the Committee indicated that it did not believe the bracketed text was necessary. Rather, the Committee replace that phrase with the phrase “that enables”</p>		
<p>68. Notes that the P in API is “programming” not “program”</p>	<p>CL22</p>	<p>During the February 2019 meeting the Committee also replaced the phrase “application interface” with “interface”,</p>		
<p>Data Translation Services Related to a COTS Financial Information System Software Solution (.16-.18)</p>				
<p>(Sub-Theme) Should include more than API, as this may be the right term as it is too narrow- (6 comments for paragraphs .13-.18 on API)</p>				
<p>69. Suggest clarifying in that API (paragraph .15 and .18) means that the API must be unaltered and auditable in how it is used and how it processes data that is moved through that API protocol via the interpretation or in non-authoritative guidance.</p>	<p>CL7</p>	<p>Task Force believes the following revisions to paragraph .18 will address this concern and seeks feedback on whether the bracketed text is needed:</p>		
<p>70. API may not be the right term to use, as a program for data translation purposes is usually used for these services (could use a third party).</p>	<p>CL12</p>	<p>If a member uses an API interface application developed by a third party to perform data translation services for a COTS FIS financial information system software solution, such as an API, threats to independence would be at an acceptable level, provided the <i>member</i> will not be designing or</p>		

		<p>developing code [<i>thus altering how the COTS FIS functions, processes data or produce results</i>] for the <i>interface application</i> API to work and all the requirements of the "Nonattest Services" subtopic of the "Independence Rule" are met.</p> <p>During the February 2019 meeting the Committee indicated that it did not believe the bracketed text was necessary. Rather, the Committee recommended the phrase "that enables" replace the phrase "<i>thus altering how the COTS FIS functions, processes data or produce results</i> for". During one of the April 2019 Task Force calls the Task Force agreed with these revisions.</p> <p>During the February 2019 meeting the Committee also requested the Task Force confirm that all references to "interface" could be deleted aside from the one reference in paragraph .15 to defining an API as an example. During one of the April 2019 Task Force calls the Task Force agreed with these revisions.</p>		
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<p>71. In certain cases, data transformation would be a normal threat that could be overcome with certain safeguards and should not result in an automatic threat to independence, and not considered an API (export to CSV) this situation should be clarified for purposes of this ED.</p>	CL12	<p>During the Task Force discussion, it was noted that when using an API, the self-review threat does not exist because the member isn't performing any designing or developing activities. This is different than when a member is using a tool, like Excel, to such an extent that the tool becomes a system.</p>		
<p>72. Consider also referring to "data translation" services as "data conversion" services.</p>	CL14	<p>Task Force does not recommend this change be made.</p>		
<p>73. Concerned that specifically referencing application programming interfaces (APIs) may be inappropriately narrow and should be revised in the Proposal. Suggests revision such as "members may use any generally available technique or technology, including application programming interfaces (APIs), to interact or provide data translation services for a COTs provided the member's work does not alter how the COTS financial information system functions, processes data or produce results.</p>	CL17	<p>The majority of the Task Force does not believe it is necessary to provide further clarification to what is meant by design and development.</p>		
<p>74. API may not be used correctly in this paragraph. A member could use a third-party tool that performs data translation services (that is, it's not usually an API connector but rather a program for data translation purposes.</p>	CL18	<p>The Task Force believes this concern is addressed by the recommended revisions found in rows 69 and 70 of this document.</p>		
<p>System and Network Maintenance, Support, and Monitoring (.19-.20)- (Sub-Theme) Add examples of permissible services</p>				
<p>75. Clarify the examples of permissible services described in paragraph .20b and</p>	CL4	<p>Task force doesn't believe clarification is necessary because</p>		

.20c that appear to be part of the precluded services in paragraphs .19f and .19c, respectively.		the examples of services that impair independence make it clear that the member would be taking on much more responsibility		
76. Suggest that PEEC consider whether further guidance could better distinguish the examples in pars. .19 and .20 especially with respect to what a discrete, nonrecurring project is.	CL4			
77. Provide additional clarification and example scenarios in which permissible services are being provided over multiple periods as separate and distinct projects that would not be considered outsourcing an ongoing management responsibility.	CL14			
(Sub-Theme) Language as written is narrow and does not represent value added services				
78. Language as written is overly narrow and fails to recognize that the listed services delivered represent value added services	CL6, CL13, CL15, CL21, CL23	Just because a service adds value, doesn't mean independence isn't impaired. The Task Force does not believe an edit is necessary.		
(Sub-Theme) Key distinction in the examples should be management making key decisions				
79. The key distinction in the examples listed in section 19 should be management's decision-making status and involvement in the delivery process (CL6, CL13 and CL23 offer up proposed revised language).	CL6, CL13, CL15, CL21, CL23	The Task Force does not recommend any changes because no safeguards are available when a member performs monitoring activities for an attest client.		
(Sub-Theme) Should not depend on recurring or non-recurring services to assess independence				
80. Recurring or ongoing services would not much more likely to impair independence (if management takes responsibility (CL13) -(should not depend on recurring or non-recurring CL25) (CL6 and CL13 offer up proposed revised language).	CL6, CL13, CL15, CL25	The Task Force disagrees.		
81. More guidance is necessary to assist members in differentiating between ongoing and discrete activities (.19e vs.	CL7	The Task Force believes this is a broader question and is not recommending any changes.		

<p>20c) For example, if the member applies updates and patches only at the direction of the client and under their supervision, would that be considered a discrete activity since the member is executing each update as a separate occurrence and is not taking responsibly for performing ongoing maintenance?</p>				
<p>82. Clarification with respect to “Monitoring” activities, appears to be a potential inconsistency between the extant Code and the Proposed Interpretation with respect to “monitoring activities.”</p>	CL8	<p>The Task Force does not believe revisions are needed to address this comment since the proposal is intentionally different than the extant.</p>		
<p>83. Forcing members to establish each instance of providing these services as “discrete” engagements places an unnecessary burden on the practitioner.</p>	CL11	<p>The Task Force does not believe the substance of the guidance hinges on establishing separate instances rather on whether the attest client has outsourced a management responsibly.</p>		
<p>84. Confused as to why discrete functions could be overcome but ongoing functions, processes, and activities could not, should include specific examples rather than implying that performance of such services would be an automatic threat to independence that cannot be overcome. Believe there could be instances where ongoing maintenance, support and monitoring</p>	CL12	<p>The Task Force believes the substance of the guidance hinges on whether the attest client has outsourced a management responsibly.</p>		
<p>85. The restrictions outlined would NOT allow members to perform cybersecurity monitoring for attest clients, which is a service we have discussed providing.</p>	CL14	<p>The Task Force agrees that ongoing cybersecurity monitoring would impair independence. For more information regarding cybersecurity see the NAS FAQ Document in particular question 3 under Cyber Security Services.</p>		

(Sub-Theme) General Paragraphs .19-.20				
86. A blanket independence impairment does not seem appropriate	CL6, CL15	The Task Force disagrees.		
87. Is the reference to “new software” (paragraph .20d) critical to the determination about whether this is an acceptable service?	CL8	The Task Force removed the term “new” because due to staffing changes, training maybe necessary. During the February 2019 meeting the Committee did not express any concerns with this revision.		
88. Confirm that situations whereby a member licenses permissible software, as provided for under the Hosting Interpretation and under the proposed interpretation (when not related to a financial system) and such software requires certain bug fixes or other routine patches	CL8	The Task Force believes it is clear it would be permissible and so is not recommending any edits.		
89. In paragraph .19, is there a concern if the firm is performing services at the client’s direction, but the firm bills the client according to a set monthly subscription service?	CL12	The Task Force doesn’t believe the way a member bills a client should be the determining factor regarding whether a service is ongoing or discrete so is not recommending any revisions.		
90. Consider defining “maintenance”, “support” and “monitoring”.	CL14	The Task Force does not believe this is necessary.		
Comments on Question 1				
(Question) Is the terminology used in the proposal consistent with industry practice and will it be readily understood by members who do and do not practice in this arena?				
91. Agrees with consistency and readily understood	CL16, CL24	Noted by Task Force.		
92. Agrees with consistency and readily understood/ recommends clarification.	CL 2	Noted by Task Force.		

<p>93. Agrees with consistency/recommends clarification</p> <p>CL8 could there be a situation where a software package or solution designed and developed by a 3rd party (not the member) would not be considered a COTS solution? CL19 recommends .02c be clarified as a <i>financial</i> information system. CL22 notes that the P in API is “programming” not “program” and to add a “spreadsheet” as an example of a template.</p>	<p>CL7, CL8, CL14, CL18, CL19, CL22</p>	<p>The specific comments made by CL8, CL19 and CL22 are addressed in rows 31, 65 and 68 respectively.</p>	<p>Same request as rows 31, 65 and 68.</p>	
<p>94. Agrees terminology will be readily understood</p>	<p>CL1, C16, CL21, CL26</p>	<p>Noted by Task Force.</p>		
<p>95. Agrees terminology will be readily understood/should avoid technology related terms (e.g., dashboard) that given the rapid evolution of technology, may fall out of use in a short period of time.</p>	<p>CL4</p>	<p>Believe these concerns are addressed in rows 7 and 8 by the proposed revisions to item iii. of paragraph .02.</p>	<p>Same request as rows 7 and 8.</p>	
<p>96. Agrees with consistency/not readily understood</p>	<p>CL10</p>	<p>Noted by Task Force.</p>		
<p>97. Disagrees/ Not Consistent</p> <ul style="list-style-type: none"> ○ CL3 believes inconsistent with GAS ○ CL13 believes it is too broad and implies any information system could have a material impact on financial decisions made by management and provides several examples. Suggest clarification or at least limited to direct financial information systems. ○ CL18 need to use more current technology and consider future 	<p>CL3, CL9, CL12, CL18, CL25</p>	<p>Task Force noted that GAS must be applied on top of the AICPA and could always run it by the GAO to see if they have any comments, but they didn’t respond to the proposal and often do comment. Also, the Task Force noted that it had numerous discussions about the use of the term significant and concluded that it was the preferred term. The Task Force also noted that the proposal uses the broadest</p>		

technology (newer technology than API, there is bot-to-bot, virtual environments, various configurations on cloud systems and decentralized networks (blockchain))		terms possible so that the interpretation will hopefully not get outdated too quickly and technology specific questions should be addressed as they are received.		
98. Disagrees/Not readily understandable	CL11, CL20	Noted by Task Force.		
99. No comment	CL5, CL6, CL13, CL15, CL17, CL23, CL27	Noted by Task Force.		
Comments on Question 2a				
(Question) Do you believe it is appropriate to allow members to use professional judgment to determine what is “significant”?				
100. Agrees with proposed interpretation (no specific guidance)	CL1, CL2, CL3, CL7, CL16, CL19, CL20, CL21, CL26, CL27	Noted by Task Force.		
101. Term Significant Should Be Defined. CL25 suggest the guidance included on page 6 that indicates information is significant if it is probable that it will be material to the financial statements.	CL10, CL25	This concern was addressed in row 25 of this document.	Same request as row 25.	
102. Agrees Professional Judgment Appropriate. Suggest linking term to materiality/ including materiality in proposed interpretation, including guidance from the ED Explanation/ consider providing specific general application guidance or provide such details in an illustrative example. CL14 provides some suggestions regarding general application guidance and that	CL4, CL8, C11, CL14			

might be helpful. Also, recommend the interpretation include a documentation requirement related to the member's evaluation regarding significant.				
103. Appropriate to provide some guidance such as the guidance included on page 6 that indicates information is significant if it is probable that it will be material to the financial statements. The added guidance should also note consideration of the nature of the information and the likelihood that it could be material or become material. Also, helpful to include examples of systems that may generate significant financial information in FAQs so that any updates necessary because of the fast pace of change can easily be done	CL24			
104. Believe the PEEC should replace "significant" with "material"	CL22	Task Force noted that it had numerous discussions about the use of the term significant and concluded that it was the preferred term.		
105. Consider replacing "significant" with "heavy" and clarify that independence should be considered for impairment if the member has heavy influence on the way financial transactions are processed and recorded on the books and records of an entity.	CL19			
106. No comment on definition- term can be interpreted to be more restrictive so clarify, add examples or issue FAQs	CL12	Task Force recommends that questions be addressed when they come in as opposed to trying to anticipate what the questions will be.		
107. No Comment	CL5, CL6, CL9, CL13, CL15, CL17, CL18, CL23	Noted by Task Force.		

Comments on Question 2b.			
(Question) By including the concept of “significant” it could be perceived as the proposal is less restrictive that extant. Is it appropriate to allow members to design and develop a financial information system that is not significant?			
108. Appropriate exception. CL1 recommends documentation of conclusion that FIS is not significant. CL14 recommends this as well as provide examples in nonauthoritative guidance. CL24 notes that this scope is consistent with the SEC and IESBA.	CL1, CL3, CL8, CL11, CL14, CL16, CL20, CL21, CL22, CL24, CL25	The specific comments from CL 1, CL14, and CL 24 are addressed in rows 48 through 50 respectively.	Same request as rows 48 through 50.
109. Exception Appropriate/ add language that would clarify that design and development services should be looked at from an aggregated perspective as well and if significant then prohibited.	CL4	This comment was addressed in row 47.	Same request as row 47.
110. Not Appropriate	CL9, CL10	Noted by Task Force.	
111. Does not believe interpretation would support such conclusion (less restrictive)	CL2, CL12	Noted by Task Force.	
112. Makes sense in theory, not in practice since the evaluation would require ongoing consideration	CL7	Noted by Task Force.	
113. No Comment	CL5, CL6, CL13, CL15, CL17, CL18, CL19, CL23, CL26, CL27	Noted by Task Force.	
Comments on Question 2c			
(Question) Is it clear that “financial processes” is intended to be applied broadly and would include “IT General Controls”?			
114. Clear	CL2, CL3, CL4, CL10, CL21, CL22	Noted by Task Force.	

<p>115. Clear/ stronger language should be used/may be appropriate if such objective was explicitly stated within the interpretation/would be useful if the final Interpretation provided more examples. CL14 suggests using the phrase “financial consolidation and reporting process”</p>	<p>CL1, CL14, CL16</p>	<p>Believe these concerns are addressed in row 35 by the proposed revisions to item iv. of paragraph .02.</p>	<p>Same request as row 35.</p>	
<p>116. Clear but add information technology controls as an example to the interpretation or issue a FAQ that provides this as an example.</p>	<p>CL24</p>			
<p>117. Unclear. CL7 recommends adding definition of page 6; CL8 should consider the scope of the attest service and whether the member is engaged to issue an option on internal control. CL9 members should be able to share expertise in financial processes and IT general controls when the client is implementing the system since they are likely to do so in connection with an audit when making recommendations on how to change or add controls. CL11 recommends an edit to definition of financial information system in its letter. CL12 says it would be clear if the definition from page 6 was carried forward. CL 25 believes the definition of a financial information system would be clearer if it was modified to state that the items included in i. through iv. of paragraph .02a would typically meet the definition of, or be part of, a financial information system</p>	<p>CL7, CL8, CL9, CL11, CL12, CL20, CL25</p>			
<p>118. No Comment</p>	<p>CL5, CL6, CL13, CL15,</p>	<p>Noted by Task Force.</p>		

	CL17, CL18, CL19, CL23, CL26, CL27			
Comments on Question 3				
(Question) Is it clear that management level dash board reporting would be included in “systems that gather data to assist management in making decisions that directly affect financial reporting”?				
119. No Decision- Multiple Dashboards; depends on dashboard reporting in question. CL7 does it only assist management with improving efficiency or effectiveness of operations?	CL1, CL7	Believe these concerns are addressed in rows 7 and 8 by the proposed revisions to item iii. of paragraph .02.	Same request as rows 7 and 8.	
120. Include. CL16 notes that members should stay away from implementation decisions that have an effect on internal controls over financial reporting but assisting client to implement finance-related tools should be an acceptable service.	CL3, CL8, CL10, CL16, CL22, CL25			
121. Include w/ clarification (FAQ that uses example in explanation as well as others) CL24 notes it would be helpful to: (a) include a dashboard as an example in paragraph .11 and (b) issue a FAQ regarding possible ways a member could determine if the dashboard reports would have a significant impact on management’s decision making. CL27 suggests “directly affect (or impact) financial reporting”	CL4, CL14, CL24, CL27			
122. Exclude. CL20 believes you should be able to perform dashboard services since they only gather information that already exists and presents it differently than a	CL2, CL11, C12, CL17, CL18, CL19,			

typical financial statement. CL23 believes it is premature to include dashboards given the inconsistent application of this practice in the middle market today.	CL20, CL21, CL23			
123. No Comment	CL5, CL6, CL9, CL13, CL15, CL26	Noted by Task Force.		
Comments on Question 4				
(Question) If the proposal is adopted as proposed, will the extended period be needed for members to adopt the revised guidance?				
124. Proposed Implementation Sufficient. CL22 recommends early implementation be allowed.	CL1, CL2, CL4, CL7, CL8, CL9, CL10, CL11, CL14, CL16, CL22, CL24, CL27	The Task Force believes that additional time should be provided for members to implement this guidance even though in substance there is not much that is more restrictive than the extant. However, since the Task Force is seeking adoption at the May 2019 meeting, it is recommending the period be just slightly over a year and be effective for periods beginning after December 31, 2020.	Seek the Committee's feedback on the Task Force's recommendation.	
125. No Extended time needed because the guidance is generally less restrictive than the current guidance.	CL 25			
126. More Time needed past the proposed implementation.	CL12, CL18, CL20, CL21			
127. No Comment	CL3, CL5, CL6, CL13, CL15, CL17, CL19, CL23, CL26	Noted by Task Force.		
General Comments				
(Sub-Theme) Guidance in interpretation should be principles based vs. rules based				
128. Final interpretation should expressly state that such use of a member's electronic practice aids software to aid in	CL2	The Task Force believes adding the term "nonattest" to paragraph .01 will provide some assistance to		

the preparation of a client's financial statements is permitted, as it has been heretofore pursuant to ET sec. 1.295 and does not constitute a threat to independence		addressing this concern and that further guidance, such as FAQs, should be developed once specific questions are raised.		
129. Does not address the impact these services have on other types of attestation engagements. Suggests that PEEC broaden the scope of the interpretation to go beyond financial reporting considerations. (e.g., should a member be able to install a non-financial system and issue a SOC 2 or 3 report on the same system?)	CL4	This concern is addressed in row 2.	Same request as row 2.	
130. Support the ED as drafted and happy to discuss the implications for education or additional feedback we require.	CL5	Task Force noted.		
131. Interpretation should specifically state that a member cannot provide implementation, installation, configuration or customization services for a system the member designed or developed since the definition of COTS refers to third party, and members could be designing systems that are COTS.	CL7	Task Force does not believe this is necessary as it is already clear.		
132. Interpretation should address that design or development may include various methods such as custom solutions/products, modules/components for COTS systems; components for commercially available platform; or a framework solution such as SharePoint.	CL7	Task Force does not believe further clarification should be provided at this time.		
133. The ED is too confusing and restrictive and doesn't take into consideration the vital role that members' play in providing	CL9	Task Force disagrees.		

value-added information system services and products to clients.				
134. PEEC should review this current proposal and the hosting FAQs to ensure they are consistent with the previously issued guidance because the substance of how the software is used and who performs the various functions should continue to be the relevant criteria, not who holds the license. Also, developing FAQs that address current fact patterns that are relevant to current technology and update these as new technologies evolve.	CL12	Not applicable.		
135. Is there a concern that subscriptions and bundling of services regarding the appearance of impairing independence, suggest clarification here or perhaps Q&As that walk-through fact patterns and whether they might impair independence?	CL12	Task Force believes this is beyond the scope of the interpretation.		
136. Concerned that the conclusions reached in the bookkeeping interpretation are not dependent upon who is the software licensee is yet paragraph .04c of the Hosting Services interpretation and discussions with Ethics Staff seems to imply it is dependent upon who the software licensee is	CL12	Comment appears to be related to the Hosting Services interpretation, not the current exposure draft. Staff notes that the Hosting FAQs being considered by the PEEC at its February meeting addresses this issue.		
137. Recommend that this interpretation be moved to a FAQ or put all technology examples in an FAQ leaving only a principles-based interpretation.	CL18	Task Force disagrees.		
138. Concerned that this theory (CPA's code a threat to independence that cannot be overcome) is conceptually flawed, especially if IT services in conjunction	CL18	This concern is addressed in row 1.		

with assurance services are not specifically scoped out.				
139. Concerned that the interpretation does not take into consideration other sources and uses of code that could be then attributed to the CPA as they are not specifically addressed in the current rules-based interpretation.	CL18	Task Force noted.		
140. Believe this interpretation penalizes the use of technology.	CL18	Task Force disagrees.		
141. Proposing such rules-based interpretive guidance could lead to more confusion and additional questions, especially in an area of professional services that is continually changing as new technologies and business practices are developed.	CL19	Task Force disagrees.		
142. Commercial Off-The-Shelf (COTS) financial information systems-concept is used throughout the exposure draft and it seems to ignore what is happening more and more in practice.	CL19	Task Force noted.		
143. Increased clarity could be achieved for members who do and do not practice in this arena if examples were provided delineating between common activity causing and not causing concern.	CL20	Task Force noted.		
144. We request an exception for systems like UAN that are required by law, cannot be customized by the client, has broad use, and has substantial safeguards in place be immune from the 'design and development' criteria.	CL26	Task Force believes members should use their professional judgement.		

Information technology services

1. Why does the “[Information Systems Design, Implementation, or Integration](#)” interpretation indicate that *independence* would be *impaired* if a *member* is operating a *client’s* network?

Operating an *attest client’s* network is considered to be a management responsibility that would violate the “General Requirements for Performing Nonattest Services” interpretation.

- ❖ FAQ 1 is recommended for deletion. The Task Force believes the substance of this FAQ is now addressed in paragraph .20 wherein the examples of services are noted to “...involve an ongoing function, process, or activity that in effect would result in the *member* assuming a management responsibility...”

2. Would outsourcing the *client’s* entire network operation and independently operating the *client’s* network *impair independence*?

Yes.

- ❖ FAQ 2 is recommended for deletion. The Task Force believes the substance of this FAQ is more clearly addressed in the examples contained in paragraph .20.

3. Would performing network maintenance (for example, updating virus protection, applying updates and patches, or configuring user settings, consistent with management’s request) *impair independence*?

No. Performing network maintenance is not considered to be operating the *attest client’s* network and, therefore, would not *impair independence*, provided a *client* employee with the necessary skill, knowledge, and/or experience is making all decisions and approving all activities. [Added prior to June 2005]

- ❖ FAQ 3 is recommended for deletion. The Task Force believes that paragraphs .20 and .21 provide far more clarity into when maintenance activities do and do not impair independence, especially the statement in paragraph .21 that indicates “...such services that do not *impair independence* may include being engaged for a discrete project...”

4. Would assisting an *attest client* with a server project (for example, install, migrate, or update its network operating system; add equipment and users; or copy data to another computer) *impair independence*?

No. Provided the *member* does not make other than insignificant modifications to the source code underlying the *attest client’s* financial information system. [Added prior to June 2005]

- ❖ FAQ 4 is recommended for deletion. Since the provision to allow members to make insignificant modifications to the source code underlying the *attest client’s* financial

information system was deleted from the interpretation, the Task Force believes eliminating this FAQ is necessary

5. Would supervising *client* personnel in the daily operation of the *attest client's* financial information system *impair independence*?

Yes. In this case, the *member* would be performing management responsibilities (that is, directing or accepting responsibility for the actions of the *attest client's* employees), which would *impair independence*. [Added prior to June 2005]

❖ FAQ 5 is recommended for deletion. The Task Force believes the substance of this FAQ is now clearly addressed in the example b. of paragraph .20

6. Would assisting an *attest client* with procuring and securing internet access *impair independence*?

No, provided an individual designated by the *attest client* to oversee the service has the necessary skill, knowledge, and/or experience and makes all decisions concerning the internet provider and services to be provided.

❖ FAQ 6 is recommended for deletion. The Task Force believes this guidance is elementary and could call into question managements ability to have SKE. In addition, the Task Force is concerned that when read in conjunction with the new interpretation, members could misapply the guidance.

7. What criteria should a *member* use to determine whether an *attest client's* information system is unrelated to its *financial statements* or accounting records?

Information systems that produce information that is reflected in the amounts and disclosures in the *attest client's financial statements*, used in determining such amounts and disclosures, or used in effecting internal control over financial reporting are considered to be related to the *financial statements* and accounting records. However, information systems that are used only in connection with controlling the efficiency and effectiveness of operations **and will have no significant impact on the financial statements, accounting records or internal controls over financial reporting** are considered to be unrelated to the *financial statements* and accounting records. [Added prior to June 2005]

❖ FAQ 7 is recommended for deletion. The Task Force believes the substance of this FAQ is now clearly addressed in.03 a. iv.

8. Which factors should a *member* consider in determining whether the modifications made to source code underlying an *attest client's* financial information system are other than insignificant?

If the modifications have more than an insignificant effect on the functionality of the software, they should be considered to be other than insignificant. [Added prior to June 2005]

- ❖ FAQ 8 is recommended for deletion since this exception is no longer part of the revised interpretation.

Staff Augmentation Task Force**Task Force Members**

Lisa Snyder (Chair), Shelly Van Dyne, Coalter Baker, Jeff Lewis, Brian Lynch, Bill Mann
Staff: Ellen Gorla, John Wiley

Task Force Charge

The Staff Augmentation Task Force's (the "Task Force") 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 Task Force seeks the Committee's approval to adopt the proposed "Staff Augmentation Arrangements" interpretation (ET Section 1.295.157) with revisions.

Please Note

After the Staff Augmentation Task Force met and concluded as described in this agenda item, the AICPA's legal team informed Staff that the safeguards articulated in para .03 (see Agenda Item 4B) may create a risk that, under employment laws, the client could be considered a co or joint employer of the augmented staff. Staff continues to work with the legal team to address this issue and determine possible alternative language or approach and will update the Committee with more details at the meeting.

Summary of Issues

Seven of the eleven comment letters were supportive of the proposal ([CL 2](#), [CL 4](#), [CL 5](#), [CL 6](#), [CL 8](#), [CL 9](#) and [CL 11](#)). Four of the comment letters supportive of the proposal recommended changes as discussed in their responses to specific questions ([CL 4](#), [CL 5](#), [CL 8](#), and [CL 11](#)). Three of the eleven comment letters were supportive of the proposal, and also recommended that additional non-authoritative guidance in the form of a frequently asked questions document ("FAQ") be issued ([CL 2](#), [CL 6](#), and [CL 9](#)). Three of the eleven comment letters were not supportive of the proposal ([CL 1](#), [CL 3](#), and [CL 7](#)). One comment letter did not submit general comments ([CL 10](#)).

[CL 3](#) believes that if the client oversees the services performed by the augmented staff, the augmented staff would be considered simultaneously employed by the attest client, which under a longstanding policy, would result in an independence impairment.

[CL 1](#) and [CL 7](#) recommended that additional non-authoritative guidance in the form of a frequently asked questions document be issued in lieu of an interpretation since the "Nonattest Services" and "Conceptual Framework Approach" subtopics currently provide guidance for members. Staff confirmed via email that [CL 1](#) does not believe every situation would impair independence and Staff is waiting to hear back from [CL 7](#).

[CL 11](#) proposed that paragraph .01 be revised to reflect a definition of staff augmentation services. In addition, [CL 11](#) did not believe that the staff augmentation arrangement itself creates self-

review threats. Accordingly, it believes the potential threats that may exist when a member or member's firm has a staff augmentation arrangement include management participation and familiarity threats.

Task Force Recommendation

The Task Force is supportive of adding a description of staff augmentation arrangements and believes doing so will help members better understand the interpretation. To be consistent with other nonattest services interpretations, the Task Force recommends that the description appear as a new stand-alone paragraph .01. The paragraph would read as follows:

- .01 For purposes of this interpretation, staff augmentation arrangements involve providing firm personnel (“augmented staff”) to an attest client whereby the attest client is responsible for the direction and supervision of the nonattest services performed by the augmented staff. Under such arrangements, the firm bills the attest client for the nonattest services rendered by the augmented staff but does not direct or supervise the actual performance of the nonattest services.**

The Task Force also recommends that it would be helpful to clarify that if augmented staff is compensated directly by the attest client that independence would be impaired because the augmented staff would appear to be employed by the attest client. To address this concern the Task Force recommends adding the following boldface italic phrase to the beginning of example d. in paragraph .04 (exposed paragraph .05)

- d. ***“Compensated directly by the attest client for the activities performed or is able to participate in compensation or benefit plans (including health or retirement plans) of the attest client ...”***

Responses to Specific Questions in Exposure Draft

Question #1: *Do you agree that the duration of the arrangement should be addressed in paragraph .02, and do you agree with the term “short period of time”? Are there other terms that you recommend PEEC consider that would be more appropriate and better understood?*

Four comment letters feel the term “short period of time” was ambiguous or vague and could be widely interpreted, but did not offer any alternative terms ([CL 1](#), [CL 2](#), [CL 5](#), and [CL 7](#)). [CL 5](#) does not agree with the duration of the engagement being included as a required safeguard in paragraph .02. as it feels the term “short period of time” is ambiguous and could be subject to wide interpretation and inconsistent application. [CL 5](#) questions whether it is really appropriate for the “duration of the engagement” to be a factor a member considers when performing the required appearance evaluation called for in the interpretation.

Seven comment letters suggest an FAQ specifically addressing the duration of the engagement if the concept remains in an issued interpretation, including examples ([CL 1](#), [CL 2](#), [CL 4](#), [CL 5](#), [CL 6](#), [CL 7](#), and [CL 11](#)).

One comment letter agrees that the engagement should be for a time period that the client understands has a beginning and end; therefore, it seems that one approach would be that the service provided be defined as a “discreet” project ([CL 10](#)).

[CL 11](#) believes that the duration of the arrangement should be addressed in paragraph .02. [CL 11](#) noted it is not likely that alternative language to the term “short period of time” would provide more clarity, so it believes that a frequently asked question would be an effective way of providing additional guidance to encourage consistent application with respect to duration. [CL 11](#) believes that the language in paragraph .02 should be amended to exclude bullet points a - b, which represent requirements in the existing AICPA code.

Task Force Recommendation

The Task Force recommends the phrase “short period of time” remain in the interpretation but to add clarification that if the arrangement is in place for more than a year, there is a rebuttable presumption that the period would not be considered a short period of time. The Task Force is not recommending the interpretation provide further specificity regarding the period of time, rather that the Task Force prepare FAQs describing situations of how the member may use the factors in paragraph .05, combined with the duration of the arrangement, to determine whether the staff augmentation arrangement creates the appearance of employment. The Task Force also recommends that safeguard “b.” be removed from paragraph .03 (exposed paragraph .02) since the prohibition of performing management responsibilities is addressed in the General Requirements and therefore, it is redundant to include in the list of additional safeguards.

Question #2: *Do you agree that staff augmentation is a nonattest service and that the proposed interpretation should be placed in ET section 1.295? If not, please explain where you believe it would be better placed.*

Ten of the eleven comment letters agree that the proposal should be placed in ET Section 1.295 if adopted. One comment letter does not support the proposal as a whole and did not provide a specific response ([CL 3](#)).

Task Force Recommendation

The Task Force recommends the interpretation remain in the Nonattest Services subtopic. The Task Force also recommends that a cross reference to this interpretation be added to the “*Simultaneous Employment or Association With an Attest Client*” interpretation.

Question #3: *Do you have any concerns regarding application of the proposed interpretation to client affiliates? If so, please specify the type of affiliate (that is, parent, subsidiary, or sister entity), and describe the concerns and related threats and potential safeguards.*

Nine comment letters did not have any specific concerns in applying the interpretation to affiliates. One comment letter ([CL 3](#)) did not agree that such services should be provided to affiliates of an attest client. One comment letter ([CL 8](#)) did not provide a response.

Task Force Recommendation

The Task Force does not believe revisions are necessary to address the “Client Affiliate” interpretation.

Question #4: *Do you foresee any hardships or regulatory issues that are created by the proposal? If so, please explain.*

Nine comment letters did not foresee any hardships or regulatory issues not addressed elsewhere in their responses to questions or general comments. Other comment letters noted the following potential hardships:

- Member loss of staff augmentation services or attest services client ([CL 2](#)).
- Lack of uniformity in application and enforcement of the interpretation ([CL 3](#)).
- If the scope of activities is not documented there may be challenges in ensuring the augmented staff does not perform activities that would be prohibited by the “Nonattest Services” interpretation. ([CL 4](#)).
- PEEC should consider incorporating a statement that the member should refer to and consider their obligations under other applicable laws, regulations and rules, such as those applicable to tax services. ([CL 6](#)).
- Diversity in practice created by use of the terms such as “short period of time” ([CL 7](#)).
- Application of multiple sets of rules: providing this guidance will not help, as the SEC, as noted in the exposure draft, has come out strongly against such services and has liberally interpreted them as “acting as an employee,” and therefore prohibited. PEEC should continue to provide additional tools and guidance to reinforce the significant differences that exist between SEC and AICPA rules in order to try to avoid more violations. In addition, PEEC should consult with the Government Accountability Office to determine whether this guidance will fit within its independence requirements so as to avoid another situation where the auditors have the potential of inadvertently violating a different regulator’s rules. ([CL 10](#)).

Task Force Recommendation

The Task Force does not recommend any revisions be made to address the noted concerns.

Question #5: *Do you agree with PEEC’s approach to address the appearance of prohibited employment set forth in paragraphs .03–.05? If not, please explain what you believe would be a better approach.*

- Three comment letters agreed with the approach in paragraphs .03-.05 ([CL 2](#), [CL 4](#), and [CL 6](#)).
- Three comment letters requested additional clarity in the form of examples and/or definitions of staff augmentation arrangements ([CL 5](#), [CL 9](#), and [CL 10](#)).
- One comment letter has questions as to whether this proposal could create additional co-employment risk in employment law. The commenter suggests having an employment attorney review this proposal as written to ensure there are no unintended legal consequences ([CL 1](#)).
- [CL 1](#) also noted that Paragraph .03 of the ED indicates the factors that should be considered are “the duration” (paragraph .03a) and “the frequency” (paragraph .03c). [CL 1](#) believes that this language implies that the duration and frequency have to be considered together. Following this logic, providing augmented staffing services five days a week for one week might be acceptable, but, providing those services two days a week for two years might not be acceptable. If duration and frequency are individually considered (as they would be in Paragraph .02), the result may be different than if considering them together. Therefore, [CL 1](#) would suggest that paragraph .02d be eliminated from the ED and the concepts in paragraphs .03a and .03d be combined. This

approach probably would narrow the range of possible outcomes even though, individually, the terms are still vague.

- One comment letter suggests moving the provisions of paragraphs .03-.05 to the Simultaneous Employment or Association with an Attest Client interpretation 1.275.005. The commenter suggests there could be cross references between this new ET and the existing ET ([CL 7](#)).
- One comment letter noted that there should be more clarity surrounding the idea of appearance, and that the interpretation does not indicate what threats are to be evaluated as it relates specifically to the appearance of simultaneous employment ([CL 8](#)).
- One comment letter did not believe that any safeguards could reduce threats to an acceptable level ([CL 3](#)).

Task Force Recommendation

The Task Force recommends adding a subheading before paragraph .04 (exposed paragraph .03) to provide further clarification that the remaining paragraphs provide guidance related to the appearance that the augmented staff is employed by the attest client. In addition, the Task Force recommends that the examples of situations that result in an augmented staff person appearing to be an employee of the attest client, be included in paragraph .04 since no safeguards could be applied to eliminate or reduce threats to an acceptable level.

Question #6: *Do you suggest any additional factors for evaluation of the appearance of prohibited employment that PEEC should consider?*

The following additional factors were suggested in the comment letters:

- The existence of a permanent, dedicated workspace (office, cubicle, etc.) on the client's premises; or the member's staff participation in company events or activities reserved for the client's employees only ([CL 2](#)).
- Paragraph .03 - The size of the client organization should be a consideration. Threats would likely be greater at smaller client organizations since there would be more reliance on the augmented staff and greater chances of the appearance of dual employment. However, if this factor is added to the interpretation, consideration of potential safeguards may be warranted ([CL 4](#)).
- Paragraph .03 - To address the appearance of dual employment, augmented staff should be provided the same type of access and privileges provided to vendors. If augmented staff are provided the same level of access and privileges as employees, there could be the appearance of dual employment ([CL 4](#)).
- Paragraph .04 – Augmented staff should be restricted from having direct contact with the client's customers, clients, vendors, or service providers as access to those individuals would appear to be holding the staff out as employees and also may put them in a position for being responsible for making management decisions ([CL 4](#)).
- Additional factors to be considered include the reason for the augmentation arrangement and the size and complexity of the client's operations ([CL 9](#)). (Examples in CL summary)
- ([CL 10](#)) The risk of scope creep is high when staff/client are not aware of or do not understand the rules; without some mechanism for the member to monitor what the staff

is doing, it is possible that the staff will perform prohibited nonattest services. The longer the duration of the assignment, the more likely it is that this will occur as the line between augmented staff and employee is likely to blur, particularly in situations which require daily work over a longer period of time.

Question #7: *Do you suggest any other safeguards that PEEC should consider to reduce threats to an acceptable level?*

Five comment letters did not suggest any additional safeguards. The following additional safeguards were submitted in the comment letters:

- One comment letter recommends a specific prohibition against the staff being paid directly by the client, either in the form of general compensation or a bonus. All fees for the staff augmentation arrangement should be billed by the member's firm or the member, if a sole proprietor ([CL 2](#)).
- One comment letter suggested having another firm re-perform the nonattest service that the augmented staff member performed to the extent necessary to enable the other firm to take responsibility for the service. The commenter further noted that the proposal does not provide any definitions or indicators that members could use to evaluate and determine whether a designated individual has suitable skills, knowledge, and experience ([CL 8](#)).
- One comment letter recommended a paragraph highlighting management participation threats along with potential safeguards. Para. .05a of the proposed interpretation provides a safeguard against familiarity threats. The commenter also indicated that limiting the level of personnel on a staff augmentation engagement may be an effective safeguard ([CL 11](#)).
- One comment letter recommended that language should be added to indicate that some situations may require multiple safeguards be applied to eliminate or reduce the threat(s) to an acceptable level ([CL 11](#)).

A general comment was made that the level and number of individual(s) assigned by the member to assist with the staff augmentation engagement (e.g., should partners and partner equivalents be permitted to be augmented staff)

Task Force Recommendations Related to Questions 6 and 7

The Task Force recommends adding two additional examples of safeguards. One safeguard would prohibit augmented staff from participating in employee-only events or activities. The other safeguard would require the firm to ensure that the attest engagement staff who will interact with the augmented staff have adequate experience and stature to deal effectively with the augmented staff when the augmented staff is a partner or partner equivalent in the firm. The Task Force considered whether partners and partner equivalents should be prohibited from serving as augmented staff due to the management participation threat but concluded that threats could be reduced to an acceptable level if this safeguard is applied when the attest engagement staff will have significant interaction with the partner. The Task Force also considered adding the proposed safeguard suggested by [CL 8](#), "Having another firm re-perform the work that the augmented staff performed to the extent necessary to enable the other firm to take responsibility for the work" but concluded it would be unlikely for a client to use augmented staff and then engage a second firm to re-perform the work.

Additional General Comments Not Otherwise Discussed

- Including indicators that members could use to evaluate the skills, knowledge, and experience of the individual designated to oversee the augmented staff member's activities.
- Consider adding that advocacy threats and familiarity threats may exist when a member or member's firm has a staff augmentation arrangement.
- Replace the safeguard in paragraph .02 d. with the requirement that, "The arrangement does not result in the appearance of a prohibited employment arrangement."

Task Force Recommendation

The Task Force recommends that the advocacy and familiarity threats be added since they are now identified as possible threats in the IESBA's revised code.

Effective Date

The Task Force recommends the interpretation be effective six months after notice of adoption is issued in the Journal of Accountancy, with early implementation allowed.

Action Needed

The Task Force seeks the Committee's approval to adopt the proposed interpretation as revised by the Task Force. The Committee is asked to provide input into the FAQs that it believes should be developed.

Communications Plan

Mr. Wiley will update the Committee on the project's communication plan.

Materials Presented

Agenda Item 4B – Proposed Revised Interpretation

Agenda Item 4C – Comment Letter Summary

Agenda Item 4D – Comment Letter Analysis

Agenda Item 4E – Proposed Interpretation

Agenda Item 4F – Proposed FAQs

Final Text of Proposed “Staff Augmentation Arrangements” Interpretation

Task Force’s recommended additions appear in **bold italic** and deletions are ~~stricken~~

1.295.157 Staff Augmentation Arrangements

- .01 **For purposes of this interpretation, staff augmentation arrangements involve providing firm personnel (“augmented staff”) to an attest client whereby the attest client is responsible for the direction and supervision of the nonattest services performed by the augmented staff. Under such arrangements, the firm bills the attest client for the nonattest services rendered by the augmented staff but does not direct or supervise the actual performance of the nonattest services.**
- .02 When a member or member’s firm has a staff augmentation arrangement with an attest client, self-review **advocacy, familiarity** and management participation threats to the member’s compliance with the “Independence Rule” (ET sec. 1.200.001) may exist.
- .03 Threats to compliance with the “Independence Rule” (ET sec. 1.200.001) would not be at an acceptable level, and independence would be impaired unless, in addition to applying the “General Requirements for Performing Nonattest Services” interpretation (ET sec. 1.295.040), all the following safeguards are met:
- 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
 - determining the nature and scope of the activities to be provided by the ~~individual performing the augmented staff services (the “augmented staff”);~~
 - supervising and overseeing the activities performed by the augmented staff; and
 - evaluating the adequacy of the activities performed by the augmented staff and the findings resulting from the activities.
 - ~~The activities do not result in the augmented staff assuming management responsibilities as described in the “Management Responsibilities” interpretation (ET sec. 1.295.030) of the “Independence Rule” (ET sec. 1.200.001).~~
 - The augmented staff performs only activities that would not otherwise be prohibited by the “Nonattest Services” interpretation (ET sec. 1.295.000) of the “Independence Rule” (ET sec. 1.200.001).
 - The duration of the arrangement is for a short period of time. **There is a rebuttable presumption that an arrangement that extends beyond one year would not be considered a short period of time.**

Appearance of Employment Considerations

- .04 **Due to simultaneous employment being prohibited by** ~~In all circumstances, the member should consider whether the staff augmentation arrangement creates the appearance of prohibited employment with the attest client. (See the “Simultaneous Employment or Association with an Attest Client” interpretation [ET sec. 1.275.005] of the “Independence Rule” [ET sec. 1.200.001]~~ **the member should consider whether the staff augmentation arrangement creates the appearance of employment with the attest client and therefore impair independence. Examples of situations where the appearance of employment would exist, and independence would be considered impaired are when the augmented staff is:**
- Listed as an employee in the attest client’s directories or other attest client publications

- b. Referred to by title or description as supervising or being in charge of any business function of the attest client
 - c. Identified as an employee of the attest client in correspondence such as email, letterhead, or internal communications
 - d. **Compensated directly by the attest client for the activities performed or is** able to participate in compensation or benefit plans (including health or retirement plans) of the attest client
- .05 When evaluating **whether situations not covered by paragraph .04 of this interpretation result in** the appearance of employment with the attest client, the member should consider factors such as the following:
- a. The duration of the staff augmentation arrangement
 - b. Whether the augmented staff will provide services to other clients during the period of the arrangement
 - c. The frequency with which the augmented staff will perform activities at the attest client's location (for example, daily)
 - d. Whether the arrangement is discrete or recurring in nature and, if recurring, the frequency of such recurrence.
- ~~.06 However, threats to compliance with the "Independence Rule" (ET sec. 1.200.001) would not be at an acceptable level and independence would be impaired if the augmented staff is held out or treated as an employee of the attest client, such as being any of the following:~~
- ~~a. Listed as an employee in the attest client's directories or other attest client publications~~
 - ~~b. Referred to by title or description as supervising or being in charge of any business function of the attest client~~
 - ~~c. Identified as an employee of the attest client in correspondence such as email, letterhead, or internal communications~~
 - ~~d. Able to participate in compensation or benefit plans (including health or retirement plans) of the attest client~~
- .07 **If the member determines that threats to the appearance of independence exist, the member should determine whether the threats are at an acceptable level and, if not, whether safeguards can be applied to eliminate or reduce threats to an acceptable level. Examples of such safeguards are** The significance of any threats should be evaluated, and safeguards applied, when necessary, to eliminate the threats or reduce them to an acceptable level. These are some examples of such safeguards:
- a. Not using the augmented staff on the attest engagement team, or not using the augmented staff to perform attest procedures on any areas for which the staff performed activities during the augmented staff arrangement
 - b. Discussing the threats and any safeguards applied with those charged with governance
 - c. Rotating the individuals performing the staff augmentation activities
 - d. Monitoring the scope of activities performed by the augmented staff
 - e. **Not permitting the augmented staff to participate in employee-only events or activities.**
 - f. **Ensuring that the attest engagement team members who will interact with the augmented staff have sufficient experience and stature to deal effectively with the augmented staff in conducting the engagement when the augmented staff is a partner or partner equivalent of the firm.**

Effective Date

- .08 This interpretation is effective **[insert date which should be** six months after notice of adoption is published in the *Journal of Accountancy*]. Early implementation is allowed.

Comment Letter Summary
Proposed “Staff Augmentation Services” interpretation of the “Independence Rule”

General Comments		
<u>CL 1</u>	TIC Objects, recommends FAQ	<p>TIC does not believe that adding an additional interpretation is necessary as the current Code already has adequate guidance and safeguards that could be applied in many of these situations. Currently, AICPA members already are referencing sections 1.210 and 1.295 of the Code regarding nonattest services when providing bookkeeping and other related services. TIC would suggest that, if the ethics team is receiving significant questions related to staff augmentation arrangements that are not already covered in ET sections 1.210 and 1.295, perhaps the issuance of specific questions and answers might be a better way to address these issues. TIC believes that providing specific situations and fact patterns might be a more effective way to address potential independence issues when firms are providing staff augmentation services.</p> <p>There was confusion as to whether certain arrangements would fall under the scope of this interpretation, so TIC suggests adding some examples for clarity. TIC believes that if PEEC defined the term staff augmentation similar to how it is described in the international standards, that might result in less confusion in practice. For example, IESBA section 290.140 notes that this section applies to loaned staff where the client “is responsible for directing and supervising the activities of the loaned staff”. TIC believes that if PEEC changed the definition of staff augmentation to the IESBA definition INCLUDING the limitation that it pertains only to services where the loaned staff are directed and supervised by the client, then a lot of TICs concerns would be alleviated because the non-attest services that already are addressed in ET Section 1.295 are firm-directed services. If that change were made, augmentation clearly would not apply to the firm supervised array of non-attest services that currently are allowed with the appropriate safeguards that already are addressed in ET section 1.295.</p> <p>In addition, TIC believes that PEEC might also consider adding some of the commentary from the background section of this ED into ET Section 1.295 which may result in less confusion.</p>
<u>CL 2</u>	NYSSCPA Support, suggests FAQ	<p>We support PEEC’s efforts to provide specific guidance regarding situations in which a member or a member’s firm provides human resource capital as a service to clients under a staff augmentation arrangement.</p>

		<p>The Society notes that the term “staff augmentation arrangement” is not defined in the proposed interpretation. For members who do not currently participate in such arrangements, we recognize that the term “staff augmentation arrangement” might be confusing. Because not all members or member’s firms participate in such arrangements, we believe that including a clear and concise definition of these types of arrangements would be useful. By adding such a definition, members who do not routinely provide this type of service would better recognize such an arrangement should they be asked to provide human resource capital to a client.</p> <p>We also suggest that either the interpretation, or, as discussed above, an FAQ released contemporaneously with the issuance of this interpretation, reiterate that all nonattest services provided by the member or member’s firm to an attest client needs to be considered in the aggregate to determine if a threat to independence from the performance of multiple nonattest services is at an acceptable level. We know that this is an area of concern to the AICPA Peer Review Program and suggest that with the addition of each new interpretation to ET section 1.295, the PEEC should take the opportunity to remind practitioners of the requirement to consider whether a threat from the performance of multiple nonattest services exists and the requirement to document such consideration.</p>
<p><u>CL 3</u></p>	<p>NASBA Objects, recommends FAQ</p>	<p><i>Appearance of prohibited employment cannot be overcome by the application of safeguards.</i> First and foremost, we are concerned that the manner in which staff would be employed in this proposal would make them indistinguishable from an attest client’s other employees because client management would be responsible for directing the staff’s daily activities. We believe this will be the case even if the member applies the required and suggested, optional safeguards described in the Exposure Draft. Avoiding simultaneous employment, in substance and appearance, is fundamental to independence and should be respected in all circumstances. We do not believe any safeguards would effectively mitigate threats to the appearance of independence when a firm uses these arrangements.</p> <p><i>The proposed interpretation weakens the Code’s independence requirements and does not serve the public or profession’s interests.</i> For decades, the Code (ET Section 1.275.005) has prohibited any firm professional from simultaneous employment with an attest client during the period covered by the financial statements or the period of the professional engagement. The Code provides only one exception to this rule; it allows members to serve as part-time, non-tenured adjunct instructors at educational institutions if the member applies safeguards, notably that the member not be a member of the institution’s attest engagement team or in a position to influence the engagement. The PEEC adopted this exception only after much debate, due to shortages of qualified teaching personnel. While the PEEC was reluctant to create an exception</p>

to this rule, it was agreed to be in the public and the profession's best interests to allow members to teach the next generation of accountants and auditors. Further, we believe that in most cases, the client in need of staff augmentation could obtain these services from a provider that is not required to be independent.

The proposed interpretation will be challenging to interpret, apply and enforce.

The proposed interpretation requires the member to apply significant judgement in determining whether independence would be maintained during a staff augmentation engagement. For example, the notion of whether an engagement would be of "short duration" can be interpreted broadly to mean anything from one week to one year. Further, NASBA is concerned that some members, especially from smaller firms, may justify performing staff augmentation services even though, because of their size, they lack adequate safeguards to help mitigate self-review and other threats to independence, e.g., use of separate teams to perform attest and staff augmentation services. We also believe State Board regulators will find it particularly challenging to enforce the rule given its subjectivity, which may result in disciplinary actions against licensees and firms for violating independence.

The proposed interpretation is unique among the nonattest services currently addressed in the Code in that it requires the member to apply greater judgment than is typically required. Other nonattest services provisions in the Code more clearly describe the types of services and activities that would or would not impair independence. For example, the interpretation on Executive or Employee Recruiting (ET 1.295.135) describes the activities that would or would not impair independence: NASBA acknowledges that the proposed interpretation for staff augmentation requires the member to apply certain safeguards. However, even those safeguards rely to some extent on member judgment as to what would be considered an arrangement of "short duration." Factors the member should consider in evaluating the appearance of prohibited employment (e.g., frequency, recurrence) are similarly vague. Though the interpretation would prohibit certain actions, in the end whether the member applies safeguards (such as the use of separate engagement teams) is purely a matter of member judgment.

Overall, NASBA recommends the PEEC not adopt the proposed interpretation as we believe the premise that firms may lend their staff to perform services under the client's supervision is inconsistent with the existing and longstanding provision in the Code that bars simultaneous employment with an attest client.

(Q6) NASBA suggests the PEEC not move forward with this proposal. If the AICPA staff are receiving inquiries on these services, PEEC may wish to consider frequently-asked questions or other nonauthoritative guidance to address the independence implications of such arrangements.

<u>CL 4</u>	Crowe LLP Supports	We support PEEC's efforts to provide guidance related to professional services that involve providing human resource capital. The AICPA's non-authoritative frequently asked questions document includes a question related to temporary controllership services, which we believe provides a presumption that staff augmentation services are permitted. However, we appreciate that adding staff augmentation arrangements to the non-attest service interpretation would clarify the requirements.
<u>CL 5</u>	Plante Moran PLLC Supports, recommends additional guidance	We have reviewed the December 7, 2018 Exposure Draft – Interpretation of the AICPA Code of Professional Conduct, Staff Augmentation Arrangements Interpretation (ET Sec. 1.295.157) and understand the objectives that the Committee is attempting to achieve by addressing staff augmentation services separately from other nonattest service arrangements. However, as described below, we believe additional guidance would make the standard more understandable and easier to implement.
<u>CL 6</u>	Grant Thornton Supports, recommends FAQ	Grant Thornton suggests that PEEC consider developing non-authoritative guidance in the format of a frequently asked questions document that highlights various scenarios and examples of staff augmentation that would be permitted or prohibited under the new interpretation. For example, the scenarios can cover short-term duration, frequency of the staff augmentation engagement, cumulative independence evaluation of all nonaudit services, including the staff augmentation and the evaluation of audit fees vs nonaudit fees, level and number of individual(s) assigned by the member to assist with the staff augmentation engagement, nature of the activities performed by the augmented staff (a.g. tax compliance, financial reporting related, etc) and the application of safeguards to eliminate the threats or reduce them to an acceptable level.
<u>CL 7</u>	Clifton Allen Larson Objects, recommends FAQ	<p>In our view, staff augmentation services are already covered under ET sec. 1.295 Nonattest Services and ET sec. 1.210 Conceptual Framework Approach. The only additional required safeguard introduced in this ED is the duration safeguard and the current ED language does not provide clarity on this additional requirement. (See response to specific comment #1 below.) Therefore, we believe the issuance of this proposed ethics interpretation would not provide additional clarity, but would add confusion in the application.</p> <p>As an alternative to the issuance of this new ET, CLA recommends PEEC consider adding the example threats and safeguards noted in the ED into the existing AICPA Frequently Asked Questions: Nonattest Services document to assist in evaluating staff augmentation services. If PEEC proceeds with issuance of this ET, please consider including a definition of staff augmentation arrangements (including general</p>

		characteristics) as described in the background section of the proposed ET and consistent with the IESBA definition.
<u>CL 8</u>	GAO <i>Supports with recommended changes</i>	<p>We support PEEC’s efforts to clarify the independence requirements and considerations for situations in which members and members’ firms provide human resource capital as a service to clients under staff augmentation arrangements. However, we are concerned that the proposed interpretation may lead members to incorrectly conclude that independence threats are at an acceptable level even when reasonable, informed third parties would perceive the members independence as impaired. For example, if a government auditor was augmented to an audited government entity, and that auditor appeared to be employed by the entity, the public would likely conclude that the auditor was not independent. Accordingly, we believe that members should critically evaluate the threats to independence and safeguards and document the threats and safeguards applied.</p> <p>In addition, we believe that the proposed interpretation could benefit from the following:</p> <ul style="list-style-type: none"> - Including indicators that members could use to evaluate the skills, knowledge, and experience of the individual designated to oversee the augmented staff member’s activities. - Clarifying the threats that exist if a staff augmentation arrangement creates the appearance of prohibited employment with the attest clients; members should consider any threat posed by the appearance of prohibited employment to be a significant threat. - Defining “appearance” in “appearance of prohibited employment.” - Adding that advocacy and familiarity threats may exist when a member or member’s firm has a staff augmentation arrangement with an attest client, and adding guidance on evaluating the threats and identifying relevant safeguards.
<u>CL 9</u>	BDO <i>Supports, recommends FAQ</i>	<p>Overall, we support the proposed interpretation, which contains guidance concerning independence when a member or a member’s firm has a staff augmentation arrangement with an attest client.</p> <p>We agree that additional guidance is needed as to when staff augmentation arrangements could compromise independence and also agree that threats to independence are created under such arrangements due to the appearance of employment with an attest.</p> <p>While we appreciate the opportunity to comment on the proposed interpretation, we believe the proposed standard, as currently written, may not promote consistency in application of the Code, and may be difficult to interpret due to the lack of clarity in the proposed required safeguard: “The duration of the arrangement is for a short period of time.” Please see further commentary below.</p>

CL 10	Baker Tilley Virchow Krause	n/a
CL 11	KPMG Supports with recommended changes	<p>We suggest that the interpretation define a staff augmentation arrangement including information about how such an arrangement differs from other nonattest services provided to attest clients. We believe that in staff augmentation arrangements, the client is responsible for the supervision of the augmented staff's activities. In other nonattest services, the firm provides supervision over professional staff. Without providing a definition for staff augmentation services, the applicability of the interpretation could be broader than intended.</p> <p>We believe that delivering an otherwise permissible nonattest service as a staff augmentation engagement may give the appearance of an employment relationship and, thus, create management participation and familiarity threats. While the nature of the underlying services may create self-review threats, we don't believe that the staff augmentation arrangement itself creates self-review threats. Accordingly, we believe the potential threats that may exist when a member or member's firm has a staff augmentation arrangement include management participation and familiarity threats.</p> <p>Where we propose changes to the interpretation in the comment letter, we used the following legend: 1) Text written in bold indicates information we propose adding to the interpretation and 2) Strikethrough indicates text from the exposure draft that we propose deleting.</p> <p>Based on the commentary above, we propose the following revisions to paragraph .01:</p> <p>.01 Staff augmentation arrangements are those that consist of the delivery of a permissible service for which the client is responsible for directing and supervising the activities of the augmented staff. When a member or member's firm has a staff augmentation arrangement with an attest client, self-review and management participation and familiarity threats to the member's compliance with the "Independence Rule" (ET sec. 1.200.001) may exist.</p> <p>Continuity and frequency of such arrangements, as well as the degree of exclusivity of personnel, can vary depending upon factors specific to the nature of the activities being performed by the augmented staff. For this reason, we believe that the cumulative effect of these factors should be considered together with the duration of the engagement when evaluating threats to independence. Any one factor may or may not be determinative of a significant threat. In addition, multiple factors could result in significant threats when considering the cumulative effect of threats in the aggregate. We recommend</p>

		<p>that this be communicated within the interpretation in paragraph .01. We suggest the following language as an example:</p> <p style="text-align: center;"><i>Threats should be evaluated both individually and in the aggregate as threats can have a cumulative effect on independence. Threats may become more significant when considering the depth and breadth of the threats in totality.</i></p>
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Q1: Do you agree that the duration of the arrangement should be addressed in paragraph .02, and do you agree with the term short period of time? Are there other terms that you recommend PEEC consider that would be more appropriate and better understood?

CL 1	TIC	TIC believes that using the term “short period” is ambiguous and subject to interpretation. Also, it sounds as though recurring short periods may be allowed as that is a consideration in paragraph .03d of the ED. TIC would suggest some clarification or perhaps examples in order to better demonstrate what is meant by the term “short period” if it is not defined in the ED. TIC also believes that PEEC may want to consider clarifying recurring engagements versus non-recurring engagements for purposes of this ED. TIC has additional comments related to this issue in our response to question 6.
CL 2	NYSSCPA	The Society believes that the duration of the engagement is an important consideration when assessing whether the threat to independence created by the arrangement is reduced to an acceptable level. However, we find the phrase short period of time to be too vague to serve as an adequate safeguard to the threat created by the arrangement, even when considered in relation to the other proposed safeguards. Having said that, we have been unable to determine a more acceptable term to address the issue of duration of the arrangement. We suggest that the PEEC consider issuing, contemporaneous with the release of the Interpretation, an FAQ that addresses this issue and how the issue of duration might be addressed in the engagement letter.
CL 3	NASBA	As noted above, NASBA is concerned about the use of subjective terms in this proposed interpretation, which we see as problematic.
CL 4	Crowe LLP	We agree the duration of the arrangement should be addressed in paragraph .02 as we believe the duration of the service is important to the independence considerations. We appreciate the challenge in identifying a term that appropriately and completely conveys the intent that the service not be permanent or long-term in nature. We believe “short period of time” does address that the service should not be permanent or long-term; however, we recommend PEEC consider issuing an FAQ

		providing examples and additional guidance on how to evaluate the duration of the arrangement specifically for discrete and recurring engagements.
CL 5	Plante Moran PLLC	<p>We do not agree with the duration of the engagement being included as a required safeguard in paragraph .02. The term “short period of time” is ambiguous and could be subject to wide interpretation and inconsistent application. We believe that including the “duration of the engagement” in paragraph .03 as a factor to consider when evaluating whether the appearance of prohibited employment is created is sufficient to address concerns about the length of time the staff augmentation services are provided.</p> <p>If the Board retains “a short period of time” as a required safeguard, we would suggest that the term “short period” be well-defined in the interpretation and examples of situations that would clearly meet and not meet the definition be included. For example, the inclusion of specific examples in ET 1.295.143 Hosting Services as to what types of arrangements constitute “hosting services” is helpful in applying that standard. We suggest a similar approach be applied to this interpretation.</p> <p>It is unclear how the term “short period of time” would be interpreted when services are being provided on a “short term” but recurring basis. Would staff augmentation services provided for a short period of time, but repeated on a recurring basis, say monthly, quarterly or annually, meet the “short period of time” safeguard? Additional guidance or examples about how to evaluate reoccurring staff augmentation services should be added to the interpretation, particularly those that reoccur on an infrequent basis (like annually, for example). As proposed, the “short period of time” safeguard is only required when the nonattest services are provided through staff augmentation contracts. If that safeguard is only applicable to staff augmentation services, then the standard needs to clearly define what constitutes “staff augmentation services”. We also recommend including examples of situations and fact patterns that would meet that definition in the interpretation. Without a clear definition and examples, members may be confused as to which nonattest service contracts are subject to the “short period of time” safeguard. We suggest that the interpretation incorporate the definition included in international standards. IESBA section 290.140 states that staff augmentation services relate to “loaned staff where the client is responsible for directing and supervising the activities of the loaned staff”. This definition is clearly evident in the introductory material to the exposure draft. We believe that including the definition in the final standard would assist members in applying the interpretation.</p>
CL 6	Grant Thornton	Grant Thornton agrees that duration of the arrangement should be addressed in paragraph .02 and with the use of the term “short period of time” as it supports convergence with the international standards. However, we also agree that the use of this terminology may be easily misunderstood when

		<p>applied in practice. We suggest PEEC consider providing additional guidance, including example scenarios that would be considered a “short period of time” as well as scenarios that would not be considered a “short period of time”, to aid in consistent application of the interpretation in practice.</p> <p>We also suggest that such example scenarios (e.g., tax compliance services performed under staff augmentation arrangements that the client requests on an annual basis) include consideration of frequency, recurrence, continuity and exclusivity. Also, consider guidance on whether the nature of the activities and scope of the assignment should be taken into consideration when evaluating the permissibility of the staff augmentation, including impact that may have on whether the duration of the arrangement is considered a “short period of time” if the assignment can be completed within a “reasonable amount of time”. For example, a member has staff augmentation arrangements with two separate clients and performs the same assignment under each arrangement. Depending on the size and complexity of the client, one assignment may take a few months to complete and the other assignment may take more than six months to complete. Even if both arrangements are considered a “reasonable amount of time” to complete the assignment, would one arrangement be considered a “short period of time” and not the other?</p> <p>At this time, we have no other terms to recommend for PEEC’s consideration.</p>
CL 7	Clifton Allen Larson	<p>CLA believes the term short term period of time is vague and would lead to diversity in practice. To avoid confusion and diversity in practice it would be useful for PEEC to expand on the terminology by providing examples which define “short term”.</p>
CL 8	GAO	<p>We agree that the duration of the arrangement should be addressed in paragraph .02, and with the term short period of time. We appreciate PEEC’s efforts to align the interpretation with International Ethics Standards Board for Accountants’ (IESBA) International Code of Ethics for Professional Accountants.</p> <p>With regards to paragraph .02, we also believe that PEEC should add a requirement that members document any threat from a staff augmentation arrangement and how the safeguards listed in the paragraph were met.</p>
CL 9	BDO	<p>We do believe that the duration of the arrangement should have limits, however, we do not believe that a “short period of time” will be interpreted and applied uniformly by members. In addition, it may be difficult to enforce and more factors should be provided in paragraph .03 to clarify the intent of this safeguard.</p>

		<p>As noted in the explanatory language of the exposure draft, this particular safeguard is required to address the appearance of prohibited employment with an attest client. The appearance of prohibited employment may be affected by other factors besides the duration as described in paragraph .03 of the proposed standard. We believe it might be more appropriate if the safeguard in paragraph .02 d. would be replaced with the requirement that, “The arrangement does not result in the appearance of a prohibited employment arrangement.” Paragraph .03 would then address the required factors to consider concerning the appearance of prohibited employment and provide guidance to members in determining whether the arrangement would result in the appearance of prohibited employment. As already noted in paragraph .03, the duration of the engagement would be one such factor to consider in determining whether the staff augmentation arrangement would appear to be prohibited employment with the attest client.</p> <p>We also believe it would be helpful to issue FAQs that provide guidance on how a member should evaluate the “duration of the staff augmentation arrangement” with one example that could result in the appearance of employment and another that would not.</p>
CL 10	Baker Tilley Virchow Krause	<p>We agree that the engagement should be for a time period that the client understands has a beginning and end; therefore, it seems that one approach would be that the service provided be defined as a discreet project. For example, in situations where a loaned staff replaces a former employee, the understanding with the client should include the expectation that the arrangement would end after a new employee had been hired and sufficiently trained.</p> <p>We believe the guidance in 1.295.150 related to internal audit may inform some of the guidance that should be used here.</p>
CL 11	KPMG	<p>We believe that duration of the arrangement should be addressed in paragraph .02. As it is not likely that alternative language to the term “short period of time” would provide more clarity, we believe that a frequently asked question would be an effective way of providing additional guidance to encourage consistent application with respect to duration.</p> <p>We believe that the language in paragraph .02 should be amended to exclude bullet points a - b, which represent requirements in the existing AICPA code, as follows:</p> <p><i>.02 Threats to compliance with the “Independence Rule” (ET sec. 1.200.001) would not be at an acceptable level, and independence would be impaired unless, in addition to applying the</i></p>

“General Requirements for Performing Nonattest Services” interpretation (ET sec. 1.295.040), all 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 provided by the individual performing the augmented staff services (the “augmented staff”);*
 - ii. supervising and overseeing the activities performed by the augmented staff; and*
 - iii. evaluating the adequacy of the activities performed by the augmented staff and the findings resulting from the activities.**
- b. The activities do not result in the augmented staff assuming management responsibilities as described in the “Management Responsibilities” interpretation (ET sec. 1.295.030) of the “Independence Rule” (ET sec. 1.200.001).*
- e.a. The augmented staff performs only activities that would not otherwise be prohibited by the “Nonattest Services” interpretation (ET sec. 1.295.000) of the Independence Rule” (ET sec. 1.200.001).*
- d.b. The duration of the arrangement is for a short period of time.*

We believe that exclusivity, frequency, and recurrence of the staff augmentation arrangement should be considered along with the duration of the engagement in paragraph .02. When evaluating threats to independence, the impact of additional factors may change in relevance as the duration fluctuates. As a result, professional judgment should be used in evaluating these factors to determine an appropriate duration.

We also believe that a partner or partner-equivalent should be prohibited from serving as augmented staff for financial statement attest clients. In such cases, we believe that threats to management participation and familiarity are so significant that safeguards would not be sufficient to eliminate or reduce the threats to an acceptable level. If a partner or partner-equivalent is serving as augmented staff for non-financial statement attest clients, threats to management participation and familiarity must be evaluated to understand if the threats can be reduced to an acceptable level through the application of safeguards.

See our comment in the overall considerations section above about considerations of the cumulative effect on threats related to duration, exclusivity, recurrence, and frequency.

Q2: Do you agree that staff augmentation is a nonattest service and that the proposed interpretation should be placed in ET section 1.295? If not, please explain where you believe it would be better placed.

CL 1	TIC	TIC believes that ET section 1.295, which covers nonattest services, is already sufficient to cover this issue as discussed earlier in this letter. TIC believes that adding additional guidance to existing standards could result in confusion and may be missed by practitioners. TIC believes that, if there are some specific safeguards related to staff augmentation in addition to those already in ET sections 1.210 and 1.295, simply adding those specific safeguards to the existing guidance would be much easier for members to follow.
CL 2	NYSSCPA	We concur with PEEC’s position that staff augmentation arrangements are a nonattest service and, therefore, should be added to ET section 1.295. We would suggest, as discussed above, that an FAQ be developed and released contemporaneously with the issuance of this Interpretation reminding members that as a nonattest service, these arrangements should be considered together with other nonattest services to determine if a threat from the performance of multiple nonattest services exists.
CL 3	NASBA	NASBA does not believe the proposed interpretation should be incorporated into the Code.
CL 4	Crowe LLP	We agree non-attest services can be provided as staff augmentation arrangements and including as an interpretation would address any possible inconsistencies in practice in the industry. The proposed guidance includes a safeguard that the augmented staff should only perform activities that are not otherwise prohibited by the “Nonattest Services” interpretation. We believe this safeguard is critical and recommend PEEC add to the interpretation a requirement to include the scope of activities in the documented understanding with the client about the scope of services. Adding the scope of activities to the service documentation will assist the member and client ensure the activities are not prohibited by the “Nonattest Services” interpretation.
CL 5	Plante Moran PLLC	Yes, we agree that staff augmentation is a nonattest service and the proposed interpretation should be placed in ET Section 1.295.
CL 6	Grant Thornton	Grant Thornton agrees that staff augmentation is a nonattest service and, therefore, agree that the proposed interpretation should be included in the AICPA Interpretation ET section 1.295, “Nonattest Services”.

CL 7	Clifton Allen	Larson	CLA is in agreement that staff augmentation fits the definition of a nonattest service and believe that the code as currently written addresses these services.
CL 8	GAO		<p>We agree that staff augmentation is a nonattest service and that the proposed interpretation should be placed in ET section 1.295. Accordingly, we suggest that PEEC consider adding that advocacy threats and familiarity threats may exist when a member or member's firm has a staff augmentation arrangement. Including advocacy and familiarity threats as an additional type of threat would align the proposed interpretation with other sections of the AICPA's Code of Professional Conduct and IESBA's 2018 International Code of Ethics for Professional Accountants. The Code of Professional Conduct states that advocacy threats may exist when members perform nonattest services (ET section 1.295.010.01) and states that advocacy and familiarity threats exist if a partner or professional employee of the member's firm is simultaneously employed or associated with an attest client (ET section 1.275.005.02). In addition, the 2018 International Code of Ethics for Professional Accountants provides that loaning personnel to an audit client might create a self-review, advocacy, or familiarity threat.</p> <p>We also believe that the proposed interpretation could benefit from adding guidance on evaluating these threats, such as relevant factors for members to consider, and guidance on safeguards that could be applied to reduce any threats to an acceptable level.</p>
CL 9	BDO		Yes. We believe that staff augmentation is a non-attest service and that the proposed interpretation should be placed in ET section 1.295.
CL 10	Baker Virchow Krause	Tilley	We agree that this guidance should be provided in ET 1.295.
CL 11	KPMG		We support the proposed inclusion of the staff augmentation arrangements in ET 1.295 Nonattest Services. We believe that staff augmentation arrangements constitute a method of providing nonattest services.

Q3: Do you have any concerns regarding application of the proposed interpretation to client affiliates? If so, please specify the type of affiliate (that is, parent, subsidiary, or sister entity), and describe the concerns and related threats and potential safeguards.

CL 1	TIC		TIC does not have specific identifiable concerns related to the application of the proposed interpretation to client affiliates.
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CL 2	NYSSCPA	Where the attest client's combined or consolidated financial statements include those of sister entities or subsidiaries, the proposed interpretation should apply to those entities. We believe that, in situations where the attest client's financial statements do not include affiliates, the proposed interpretation should also be applied to avoid the appearance of prohibited employment. Furthermore, the nonattest services applied to all affiliates of the attest client should be aggregated to determine if a threat to independence of the member or member's firm exists. Failing to do so might allow a member or member's firm to consciously circumvent the letter of the interpretation.
CL 3	NASBA	NASBA does not agree that the service should be provided to the attest client or to client affiliates included in the financial statement reporting entity's financial statements.
CL 4	Crowe LLP	We do not have any specific concerns about applying the proposed interpretation to client affiliates assuming the scope of activities is included in the documented understanding with the client. Including the scope of activities will assist members in evaluating whether the activities are not prohibited by the "Nonattest Services" interpretation. See our response to question #2 about including scope of activities to the documented understanding with the client.
CL 5	Plante Moran PLLC	No, we do not have any concerns regarding the application of this proposed interpretation to client affiliates.
CL 6	Grant Thornton	Grant Thornton does not have any concerns regarding the application of the proposed interpretation to client affiliates. We would expect that the AICPA's exception to the "Independence Rule" under paragraph .02(b) of AICPA Interpretation ET section 1.224.010 would still apply.
CL 7	Clifton Larson Allen	We believe that the AICPA Code of Professional Conduct as currently written addresses nonattest services provided to clients and client affiliates. We do not have any concerns regarding the application of this proposed ET to client affiliates.
CL 8	GAO	We are not providing comments in response to this question.
CL 9	BDO	No. We do not have any concerns regarding application of the proposed interpretation to client affiliates and believe the exceptions afforded in Interpretation 1.224.010.02.b, Client Affiliates are appropriate for staff augmentation services.

CL 10	Baker Tilley Virchow Krause	If the services are provided to an entity that is part of a consolidated or combined group for financial reporting purposes, then all of these provisions should apply. If the affiliate is not part of the financial reporting, then the current guidance provided in ET 1.224 should be sufficient for members to consider specific situations.
CL 11	KPMG	We support the application of the proposed interpretation to client affiliates in the same manner as all other nonattest services, including the exception to the client affiliate interpretation at ET 1.224.010.02.b Affiliates.

Q4: Do you foresee any hardships or regulatory issues that are created by the proposal? If so, please explain.

CL 1	TIC	TIC does have some questions related to employment law that we address in our response to question 5 below. TIC was not aware of any additional hardships or regulatory issues related to private companies that would be created by this proposal.
CL 2	NYSSCPA	The Society recognizes that a hardship might exist if the issuance of the proposed interpretation results in the loss of the staff augmentation or attest service to a member or member's firm. However, we also believe that providing staff augmentation services created self-review threats long before the proposed interpretation was issued and, as such, firms should have already made some of the determinations required by the interpretation. Accordingly, we believe that the loss of one or the other services will be minimal and should not be a determining factor in PEEC's decision to finalize this proposed interpretation.
CL 3	NASBA	As noted above, NASBA believes that both members and State Board regulators would struggle to apply and enforce the proposed interpretation. Similarly, bodies such as professional ethics committees of state CPA societies, the PEEC and AICPA Joint Trial Board will likely find it difficult to apply. We foresee the rule's application by all these parties will be far from uniform.
CL 4	Crowe LLP	We do not foresee any specific hardships or other concerns in applying this proposal assuming the scope of activities is included in the documented understanding with the client. If the scope of activities is not documented, we believe there may be challenges in ensuring the augmented staff does not perform activities that would be prohibited by the "Nonattest Services" interpretation.

CL 5	Plante Moran PLLC	No, we did not identify any additional hardships or regulatory issues, other than those discussed elsewhere in our response that would be created by this proposal.
CL 6	Grant Thornton	Grant Thornton does not foresee any hardships or regulatory issues that may be created by the proposal. However, we suggest that PEEC consider incorporating a statement that the member should refer to and consider their obligations under other applicable laws, regulations and rules, such as those applicable to tax services.
CL 7	Clifton Allen Larson	Other than diversity in practice that could be created by use of terms such as short period of time we do not foresee any additional hardships or regulatory issues created by the proposed interpretation.
CL 8	GAO	We do not foresee any hardships or regulatory issues that are created by the proposal.
CL 9	BDO	No. We do not foresee any such hardships or regulatory issues.
CL 10	Baker Tilley Virchow Krause	<p>One of the continuing issues in the profession is the problems incurred by members when switching between attest services provided for entities subject only to AICPA independence rules and entities subject to SEC independence rules. We have seen this most recently within the broker-dealer audit practice when these audits became subject to the SEC rule. There were numerous independence violations related to the provision of permitted AICPA nonattest services, which were prohibited SEC non-audit services. Providing this guidance will not help, as the SEC, as noted in the exposure draft, has come out strongly against such services and has liberally interpreted them as “acting as an employee,” and therefore prohibited.</p> <p>PEEC should continue to provide additional tools and guidance to reinforce the significant differences that exist between SEC and AICPA rules in order to try to avoid more violations. In addition, PEEC should consult with the Government Accountability Office to determine whether this guidance will fit within its independence requirements so as to avoid another situation where the auditors have the potential of inadvertently violating a different regulator’s rules.</p>
CL 11	KPMG	We do not foresee any hardships or regulatory issues that are created by the proposal.

Q5: Do you agree with PEEC’s approach to address the appearance of prohibited employment set forth in paragraphs .03–.05? If not, please explain what you believe would be a better approach.

<u>CL 1</u>	TIC	<p>TIC has questions as to whether this ED could create additional co-employment risk in employment law. TIC would suggest ensuring that an employment attorney review this ED as written to ensure there are no unintended legal consequences. TIC has discussed this issue with the ethics staff in advance of this letter and is happy to discuss further.</p> <p>TIC also is concerned that this ED requires additional safeguards, where the safeguards that already are in place in ET sections 1.210 and 1.295 are adequate to address issues related to staff augmentation.</p>
<u>CL 2</u>	NYSSCPA	The approach to address the appearance of prohibited employment set forth in paragraph .03 through .05 is appropriate.
<u>CL 3</u>	NASBA	NASBA does not believe there are any safeguards a firm could apply to effectively mitigate threats to independence (either in fact or appearance) under this proposal.
<u>CL 4</u>	Crowe LLP	The approach outlined appears appropriate.
<u>CL 5</u>	Plante Moran PLLC	Paragraph .04a-d of the proposed interpretation details specific situations which would automatically impair independence as the accounting firm staff would appear to be an employee of the client, conflicting with ET-1.275.005 Simultaneous Employment or Association with the Attest Client. As the interpretation is worded, these situations are only prohibited when “staff augmentation” services are provided and would not automatically impair independence in other nonattest service arrangements. We agree that the unique aspects of staff augmentation services warrant the additional safeguards. Therefore, as previously communicated in our response to question two, “staff augmentation services” needs to be clearly defined in the interpretation. Otherwise members will need to apply professional judgement as to when these additional prohibitions will or will not be applicable, resulting in inconsistent application of the proposed standard.
<u>CL 6</u>	Grant Thornton	Grant Thornton agrees with PEEC’s approach to address the appearance of prohibited employment set forth in paragraphs .03-.05.
<u>CL 7</u>	Clifton Larson Allen	While we understand the connection between the staff augmentation arrangements and the appearance of prohibited employment, the factors, threats and safeguards in pars .03-.05 are not directly related to nonattest services. We suggest moving the information in pars .03-.05 to ET Sec. 1.275.005 Simultaneous Employment or Association With an Attest Client. There could be cross

		references between this new ET and the existing ET 1.275.005 to ensure consideration in both sections of the Code.
CL 8	GAO	<p>The proposed interpretation discusses evaluating the appearance of prohibited employment with the attest client in paragraph .03. However, the proposal does not indicate what threats a member should consider when evaluating the appearance of prohibited employment. The proposal also does not indicate what a member should conclude if he or she determines that there is an appearance of prohibited employment. We believe that members should consider any threat posed by the appearance of prohibited employment to be a significant threat.</p> <p>Accordingly, members should apply safeguards to eliminate the threat or reduce it to an acceptable level and document the identified threat and safeguards applied. We also believe that the interpretation could benefit from additional guidance on the term appearance. While the definition of independence in appearance (ET section 0.400.21.b) discusses a reasonable and informed third party who has knowledge of all relevant information, there is no guidance on the word appearance in the proposed interpretation.</p>
CL 9	BDO	We believe more examples as to the factors that may affect the appearance of prohibited employment should be included as noted in our response to question six.
CL 10	Baker Tilley Virchow Krause	The considerations provided in paragraph .03 are useful, but it is not clear whether these situations are ones that cannot be managed by applying safeguards. More clarity here would be useful.
CL 11	KPMG	See our comments in the overall considerations section as well as the response to Question 7 below.

Q6: Do you suggest any additional factors for evaluation of the appearance of prohibited employment that PEEC should consider?

CL 1	TIC	TIC believes that the use of the term “frequency” in paragraph .03c of the ED will result in similar concerns and consequences as using the term “short period.” For example, paragraph .02d of the ED indicates that “the duration of the arrangement is for a short period of time” is a required safeguard. Paragraph .03 of the ED indicates the factors that should be considered are “the duration” (paragraph .03a) and the frequency (paragraph .03c). TIC believes that this language implies that the duration and frequency have to be considered together. Following this logic, providing augmented staffing services
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		<p>five days a week for one week might be acceptable, but, providing those services two days a week for two years might not be acceptable. If duration and frequency are individually considered (as they would be in Paragraph .02), the result may be different than if considering them together.</p> <p>Therefore, TIC would suggest that paragraph .02d be eliminated from the ED and the concepts in paragraphs .03a and .03d be combined. This approach probably would narrow the range of possible outcomes even though, individually, the terms are still vague.</p>
CL 2	NYSSCPA	<p>Other factors that might be addressed in evaluating the appearance of prohibited employment include:</p> <ul style="list-style-type: none"> - The existence of a permanent, dedicated workspace (office, cubicle, etc.) on the client's premises; or - The member's staff participation in company events or activities reserved for the client's employees only.
CL 3	NASBA	<p>NASBA suggests the PEEC not move forward with this proposal. If the AICPA staff are receiving inquiries on these services, PEEC may wish to consider frequently-asked questions or other nonauthoritative guidance to address the independence implications of such arrangements.</p>
CL 4	Crowe LLP	<p>We agree with the list of factors provided and believe the following additional factors should be considered:</p> <p>Paragraph .03 - We believe the size of the client organization should be a consideration. Threats would likely be greater at smaller client organizations since there would be more reliance on the augmented staff and greater chances of the appearance of dual employment. However, if this factor is added to the interpretation, consideration of potential safeguards may be warranted.</p> <p>Paragraph .03 - To address the appearance of dual employment, we believe augmented staff should be provided the same type of access and privileges provided to vendors. If augmented staff are provided the same level of access and privileges as employees, there could be the appearance of dual employment.</p> <p>Paragraph .04 – We believe augmented staff should be restricted from having direct contact with the client's customers, clients, vendors, or service providers as access to those individuals would appear to be holding the staff out as employees and also may put them in a position for being responsible for making management decisions.</p>

CL 5	Plante Moran PLLC	No, we do not have any additional suggestions for evaluation of the appearance of prohibited employment services.
CL 6	Grant Thornton	Grant Thornton has no additional factors to suggest for evaluation.
CL 7	Clifton Larson Allen	We do not have suggestions of any additional factors for evaluation related to the appearance of prohibited employment for PEEC to consider.
CL 8	GAO	We believe that the factors listed in the proposed interpretation for evaluating the appearance of prohibited employment are sufficient.
CL 9	BDO	<p>We recommend additional factors should be included along with examples as noted below.</p> <p><i>The Reason for the Augmentation Arrangement</i> The reason for the augmentation arrangement may affect the appearance of independence. For example, an audit client's employee responsible for monthly closings may be absent for a month due to emergency medical leave. In this case a reasonable and informed third party may find it acceptable for the firm to augment staff to the attest client. However, if the augmentation is for the same period (one month), yet the staff augmentation was due a less urgent matter, such as a pending retirement of the respective employee of the attest client, it may have the appearance that the augmented staff is acting as an employee.</p> <p><i>Size and Complexity of The Client's Operations</i> The size of the attest client and/or complexity of operations or financial reporting requirements may affect how the duration of the staff augmentation arrangement impacts the appearance of prohibited employment. For example, if the attest client requires a significant amount of time from the firm due to the large size and highly complex nature of the organization's operations and/or reporting requirements, a staff augmentation arrangement for six months may appear acceptable to a reasonable and informed third party. However, an augmentation engagement of the same length of time may not appear to be as appropriate if the client is smaller with less complex accounting and/or operational and financial reporting needs.</p>
CL 10	Baker Tilley Virchow Krause	Situations where the client is directing all of the activities of the loaned staff are risky as the potential for engagement creep is high. Clients are not expected to know or understand all of the rules related to nonattest services; in fact, in many situations with augmented staff, the staff do not understand all of the rules. As such, without some mechanism for the member to monitor what the staff is doing, it is

		possible that the staff will perform prohibited nonattest services. The longer the duration of the assignment, the more likely it is that this will occur as the line between augmented staff and employee is likely to blur, particularly in situations which require daily work over a longer period of time.
CL 11	KPMG	See our response to Question 7 for additional considerations with respect to the appearance of prohibited employment.

Q7: Do you suggest any other safeguards that PEEC should consider to reduce threats to an acceptable level?

CL 1	TIC	No. TIC could not think of any additional safeguards that PEEC should consider to reduce threats to an acceptable level.
CL 2	NYSSCPA	The Society suggests PEEC consider adding a specific prohibition against the staff being paid directly by the client, either in the form of general compensation or a bonus. All fees for the staff augmentation arrangement should be billed by the member's firm or the member, if a sole proprietor.
CL 3	NASBA	NASBA does not believe that additional safeguards would be effective in mitigating threats to independence caused by staff augmentation arrangements as described in the Exposure Draft.
CL 4	Crowe LLP	See our responses to question #2 and #3 about including the scope of activities in the documented understanding with the client.
CL 5	Plante Moran PLLC	No, we do not have any other suggested safeguards that should be considered to reduce independence threats to an acceptable level.
CL 6	Grant Thornton	Grant Thornton has no other safeguards to suggest for consideration.
CL 7	Clifton Larson Allen	We do not have any additional safeguards for PEEC to consider to reduce threats to an acceptable level.

CL 8	GAO	<p>Another safeguard that PEEC could consider to reduce threats to an acceptable level is having another firm re-perform the nonattest service that the augmented staff member performed to the extent necessary to enable the other firm to take responsibility for the service.</p> <p>Also, we encourage PEEC to clarify the safeguards listed in paragraph .02 of the proposed interpretation. In paragraph .02, the proposed interpretation requires client management to designate an individual or individuals who possess suitable skill, knowledge, and experience. However, the proposal does not provide any definitions or indicators that members could use to evaluate and determine whether a designated individual has suitable skills, knowledge, and experience. In the absence of indicators or definitions, the application of this safeguard could vary greatly among members.</p>
CL 9	BDO	No. We are not aware of any other safeguards.
CL 10	Baker Tilley Virchow Krause	See comments in 6 for suggestions as to a need for safeguards. As mentioned above, a mechanism for the member to monitor the activities of the augmented staff, in addition to the length of time of the engagement, are key to reducing threats to an acceptable level.
CL 11	KPMG	<p>We believe that familiarity threats may exist in addition to management participation threats in the performance of nonattest services under staff augmentation arrangements. We recommend a paragraph highlighting such threats along with potential safeguards. Para. .05a of the proposed interpretation provides a safeguard against familiarity threats.</p> <p>We believe that the level and experience of the individual(s) who will participate on the staff augmentation engagement impact the threats associated with management participation and familiarity. If personnel are limited to non-management or staff level personnel, threats may be reduced as a result. Therefore, limiting the level of personnel on a staff augmentation engagement may be an effective safeguard.</p> <p>Finally, we recommend that language should be added to indicate that some situations may require multiple safeguards be applied to eliminate or reduce the threat(s) to an acceptable level.</p>

**Professional Ethics Executive Committee
Staff Augmentation Task Force
Comment Letter Analysis**

General Comments

- 3 of 11 commenters do not agree with adoption of an interpretation as proposed but recommend that FAQ be issued instead.
- 4 of 11 commenters supported the proposal but recommended additional guidance in the form of FAQ and/or examples to support the proposal.
- 3 of 11 commenters support adoption of an interpretation.
- 1 commenter (Baker Tilley) did not submit general comments.

Responses to Specific Questions in Exposure Draft

Q1: Do you agree that the duration of the arrangement should be addressed in paragraph .02, and do you agree with the term short period of time? Are there other terms that you recommend PEEC consider that would be more appropriate and better understood?

- 6 commenters did not agree with use of the term “short period of time” as it is ambiguous / vague and could be widely interpreted.
- 7 commenters suggested a FAQ specifically addressing the duration of the engagement if the concept remains in an issued interpretation, including examples.
- There were no alternative terms suggested by commenters to describe the duration.

Q2: Do you agree that staff augmentation is a nonattest service and that the proposed interpretation should be placed in ET section 1.295? If not, please explain where you believe it would be better placed.

- 10 of 11 commenters agreed that the proposal should be placed in ET Section 1.295 if adopted.
- 1 commenter (NASBA) did not support the proposal as a whole and did not provide a specific response.

Q3: Do you have any concerns regarding application of the proposed interpretation to client affiliates? If so, please specify the type of affiliate (that is, parent, subsidiary, or sister entity), and describe the concerns and related threats and potential safeguards.

- 8 commenters did not have any specific concerns in applying the interpretation to affiliates.
- 1 commenter (GAO) did not provide a response.
- 1 commenter (NASBA) did not agree that such services should be provided to affiliates of an attest client.

Q4: Do you foresee any hardships or regulatory issues that are created by the proposal? If so, please explain.

- 9 commenters did not foresee any hardships or regulatory issues not addressed elsewhere in their responses to questions or general comments.
- Other commenters noted the following potential hardships:
 - Loss of staff augmentation services or attest services client (NYSSCPA)
 - Lack of uniformity in application and enforcement of the interpretation (NASBA)
 - If the scope of activities is not documented...there may be challenges in ensuring the augmented staff does not perform activities that would be prohibited by the “Nonattest Services” interpretation. (Crowe)
 - PEEC should consider incorporating a statement that the member should refer to and consider their obligations under other applicable laws, regulations and rules, such as those applicable to tax services. (Grant)

- Diversity in practice created by use of the terms such as “short period of time” (CLA)
- Application of multiple sets of rules: Providing this guidance will not help, as the SEC, as noted in the exposure draft, has come out strongly against such services and has liberally interpreted them as “acting as an employee,” and therefore prohibited. PEEC should continue to provide additional tools and guidance to reinforce the significant differences that exist between SEC and AICPA rules in order to try to avoid more violations. In addition, PEEC should consult with the Government Accountability Office to determine whether this guidance will fit within its independence requirements so as to avoid another situation where the auditors have the potential of inadvertently violating a different regulator’s rules. (Baker Tilley)

Q5: Do you agree with PEEC’s approach to address the appearance of prohibited employment set forth in paragraphs .03–.05? If not, please explain what you believe would be a better approach.

- 1 commenter (TIC) noted the risk of “co-employment”
- 3 commenters agreed with the approach in paragraphs .03-.05.
- 3 commenters requested additional clarity in the form of examples / definitions
- 1 commenter (CLA) suggested moving the provisions of .03-.05 to the Simultaneous Employment or Association with an Attest Client interpretation (ET Sec 1.275).
- 1 commenter (GAO) noted that there should be more clarity surrounding the idea of appearance, and that the interpretation does not indicate what threats are to be evaluated as it relates specifically to the appearance of simultaneous employment.
- 1 commenter (NASBA) did not believe that any safeguards could reduce threats to an acceptable level.

Q6: Do you suggest any additional factors for evaluation of the appearance of prohibited employment that PEEC should consider?

- 1 commenter (NASBA) indicated it did not believe PEEC should move forward with the proposal.
- 4 commenters did not have any suggested additional factors.
- (TIC) noted that Paragraph .03 of the ED indicates the factors that should be considered are “the duration” (paragraph .03a) and “the frequency” (paragraph .03c). TIC believes that this language implies that the duration and frequency have to be considered together. Following this logic, providing augmented staffing services five days a week for one week might be acceptable, but, providing those services two days a week for two years might not be acceptable. If duration and frequency are individually considered (as they would be in Paragraph .02), the result may be different than if considering them together. Therefore, TIC would suggest that paragraph .02d be eliminated from the ED and the concepts in paragraphs .03a and .03d be combined. This approach probably would narrow the range of possible outcomes even though, individually, the terms are still vague.
- Factors noted by other commenters:
 - (NYSSCPA) The existence of a permanent, dedicated workspace (office, cubicle, etc.) on the client’s premises; or the member’s staff participation in company events or activities reserved for the client’s employees only.
 - (Crowe) Paragraph .03 - The size of the client organization should be a consideration. Threats would likely be greater at smaller client organizations since there would be more reliance on the augmented staff and greater chances of the appearance of dual employment. However, if this factor is added to the interpretation, consideration of potential safeguards may be warranted.
 - (Crowe) Paragraph .03 - To address the appearance of dual employment, augmented staff should be provided the same type of access and privileges provided to vendors. If

- augmented staff are provided the same level of access and privileges as employees, there could be the appearance of dual employment.
- (Crowe) Paragraph .04 – Augmented staff should be restricted from having direct contact with the client’s customers, clients, vendors, or service providers as access to those individuals would appear to be holding the staff out as employees and also may put them in a position for being responsible for making management decisions.
 - (BDO) Additional factors to be considered include the reason for the augmentation arrangement and the size and complexity of the client’s operations. (Examples in CL summary)
 - (Baker Tilley) The risk of scope creep is high when staff/client are not aware of or do not understand the rules; without some mechanism for the member to monitor what the staff is doing, it is possible that the staff will perform prohibited nonattest services. The longer the duration of the assignment, the more likely it is that this will occur as the line between augmented staff and employee is likely to blur, particularly in situations which require daily work over a longer period of time.

Q7: Do you suggest any other safeguards that PEEC should consider to reduce threats to an acceptable level?

- 5 commenters did not suggest any additional safeguards.
- 1 commenter (NYSSCPA) recommends a specific prohibition against the staff being paid directly by the client, either in the form of general compensation or a bonus. All fees for the staff augmentation arrangement should be billed by the member’s firm or the member, if a sole proprietor.
- 1 commenter (GAO) suggested having another firm re-perform the nonattest service that the augmented staff member performed to the extent necessary to enable the other firm to take responsibility for the service. The GAO further noted that the proposal does not provide any definitions or indicators that members could use to evaluate and determine whether a designated individual has suitable skills, knowledge, and experience.
- 1 commenter (KPMG) recommended a paragraph highlighting management participation threats along with potential safeguards. Para. .05a of the proposed interpretation provides a safeguard against familiarity threats. KPMG also indicated that limiting the level of personnel on a staff augmentation engagement may be an effective safeguard.
- 1 commenter (KPMG) recommended that language should be added to indicate that some situations may require multiple safeguards be applied to eliminate or reduce the threat(s) to an acceptable level.

Text of Proposed “Staff Augmentation Arrangements” Interpretation

1.295.157 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” (ET sec. 1.200.001) may exist.
- .02 Threats to compliance with the “Independence Rule” (ET sec. 1.200.001) would not be at an acceptable level, and independence would be impaired unless, in addition to applying the “General Requirements for Performing Nonattest Services” interpretation (ET sec. 1.295.040), all 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 provided by the individual performing the augmented staff services (the “augmented staff”);
 - ii. supervising and overseeing the activities performed by the augmented staff; and
 - iii. evaluating the adequacy of the activities performed by the augmented staff and the findings resulting from the activities.
 - b. The activities do not result in the augmented staff assuming management responsibilities as described in the “Management Responsibilities” interpretation (ET sec. 1.295.030) of the “Independence Rule” (ET sec. 1.200.001).
 - c. The augmented staff performs only activities that would not otherwise be prohibited by the “Nonattest Services” interpretation (ET sec. 1.295.000) of the “Independence Rule” (ET sec. 1.200.001).
 - d. The duration of the arrangement is for a short period of time.
- .03 In all circumstances, the member should consider whether the staff augmentation arrangement creates the appearance of prohibited employment with the attest client. (See the “Simultaneous Employment or Association with an Attest Client” interpretation [ET sec. 1.275.005] of the “Independence Rule” [ET sec. 1.200.001]). When evaluating the appearance of prohibited employment with the attest client, the member should consider factors such as the following:
 - a. The duration of the staff augmentation arrangement
 - b. Whether the augmented staff will provide services to other clients during the period of the arrangement
 - c. The frequency with which the augmented staff will perform activities at the attest client’s location (for example, daily)
 - d. Whether the arrangement is discrete or recurring in nature, and if recurring, the frequency of such recurrence
- .04 However, threats to compliance with the “Independence Rule” (ET sec. 1.200.001) would not be at an acceptable level and independence would be impaired if the augmented staff is held out or treated as an employee of the attest client, such as being any of the following:
 - a. Listed as an employee in the attest client’s directories or other attest client publications
 - b. Referred to by title or description as supervising or being in charge of any business function of the attest client
 - c. Identified as an employee of the attest client in correspondence such as email, letterhead, or internal communications

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- d. Able to participate in compensation or benefit plans (including health or retirement plans) of the attest client
- .05 The significance of any threats should be evaluated, and safeguards applied, when necessary, to eliminate the threats or reduce them to an acceptable level. These are some examples of such safeguards:
 - a. Not using the augmented staff on the attest engagement team, or not using the augmented staff to perform attest procedures on any areas for which the staff performed activities during the augmented staff arrangement
 - b. Discussion of the threats and any safeguards applied with those charged with governance
 - c. Rotation of individuals performing the staff augmentation activities
 - d. Monitoring the scope of activities performed by augmented staff
- .06 This interpretation is effective six months after notice of adoption is published in the *Journal of Accountancy*. Early implementation is allowed.

Staff Augmentation Arrangements

Question 1: The Staff Augmentation Arrangements Interpretation states that if the staff augmentation arrangement extends beyond one year, there is a rebuttable presumption that the arrangement would not be considered a short period of time and, therefore, *independence* would be *impaired*. Provided all of the other *safeguards* described in par.03 are met, would *threats* be considered at an *acceptable level* if the *member's firm* enters into a staff augmentation arrangement with an *attest client* for a nine-month period (i.e., less than one year)?

Answer 1: It depends. As discussed in the interpretation the *member* must also consider whether the staff augmentation arrangement creates the appearance of employment with the *attest client*. Accordingly, even if the arrangement is for less than one year, the duration of the engagement must also be considered along with the other factors describe in par. .05 of the interpretation in order to determine if *threats to independence* are at an *acceptable level*.

For example, assume a *firm* has been asked by an *attest client* to provide a staff person to work under the *attest client's* direction to assist with an ERP project that is expected to last for a nine- month period. The staff person will be working 2-3 days per week on the project and there will be a period of 3 months during the software customization phase where the staff person will not be needed. When not working on the project, the staff person will be assigned to work on other *firm clients*. Assuming there are no other circumstances that would create the appearance of employment, it would appear reasonable to conclude that *threats to independence* would be at an *acceptable level* with this staff augmentation arrangement.

On the other hand, assume the *attest client* requests that the staff person work on the ERP project on a full-time basis (i.e., 5 days per week) for the entire nine-month period. Under this scenario, the *threats to independence* and the appearance of employment would be significant and the *member* would need to determine whether *safeguards* could be applied to reduce *threats* to an *acceptable level*.

Question 2: The Staff Augmentation Arrangements Interpretation provides factors to be considered when evaluating the appearance of employment with the attest client. An audit client has requested that the firm provide augmented staff to provide accounting assistance due to the unexpected departure of one of the client's accountants. How should these factors be applied in determining whether the staff augmentation arrangement would create a significant threat to independence due to the appearance of employment?

Answer 2: Assume the following scenarios:

Scenario 1: The attest client is in need of accounting assistance due to an unexpected leave of absence by one of their accountants who is expected to return to work in three months. The augmented staff is expected to work at the *attest client's office* three days a week for the three month period until the accountant returns. When not working at the attest client, the staff person will be assigned to work on other *firm clients*. Assuming there are no other circumstances that would create the appearance of employment, and all *safeguards* of par.03 are met, it would appear reasonable to conclude that *threats to independence* would be at an *acceptable level* with this staff augmentation arrangement. Specifically, the duration of the arrangement is for a fairly short period and is discrete in nature since it will terminate once the employee returns from his/her leave of absence.

Scenario 2: Assume that the *attest client* is in need of accounting assistance due the unexpected resignation of one of its accountants and the client has decided not to hire an employee to replace the accountant. Instead, the client has determined it would be more cost effective to have the firm provide augmented staff to work two weeks each month at the client's office (one week at the beginning of each month preparing monthly reconciliations and one week at the end of each month assisting with the monthly closing). The arrangement will continue each month throughout the year. When not working with the *attest client*, the staff person will be assigned to work on other *firm clients*. Under this scenario, due to the long duration (i.e., one year) and recurring nature (i.e., monthly) of the arrangement, the threats to independence resulting from the appearance of employment would be considered significant and the *member* would need to determine whether *safeguards* could be applied to reduce *threats* to an *acceptable level*.

Strategy and Work Plan

Task Force Members

Planning Subgroup: Brian Lynch, Samuel Burke, Carlos Barrera, Robert Denham, Lisa Snyder.
Staff: Iryna Klepcha, CPA, Ellen Gorla, CPA (NY) and Toni Lee-Andrews, CPA, CGMA

Task Force Charge

The charge of the task force is to develop a consultation paper, *Strategy and Work Plan*, for review and comment by the AICPA's members and other interested parties. This consultation paper will describe the standard setting, member enrichment, and enforcement projects the Committee plans to undertake. The *Strategy and Work Plan* will identify the issues and the Committee's recommendations as well as the timing of the projects.

Reason for Agenda Item

Staff seeks the Committee's input regarding topics and subtopics for inclusion in the Committee's *Strategy and Work Plan*, location of issues (i.e., standard setting, member enrichment, or enforcement), and timing of projects.

Summary of Issues

Staff drafted potential topics and subtopics for the consultation paper, *Strategy and Work Plan*, for review and comment by the Committee:

1. Standard Setting
 - a. Responding to the restructure of the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants (IESBA code)
 - b. Change to Statements on Standards for Attestation Engagements (SSAEs)
 - c. Business Relationships
 - d. Independence Provisions with a Financial Audit Centric Perspective
 - e. Di Minimis Fees
 - f. 529 College Savings Plans
 - g. General Maintenance of the Code
2. Member Enrichment
 - a. Data Analytics to Identify Member Enrichment Opportunities
 - b. Interlinkage between the FAQs and the Code
 - c. IESBA Independence Comparison
 - d. Artificial Intelligence (AI)
 - e. Assisting Attest Clients with Implementing Accounting Standards
 - f. Data Security
 - g. GAGAS Independence Comparison
 - h. Conflicts of Interest
3. Enforcement
 - a. Collaboration with Peer Review Division for Effective and Efficient Member/Firm Remediation
 - b. Effect on Automatic Sanctioning with Changes in Office of Professional Responsibility Enforcement

c. Reviewing the Automatic Sanctioning Guidelines for Consistency

Action Needed

The Committee is asked to provide the feedback requested as well as to raise any concerns with the recommendations included in this agenda item.

Materials Presented

Agenda Item 5B – Strategy and Work Plan Topics and Issues

Agenda Item 5C – Timing of Projects in the Current Three-Year Project Agenda

Strategy and Work Plan Topics and Issues

Standard Setting

Responding to the restructure of the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants (the IESBA code)

Issue

An increase in the number of multinational audits being performed by U.S. firms means that auditors should be familiar with the IESBA Code in addition to the AICPA Code. What is the extent that firms are relying on the AICPA Code when these codes are not in alignment? What are the potential gaps?

Change to Statements on Standards for Attestation Engagements (“SSAEs”)

Issue

The following is a summary of the most significant proposed changes to the SSAEs that affect only agreed-upon procedures engagements:

- *Responsibility for the procedures performed.* Extant AT-C section 215 is premised on specified parties determining the procedures to be performed by the practitioner and assuming responsibility for the sufficiency of the procedures. The proposed SSAE allows the practitioner, the engaging party, or any other party to develop the procedures. The practitioner would be required to obtain from the engaging party, prior to the issuance of the practitioner’s report, a written acknowledgment that the procedures performed are appropriate for the intended purpose of the engagement—but would not be required to obtain acknowledgment about the sufficiency of the procedures. If the practitioner is unable to obtain that acknowledgment, the practitioner would be required to withdraw from the engagement. Although there is no requirement to obtain acknowledgement from parties other than the engaging party, the practitioner is not precluded from doing so, and the proposed SSAE, similar to extant AT-C section 215, includes application guidance for situations in which a practitioner may wish to obtain such acknowledgments from other parties.
- *Revises when the use of a practitioner’s agreed-upon procedures report needs to be restricted.* The proposed SSAE would no longer require the practitioner to restrict the use of all agreed-upon procedures reports to the specified parties that assume responsibility for the sufficiency of the procedures. The requirement to restrict the use of the report would apply only if the practitioner is precluded from designing or performing additional procedures, the criteria are not available to users, or the criteria are appropriate only for a limited number of users. Similar to reporting under AT-C sections 205 and 210, a practitioner would have the option of restricting the use of the report to certain parties.

The change of position regarding the responsibility for the procedures performed and the use of the report will effective on or after July 15, 2021.

Staff notes that the requirement to issue a restricted use report was a factor considered by the PEEC when developing the modifications to independence as outlined in paragraphs .03 and .04

of the Agreed-Upon Procedure Engagements Performed in Accordance With SSAEs interpretation. Should the changes to AT-C section 215 (AUPs) to allow for the issuance of general use reports result in a change to any of the interpretations in the “Independence Standards for Engagements Performed in Accordance with Statements on Standards for Attestation Engagements” subtopic?

Business Relationships

Issue

The “Cooperative Arrangements with Attest Clients” interpretation (1.265.010) focuses on cooperative arrangements with an attest client. However, potential business relationships, such as subcontracting or teaming arrangements, alliances, or ordinary course of business, may create threats to compliance with the “Independence Rule”. Additionally, if a member has business relationships with the nonattest client, such as finance and accounting outsourcing, threats to compliance with the “Integrity and Objectivity Rule” may arise, depending on the significance of the business relationships. Is there adequate guidance related to business relationships in the Code?

Independence Provisions with a Financial Audit Centric Perspective

Issue

Some independence interpretations take a financial audit centric perspective (see below for the interpretations identified at the May 2019 PEEC meeting). How should this guidance be applied for non-financial statement engagements?

The “Client Affiliate” interpretation (1.224.010) states that financial interests in, and other relationships with, affiliates of a financial statement attest client may create threats to a *member’s* compliance with the “Independence Rule”. A financial statement attest client is defined as an entity whose financial statements are audited, reviewed, or compiled when the member’s compilation report does not disclose a lack of independence.

The “Entities Included in State and Local Government Financial Statements” interpretation (1.224.020) refers to the audits of financial statements of state and local governments.

Paragraph .04 of the “Scope and Applicability of Nonattest Services” interpretation (1.295.010) provides examples of attest services that are financial statement oriented.

The “Information Systems Design, Implementation, or Integration” interpretation (1.295.145) has a financial audit centric perspective. For example, paragraph .03 of the interpretation prohibits the design or development of an attest client’s financial information system or making significant modifications to the source code underlying an attest client’s existing financial information system.

The “Consenting to the Use of a Previously Issued Report” interpretation (1.226.010) provides an example of procedures required by applicable professional standards when the member is focused on the financial statements.

Di Minimis Fees

Issue

The materiality concept is used in subtopic 1.240 Financial Interests while the “Unpaid Fees” interpretation (1.230.010) does not refer to materiality. Should areas such as unpaid fees and financial interests have similar provisions? Should a di minimis fee provision extend to non-audit services?

529 College Savings Plans

Issue

According to the Code, a covered member who is the account owner of a Section 529 prepaid tuition plan has a direct financial interest in the plan. However, the account owner does not have any financial interest in a Section 529 prepaid tuition plan’s underlying investments because the credits purchased represent an obligation of the state or educational institution to provide the education regardless of the plan’s investment performance or the cost of the education at the future date.

A covered member who is owner of a Section 529 savings plan is considered to have a direct financial interest in both the plan and the plan’s underlying investments because the account owner elects which sponsor’s Section 529 savings plan to invest in, and prior to making the investment decision, the covered member has access to information about the plan’s investment options or funds.

Identifying and evaluating whether the underlying investments in Section 529 plans are considered to be the covered member’s direct financial interest or indirect financial interest is challenging. Does the owner of a Section 529 savings plan really have a direct financial interest in both the plan and the underlying investments, considering that the underlying investments are in age-based funds?

General Maintenance of the Code

Issue

The AICPA plans to address matters related to the general maintenance of the Code. The need for these matters may be identified via member enrichment (e.g., Ethics hotline) or by other means.

Examples of these matters may include clarifications of certain interpretations of the Code and use of consistent definitions. Currently three items that fall under this umbrella have been identified:

- Records requests. The PEEC plans to discuss drafting an FAQ to clarify whether the intention is to allow the member to charge for copying original records before returning them.
- Definition of Sister Entity Affiliate. In the Code, the definition of affiliates includes a sister entity of a financial statement attest client if the financial statement attest client and sister entity are each material to the entity that controls both. The PEEC plans to discuss whether an FAQ should be drafted to extend the definition of Sister Affiliate to individuals.
- Definition of Office. The AICPA Code defines an office as “a reasonably distinct subgroup within a firm, whether constituted by formal organization or informal practice, in which personnel who make up the subgroup generally serve the same group of clients or work

on the same categories of matters. Substance should govern the office classification. For example, expected regular personnel interactions and assigned reporting channels of an individual may well be more important than an individual's physical location." The PEEC plans to discuss whether an FAQ should be drafted to clarify the definition.

Member Enrichment

Data Analytics to Identify Member Enrichment Opportunities

Issue

Data analytics help organizations harness their data and use it to identify new opportunities. That, in turn, leads to smarter business moves, more efficient operations, and happier customers. Is it possible for the AICPA to use a data analytics tool to identify opportunities for member enrichment?

Interlinkage between the FAQs and the Code

Issue

There are references to nonauthoritative guidance materials throughout the Code, and cross references in the nonauthoritative guidance back to the Code. The hyperlinks included in the Code and nonauthoritative guidance bring members to the appropriate document instead of bringing them to the appropriate paragraph or item within the documents.

IESBA Independence Comparison

Issue

An increase in the number of multinational audits being performed by U.S. firms means that auditors should be familiar with the IESBA Code in addition to the AICPA Code. To what extent are firms relying on the independence provisions of the AICPA Code when the codes are not in alignment? Should the differences between the two codes be identified and if so, should standard setting or member enrichment projects or both be undertaken to ensure members are aware of these differences?

Artificial Intelligence ("AI")

Issue

AI is technology that enables computers to perform decision-based tasks previously performed by humans. Can AI remain objective while assisting member's attest and nonattest clients with professional services? To what extent can members discharge the responsibilities to AI? Is the data produced by AI accurate and reliable? Does using AI, while performing professional services, increase threats to members' compliance with the "Integrity and Objectivity Rule" and "Competence" interpretation of the "General Standards Rule"? What safeguards can be applied, if any, to eliminate those threats or bring them to an acceptable level?

Assisting Attest Clients with Implementing Accounting Standards

Issue

ASC 606, *Revenue from Contracts with Customers*, was issued jointly by the Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board ("IASB") on May 28, 2014. For public entities, the new guidance on revenue recognition was effective for annual reporting periods after December 15, 2017, including interim reporting periods within that

reporting period. For nonpublic companies and organizations (including not-for-profits), the new guidance will be required for annual reporting periods beginning after December 15, 2018, and interim and annual reporting periods after those reporting periods.

ASC 842, *Leases*, was added by ASU 2016-02 on February 25, 2016. It is effective for public business entities for annual periods beginning after December 15, 2018 (i.e., calendar periods beginning on January 1, 2019), and interim periods therein. For all other entities, ASC 842 will be effective for annual periods beginning after December 15, 2019 (i.e., calendar periods beginning on January 1, 2020), and interim periods thereafter.

What assistance do attest clients' request from members in relation to accounting standards implementation (e.g., ASC 606, ASC 842) and does this assistance create any significant threats to independence that are not eliminated or reduced to an acceptable level by the interpretations in the Nonattest Services Subtopic (ET sec. 1.295)?

Data Security

Issue

The primary focus of information security is the balanced protection of the confidentiality, integrity, and availability of data while maintaining efficient policy implementation and without disrupting organizational productivity. Are there any ethical responsibilities that members should be required to comply with related to the protection of their client's data or to address data breaches involving client data?

GAGAS Independence Comparison

Issue

In July 2018, the U.S. Government Accountability Office ("GAO") issued a new revision of Generally Accepted Government Auditing Standards, also known as the "Yellow Book". The Yellow Book is designed to help government auditors at the federal, state, and local levels produce high-quality audits that reflect competence, integrity, objectivity, and independence. The AICPA – Yellow Book Independence Comparison document ("Yellow Book Comparison") is dated June 2015. What changes need to be made to Yellow Book Comparison due to the Yellow Book revision? What are the gaps?

Conflicts of Interest

Issue

The AICPA is actively involved in identifying opportunities for member enrichment. The number of inquiries regarding conflicts of interest has increased. Do additional educational materials need to be developed to address this trend?

Enforcement

Collaboration with Peer Review Division for Effective and Efficient Member/Firm Remediation

Issue

The profession relies on the peer review program and the ethics enforcement process to determine that CPA firms are maintaining a high level of quality and that any problems or

deficiencies are addressed. Confidentiality provisions of our Bylaws limit the ethics division and the peer review division's ability to collaborate on remediation at the firm and individual member level. How can cross team collaboration be improved to enhance the efficiency and effectiveness of timely remediation, without breaching confidentiality?

Effect on Automatic Sanctioning with Changes in Office of Professional Responsibility Enforcement

Issue

According to an article posted in Tax Notes on April 1, 2019, "the IRS will be phasing out all attorney positions in its Office of Professional Responsibility and replacing them with non-attorneys, according to current and former OPR employees. Those employees told Tax Notes that acting OPR Director Beverly Babers informed personnel at a March 26 meeting that because the IRS has been successful in having revenue agents and officers interpret laws and regulations, the agency believes OPR no longer needs to hire attorneys to interpret and apply the Circular 230 rules governing practice before the IRS." The Automatic Sanctioning Guidelines cover certain actions taken by approved disciplinary bodies, including OPR. Do changes in OPR have an impact on OPR's status as an "approved disciplinary body"?

Reviewing the Automatic Sanctioning Guidelines for Consistency

Issue

Certain sanctions imposed by state boards (e.g., license revoked, license suspended, license surrendered as a disciplinary measure, etc.) are automatically covered by Bylaw 7.3.2 and are handled by the AICPA's General Counsel's Office. The AICPA uses the Automatic Sanctioning Guidelines to be consistent with the actions taken by the disciplinary body (e.g., state boards). However, some state boards may impose more severe sanctions than other state boards for the same violation by a member. Does this result in inconsistent treatment by the AICPA of its members? Is there a need to revisit the Automatic Sanctioning Guidelines to determine violations, findings or sanctions that should be viewed similar to the approach the Division has taken on matters involving continuing professional education deficiencies?

Timing of Projects in the Current Three-Year Project Agenda

The summary of active projects or initiatives, and commitments in the current PEEC Three-Year Project Agenda Plan has been developed to facilitate the Committee's discussion regarding the timing of future projects to be included in the *Strategy and Work Plan*.

ACTIVE PROJECTS/WORK STREAMS	EXPECTED COMPLETION
Information Technology and Cloud Services	
<i>Core Project</i>	May 2019
<i>Member Enrichment Efforts</i>	August 2019
<i>Communication and Training</i>	December 2020
Responding to Non-Compliance With Laws and Regulations	Ongoing
Independence in State and Local Government Environment	
<i>Core Project</i>	May 2019
<i>Member Enrichment Efforts</i>	August 2019
<i>Communication and Training</i>	December 2020
Inducements	November 2019
Compilation of Pro-Forma and Prospective Financial Information and Selected Procedures Engagements Task Force	
<i>Core Project</i>	May 2019
<i>Potential Related Projects</i>	November 2019
Staff Augmentation	
<i>Core Project</i>	May 2019
<i>Communication and Training</i>	November 2019
SEC Loans Task Force	September 2019
External Board of Director Members	May 2019
IFAC Convergence & Monitoring	Ongoing
Nonattest Services	Ongoing
Enhanced Discipline	Ongoing
Automatic Sanctioning Subgroup (PEEC) & Enhanced Enforcement	Ongoing
Codification of the AICPA Code	Ongoing

ACTIVE PROJECTS/WORK STREAMS	2019								2020											
	Q2	Q2	Q3	Q3	Q3	Q4	Q4	Q4	Q1	Q1	Q1	Q2	Q2	Q2	Q3	Q3	Q3	Q4	Q4	Q4
	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Information Technology and Cloud Services																				
Core project																				
Member enrichment efforts																				
Communication and Training																				
Responding to Non-Compliance With Laws and Regulations	ongoing																			
Independence in State and Local Government Environment																				
Core project																				
Member enrichment efforts																				
Communication and Training																				
Inducements																				
Compilation of Pro-Forma and Prospective Financial Information and Selected Procedures Engagements Task Force																				
Core project																				
Potential related projects																				
Staff Augmentation																				
Core project																				
Communication and Training																				
SEC Loans Task Force																				
External Board of Director Members																				
IFAC Convergence & Monitoring	ongoing																			
Nonattest Services	ongoing																			
Enhanced Discipline	ongoing																			
Automatic Sanctioning Subgroup (PEEC) & Enhanced Enforcement	ongoing																			
Codification of the AICPA Code	ongoing																			

Inducements Task Force**Task Force Members**

Anna Dourdourekas (Chair), Tom Campbell, Sharon Jensen, Peggy Ullmann, and Jennifer Kary, AICPA Staff: Ellen Gorla and Michele Craig

Task Force Objective

Consider the revisions made by the International Federation of Accountants' (IFAC) International Ethics Standards Board for Accountants (IESBA) to the IESBA Code of Ethics for Professional Accountants (the IESBA Code) pertaining to the offering and accepting of inducements and recommend to the Committee the appropriate actions for convergence purposes.

Reason for Agenda

To request the Committee's feedback regarding the actions that the AICPA needs to undertake in order to be in convergence with the IESBA Code.

Summary of Issues***Background***

The IESBA standard sets out a comprehensive framework that covers all forms of inducements and is applicable to both professional accountants in business and professional accountants in public practice in situations involving the offering or accepting of an inducement.

The standard sets out clear expectations for all professional accountants to understand and comply with laws and regulations that prohibit the offering or accepting of inducements in certain circumstances, such as those related to bribery and corruption. It also requires the application of an intent test where inducements are not specifically prohibited by law or regulation, and the application of the conceptual framework in all other circumstances. Enhanced guidance is provided to assist professional accountants in navigating the different situations.

Scope of Convergence

As a member body of IFAC, the AICPA would be considered to have converged with the IESBA standards if the AICPA's standards are not less restrictive than IESBA's standards. This means the guidance in the AICPA's Code must be equal to or more restrictive than the guidance provided in IESBA's Code. In cases where the AICPA's standards are less restrictive, the AICPA is required to identify and undertake actions to adopt and implement the IESBA Code. Adoption includes steps to eliminate or minimize differences between the AICPA and IESBA's standards, and implementation includes promoting proper understanding and use of the IESBA standards in practice.

A comparison of the IESBA standards on inducements to the AICPA Code's guidance related to gifts and entertainment was prepared in order to identify whether there are areas in the AICPA's Code and related interpretations that are less restrictive than the IESBA's standards. In addition to the interpretations in the AICPA Code, Staff also reviewed non-authoritative guidance from both the AICPA and IESBA.

The documents used for this comparison include:

- AICPA's Gifts and Entertainment Interpretations (located in **Agenda Item 6B**)
 - Part 1 Members in Public Practice

- “Offering or Accepting Gifts or Entertainment” interpretation [1.120.010] under the “Integrity and Objectivity Rule” [1.100.001]
 - “Offering or Accepting Gifts or Entertainment” [1.285.010] under the “Independence Rule” [1.200.001]
 - Part 2 Members in Business,
 - “Offering or Accepting Gifts or Entertainment” [2.120.010] under the “Integrity and Objectivity Rule” [2.100.001]
- IESBA’s Offering and Accepting of Inducement Standards (located in **Agenda Item 6C**)
 - Part 2 - Professional Accountants in Business, Section 250 Inducements, Including Gifts and Hospitality
 - Part 3 - Professional Accountants in Public Practice, Section 340 Inducements, Including Gifts and Hospitality
 - Part 4A - Independence for Audit and Reviews, Section 420 Gifts and Hospitality
 - Part 4B - Independence for Other Assurance Engagements, Section 906 Gifts and Hospitality
- [AICPA’s Basis for Conclusion Document Gifts and Entertainment](#) (AICPA Basis for Conclusion)
- [IESBA’s Basis for Conclusions: Revisions to the Code Pertaining to the Offering and Accepting of Inducements](#) (IESBA Basis for Conclusion)
- AICPA General Ethics Frequently Asked Questions (Ethics FAQ)-Campaign Contributions (located in **Agenda Item 6B**)

Independence Guidance

The AICPA’s independence guidance related to gifts and entertainment may be considered more restrictive than IESBA’s inducement guidance because the AICPA’s guidance extends not only to engagement team members but to individuals in a position to influence the attest engagement team. Both the IESBA and AICPA subject firms and network firms to the guidance.

According to the AICPA Basis for Conclusion document the Committee wanted to adopt a more restrictive threshold of “clearly insignificant” for covered members that were closest to the attest engagement (firm, member of the attest engagement team, or individual in a position to influence the attest engagement team) and a less restrictive threshold of “reasonable in the circumstances” for covered members who were more removed from the attest engagement. The AICPA Basis for Conclusion document also points out that the IFAC Code defined “clearly insignificant” as “trivial and inconsequential”, which indicates that the AICPA considered the IESBA’s more restrictive threshold when drafting the gifts and entertainment interpretation for independence.

Non-Independence Guidance

Following is a summary by topic of how the guidance under both Codes compare.

Immediate Family Members and Close Relatives

The IESBA standards extends to an immediate and close family member in that a Professional Accountant must stay alert to inducements to/from the family member and the individual who has a professional relationship with the Professional Accountant. Additionally, the Professional Accountant must advise the family member not to offer or accept an inducement that may influence behavior. While the AICPA does not require members to extend the gifts and entertainment guidance under the “Integrity and

Objectivity Rule” to family members, both the Conceptual Frameworks for Members in Public Practice and for Members in Business include as examples of the familiarity threat, relationships that involve family members. The Conceptual Framework for Members in Public Practice also includes an example of the self-interest threat, relationships that involve a family member. Therefore, members would be expected to apply these Conceptual Frameworks when significant threats are identified involving situations not specifically addressed in the Code.

Definitions/Examples

The IESBA Basis for Conclusion document explains that the definition of “inducement” was meant to be broad and can influence either good or bad behavior, thus going beyond just gifts and entertainment. In addition, the IESBA also considers charitable donations as a form of inducement. The AICPA Code only addresses the offer or acceptance of “gifts” or “entertainment” in its interpretations and on page 3 of the AICPA Basis for Conclusion document, notes that a charitable contribution to a charitable organization is not considered a “gift”.

Requirements for Accepting or Offering Gifts or Entertainment

The AICPA’s interpretation does not require additional steps be taken once the gift or entertainment is deemed reasonable in the circumstances, whereas the IESBA Code requires the application of the Conceptual Framework even if there is no intent to improperly influence behavior and the inducement is *not* trivial or inconsequential.

Evaluation of Relevant Factors to Determine Reasonableness and Intent to Influence Improper Behavior

The IESBA guidance prohibits any inducement that is intended to improperly influence the behavior of the recipient or others that have some relationship to the recipient, whereas the AICPA Code prohibits members from offering or accepting gifts that are not reasonable in the circumstances. Both sets of guidance provide a list of factors for consideration to determine if the gift or entertainment (inducement) would be prohibited. However, the IESBA guidance is a bit more detailed in that it includes the following additional factors to consider:

- degree of transparency with which the inducement is offered;
- whether the inducement was required or requested by the recipient; and
- the known previous behavior or reputation of the offeror.

Task Force’s Recommendations

The Task Force believes the AICPA is substantively converged with the IESBA’s inducements guidance since:

- The AICPA independence guidance for gifts and entertainment is more restrictive than IESBA’s independence guidance on this topic.
- The AICPA addresses actions with the intent to improperly influence behavior in the Campaign Contributions FAQ that allows for political contributions that are not made with the intention of influencing procurement of professional services.
- The AICPA’s conceptual framework broadly calls for members to consider relationships or circumstances that create threats to the member’s compliance with the rules and provides examples of situations that involve family members.

- The AICPA’s gifts and entertainment interpretation currently uses the threats and safeguard approach when the member is determining whether the gift or entertainment is reasonable combined with the fact that members are required to use the conceptual frameworks for situations that are not addressed by the AICPA Code.

Accordingly, the Task Force does not believe it is necessary for standard setting steps to be taken to eliminate or minimize the differences noted above under the “Integrity and Objectivity Rule”. Rather, the Task Force recommends developing frequently asked questions (FAQs) using the differences identified under the AICPA and IESBA “Integrity and Objectivity Rule”.

- Charitable contributions or donations and provide clarification that (political and charitable) contributions are acceptable if the intent is not to influence the procurement of professional services;
- An example of a situation where an immediate family member or close relative receives or participates in gifts or entertainment and explain that when this gives rise to significant threats, the Conceptual Framework should be consulted;
- Other actions that may benefit an individual or attempt to improperly influence behavior. One situation identified for the possible FAQ is one where a member routinely makes an annual contribution to a political party and their contribution escalates after the client is elected into office;
- An example of a situation where the additional factors included in the IESBA’s guidance (i.e., transparency, requirement, and previous behavior) could be helpful to consider when determining whether a gift would be considered reasonable in the circumstances.

References to the FAQs would be included in the non-authoritative box under the appropriate gifts and entertainment interpretation to promote visibility. The Task Force will ensure the description in these text boxes uses terminology that will appear in the search results indicating that the guidance is available.

Additionally, the Task Force recommends that the Committee consider whether it believes additional issues¹ related to this topic might exist and if so, whether the profession and other interested parties should be asked to provide input on what those potential issues are in the Strategy and Work Plan Discussion Memorandum that is under development.

Question for the Committee

1. Does the Committee agree that the AICPA is substantively converged with the IESBA’s inducements guidance for the reasons outlined above? Are there any other reasons the Committee believes would be important to note? If the Committee does not agree with the recommendation, what other steps does the Committee be taken to achieve convergence?
2. Does the Committee agree with the Task Force’s recommendation that standard setting is not necessary in order for convergence to be achieved, but that convergence could be achieved by issuing FAQs using the differences identified under the AICPA and IESBA “Integrity and Objectivity Rule”?

¹ Issues would include matters under either the independence or integrity and objectivity standards related to gifts, entertainment or other behaviors .

3. Does the Committee agree with the topics that the Task Force will include in the FAQs? If not, what other topics does the Committee recommend that the Task Force incorporate into the FAQs?
4. Does the Committee believe additional issues related to this topic might exist and that it would be important to solicit input from the profession and other interested parties on what those potential issues are in the Strategy and Work Plan Discussion Memorandum that is under development? If so, should the request include input related to the type of member enrichment material the commenter believes would be most helpful?

Action Needed

The Committee is asked to provide its feedback on the Task Force's recommendations for convergence.

Materials Presented

Agenda Item 6B – AICPA Related Standards

AICPA's Gifts and Entertainment Interpretations

Part 1 Members in Public Practice

1.120 Gifts and Entertainment

1.120.010 Offering or Accepting Gifts or Entertainment

- .01 For purposes of this interpretation, a client includes the *client*, an individual in a *key position* with the *client*, or an individual owning 10 percent or more of the *client's* outstanding equity securities or other ownership interests.
- .02 When a *member* offers to a client or accepts gifts or entertainment from a client, self-interest, familiarity, or undue influence *threats* to the *member's* compliance with the "[Integrity and Objectivity Rule](#)" [1.100.001] may exist.
- .03 *Threats* to compliance with the "[Integrity and Objectivity Rule](#)" [1.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards* and the *member* would be presumed to lack integrity in violation of the "[Integrity and Objectivity Rule](#)" in the following circumstances:
 - a. The *member* offers to a client or accepts gifts or entertainment from a client that violate the member's or client's policies or applicable laws, rules, and regulations; and
 - b. The *member* knows of the violation or demonstrates recklessness in not knowing.
- .04 A *member* should evaluate the significance of any *threats* to determine if they are at an *acceptable level*. *Threats* are at an *acceptable level* when gifts or entertainment are reasonable in the circumstances. The *member* should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. The following are examples of relevant facts and circumstances:
 - a. The nature of the gift or entertainment
 - b. The occasion giving rise to the gift or entertainment
 - c. The cost or value of the gift or entertainment
 - d. The nature, frequency, and value of other gifts and entertainment offered or accepted
 - e. Whether the entertainment was associated with the active conduct of business directly before, during, or after the entertainment
 - f. Whether other clients also participated in the entertainment
 - g. The individuals from the client and *member's firm* who participated in the entertainment
- .05 *Threats* to compliance with the "[Integrity and Objectivity Rule](#)" [1.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards* if a *member* offers to a client or accepts gifts or entertainment from a client that is not reasonable in the circumstances. The *member* would be presumed to lack objectivity in violation of the "[Integrity and Objectivity Rule](#)" under these circumstances.
- .06 Refer to the "[Offering or Accepting Gifts or Entertainment](#)" interpretation [1.285.010] of the "Independence Rule" [1.200.001] for additional guidance. [Prior reference: paragraphs .226–.227 of ET section 191]

1.285 Gifts and Entertainment

1.285.010 Offering or Accepting Gifts or Entertainment

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

- .02 Accepting a gift from an attest client during the *period of the professional engagement* may create undue influence or self-interest *threats* to a *member's* compliance with the "[Independence Rule](#)" [1.200.001]. If a *member's firm*, a member of the *attest engagement team*, or an *individual in a position to influence the attest engagement* accepts a gift from an attest client and the value is not clearly insignificant to the recipient, the *threat* to the *member's* compliance with the "[Independence Rule](#)" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.
- .03 Accepting entertainment from an attest client during the *period of the professional engagement* may create undue influence or self-interest *threats* to a *member's* compliance with the "[Independence Rule](#)" [1.200.001]. If a *covered member* accepts entertainment from an attest client that is not reasonable in the circumstances, the *threats* to the *member's* compliance with the "[Independence Rule](#)" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.
- .04 Offering gifts or entertainment to an attest client during the *period of the professional engagement* may create a familiarity *threat* to a *member's* compliance with the "[Independence Rule](#)" [1.200.001]. If a *covered member* offers a gift or entertainment to an attest client that is not reasonable in the circumstances, the *threat* to the *member's* compliance with the "[Independence Rule](#)" would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*. Accordingly, *independence* would be *impaired*.
- .05 The *member* should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. Examples of relevant facts and circumstances include the following:
 - a. The nature of the gift or entertainment
 - b. The occasion giving rise to the gift or entertainment
 - c. The cost or value of the gift or entertainment
 - d. The nature, frequency, and value of other gifts and entertainment offered or accepted
 - e. Whether the entertainment was associated with the active conduct of business directly before, during, or after the entertainment
 - f. Whether other attest clients also participated in the entertainment
 - g. The individuals from the attest client's and *member's firm* who participated in the entertainment
- .06 Refer to the "[Offering or Accepting Gifts or Entertainment](#)" interpretation [1.120.010] of the "[Integrity and Objectivity Rule](#)" [1.100.001] for additional guidance. [Prior reference: paragraphs .228–.229 of ET section 191]

Part 2 Members in Business

2.120 Gifts and Entertainment

2.120.010 Offering or Accepting Gifts or Entertainment

- .01 For purposes of this interpretation, a customer or vendor of the *member's* employer includes a representative of the customer or vendor.
- .02 When a *member* offers to, or accepts gifts or entertainment from, a customer or vendor of the *member's* employer, self-interest, familiarity, or undue influence *threats* to the *member's* compliance with the "[Integrity and Objectivity Rule](#)" [2.100.001] may exist.

- .03 *Threats* to compliance with the “[Integrity and Objectivity Rule](#)” [2.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* by the application of *safeguards*, **and** the *member* would be presumed to lack integrity in violation of the “[Integrity and Objectivity Rule](#)” in the following circumstances:
- a. The *member* offers to, or accepts gifts or entertainment from, a customer or vendor of the *member’s* employer that violate applicable laws, rules, or regulations or the policies of the member’s employer or the customer or vendor.
 - b. The member knows of the violation or demonstrates recklessness in not knowing.
- .04 A *member* should evaluate the significance of any *threats* to determine if they are at an *acceptable level*. *Threats* are at an *acceptable level* when gifts or entertainment are reasonable in the circumstances. The *member* should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. The following are examples of relevant facts and circumstances:
- a. The nature of the gift or entertainment
 - b. The occasion giving rise to the gift or entertainment
 - c. The cost or value of the gift or entertainment
 - d. The nature, frequency, and value of other gifts and entertainment offered or accepted
 - e. Whether the entertainment was associated with the active conduct of business directly before, during, or after the entertainment
 - f. Whether other customers or vendors also participated in the entertainment
 - g. The individuals from the customer or vendor and a *member’s* employer who participated in the entertainment
- .05 *Threats* to compliance with the “[Integrity and Objectivity Rule](#)” [2.100.001] would not be at an *acceptable level* and could not be reduced to an *acceptable level* through the application of *safeguards* if a *member* offers to, or accepts gifts or entertainment from, a customer or vendor of the *member’s* employer that is not reasonable in the circumstances. The *member* would be considered to lack objectivity in violation of the “[Integrity and Objectivity Rule](#),” under these circumstances. [Prior reference: paragraphs .226–.227 of ET section 191]

Excerpt: AICPA General Ethics Frequently Asked Questions

Campaign contributions

Question. May a member make a political contribution to the campaign of an individual that is associated with an attest client in a key position or holds a financial interest in the attest client that is material and/or enables the individual to exercise significant influence over the attest client without impairing independence or violating any other rule of conduct?

Answer. Yes. A member would not impair independence or be in violation of any other rule of conduct provided the political contribution is not made with the intention of influencing the procurement of professional services or in contravention of federal or state laws or regulations. Related Guidance: “Offering or Accepting Gifts or Entertainment” interpretation (ET sec. 1.285.010) under the “Independence Rule” and “Offering or Accepting Gifts or Entertainment” interpretation (ET sec. 1.120.010) under the “Integrity and Objectivity Rule” (ET sec. 1.100.001) [August 2012]

**FAQ related to Transfer of Files and Return of Client Records in Sale, Transfer,
Discontinuance or Acquisition of a Practice Interpretation**

Staff: April Sherman

Reason for Agenda Item

The Committee is being asked for feedback on a non-authoritative frequently asked question (FAQ) drafted by Staff to assist members with the application of the ["Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice" interpretation \[ET Sec. 1.400.205\]](#).

Summary of Issues

At the February 2019 meeting, the Committee discussed a separate issue related to the interpretation. During the discussion, Staff requested clarification regarding the application of paragraph .05 of the interpretation when a nonmember sells one's practice to a member and the nonmember retains no ownership in the successor practice.

Paragraph .05 of the extant interpretation requires that a member who acquires a practice from "another person, firm, or entity" (member successor) be satisfied that all clients subject to the sale have consented to the member's retention of the client's files *as described in paragraph .01* of the interpretation. Paragraph .01 requires that the predecessor firm obtain client consent to transfer client files that are subject to the sale. Since the Code cannot require a nonmember (nonmember predecessor) obtain such consent, Staff questioned whether paragraph .05 requires a member successor to be satisfied that a nonmember predecessor obtained client consent to transfer client files. Staff also asked for clarification as to what action the member successor should take if the nonmember predecessor refuses to obtain client consent.

Staff believes that the Committee likely originally intended for paragraph .05 to apply regardless of the predecessor firm's membership status. In the May, July, and October 2015 agendas and minutes, the Committee used the terms "practice" and "predecessor" to refer to the predecessor firm and the interpretation uses "another person, firm or entity". However, staff notes that some firms who commented on the exposure draft assumed that the predecessor firm in paragraph .05 was a member.

Question: Does the Committee believe that paragraph .05 of the interpretation should apply regardless of the predecessor firm's member status?

If the Committee believes that paragraph .05 of the interpretation should apply even when the predecessor is a nonmember, Staff has developed an FAQ to address application of the interpretation to such individuals in **Agenda Item 7B**. (Staff did not propose guidance as to any specific action the member successor should take in the event the predecessor fails to gain client consent, as the PEEC decided in July 2016 that it would not provide specific guidance and that members should use their judgment.)

The extant interpretation is below:

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

Sale or Transfer of Member's Practice

- .01 A *member* or *member's firm* (member) that sells or transfers all or part of the member's practice to another person, *firm*, or entity (successor firm) and will no longer retain any ownership in the practice should do all of the following:
- a. Submit a written request to each *client* subject to the sale or transfer, requesting the *client's* consent to transfer its files to the successor firm and, notify the *client* that its consent may be presumed if it does not respond to the member's request within a period of not less than 90 days, unless prohibited by law, including but not limited to the rules and regulations of the applicable state boards of accountancy. The member should not transfer any *client* files to the successor firm until either the *client's* consent is obtained or the 90 days has lapsed, whichever is shorter. The member is encouraged to retain evidence of consent, whether obtained from the *client* or presumed after 90 days.
 - b. With respect to files not subject to the sale or transfer, make arrangements to return any *client* records that the member is required to provide to the *client* as set forth in the "[Records Request](#)" interpretation [1.400.200] unless the member and *client* agree to some other arrangement.
- .02 In cases in which the member is unable to contact the *client*, *client* files and records not transferred should be retained in a confidential manner and in accordance with the *firm's* record retention policy or as required by applicable legal or regulatory requirements, whichever is longer. When practicing before the IRS or other taxing authorities or regulatory bodies, members should ensure compliance with any requirements that are more restrictive.

Discontinuance of Member's Practice

- .03 A member who discontinues his or her practice but does not sell or transfer the practice to a successor firm, should do all of the following:
- a. Notify each *client* in writing of the discontinuance of the practice. The member is encouraged to retain evidence of notification made to *clients*. The member is not required to provide notification to former *clients* of the *firm*.
 - b. Make arrangements to return any *client* records that the member is required to provide to the *client* as set forth in the "[Records Request](#)" interpretation [1.400.200] unless the member and *client* agree to some other arrangement.
- .04 In cases in which the member is unable to contact the *client*, *client* files should be retained in a confidential manner and in accordance with the *firm's* record retention policy or as required by applicable legal or regulatory requirements, whichever is longer. When practicing before the IRS or other taxing authorities or regulatory bodies, members should ensure compliance with any requirements that are more restrictive.

Acquisition of Practice by a Member

- .05 A member who acquires all or part of a practice from another person, *firm*, or entity (predecessor firm) should be satisfied that all *clients* of the predecessor firm subject to the acquisition have, as required in [paragraph .01](#), consented to the member's continuation

of *professional services* and retention of any *client* files or records the successor firm retains

.06 A member will be considered in violation of the “[Acts Discreditable Rule](#)” [1.400.001] if the member does not comply with any of the requirements of this interpretation.

Effective Date

.07 This interpretation is effective June 30, 2017. Early implementation is allowed.

Nonauthoritative questions and answers related to form of communication and transfer of client files to another partner in the firm are available in the FAQ document at www.aicpa.org/interestareas/professionalethics/resources/tools/downloadabledocuments/ethics-general-faqs.pdf.

Action Needed

Ms. Sherman seeks feedback from the Committee on the draft FAQ to address the applicability of the *Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice* interpretation to nonmember predecessor firms.

Materials Presented

Agenda Item 7B Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice FAQ

Transfer of Files and Return of Client Records in Acquisition of a Nonmember Practice

Question. Firm A (currently owned by a nonmember) will be sold to Firm B (owned by members). Firm A's owner will not join Firm B. Paragraph .01 of the *Transfer of Files and Return of Client Records in Sale, Transfer or Discontinuance of Member's Practice* interpretation requires that a predecessor firm obtain client consent prior to transferring client records to a successor firm if none of the predecessor firm's owners will have ownership in the successor firm. Since the Code cannot impose requirements on nonmembers, would the interpretation still require Firm B's owners to be satisfied that client consent was obtained prior to the transfer of the records (as described in paragraph .05 of the interpretation) even though Firm A is a nonmember firm?

Answer. Yes. Paragraph .05 of the *Transfer of Files and Return of Client Records in Sale, Transfer or Discontinuance of Member's Practice* interpretation requires successor members to be satisfied that the steps in paragraph .01 of the interpretation (to obtain client consent) were performed prior to the transfer of client records to the members. The requirement applies even if the predecessor is not a member.



**AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
PROFESSIONAL ETHICS DIVISION
PROFESSIONAL ETHICS EXECUTIVE COMMITTEE
OPEN MEETING MINUTES
February 12, 2019**

The Professional Ethics Executive Committee (Committee) held a duly called meeting on February 12, 2019 at the Ritz Carlton in New Orleans, LA. The meeting convened at 9:00 a.m. and adjourned at 4:00 p.m. on February 12, 2018.

<p><u>Attendance:</u> Samuel L. Burke, Chair Coalter Baker Carlos Barrera Stanley Berman Chris Cahill Tom Campbell Robert E. Denham Anna Dourdourekas Greg Guin* Brian S. Lynch</p>	<p>William Darrol Mann William McKeown Steven Reed James Smolinski Lisa Snyder Kelly Hunter Stephanie Saunders Shelly Van Dyne Sharon Jensen</p> <p><u>Not in attendance:</u> Martin Levin</p>
<p><u>Staff:</u> Sue Coffey, Executive VP James Brackens, VP - Ethics & Practice Quality Toni Lee-Andrews, Director Ellen Gorla, Associate Director Brandon Mercer, Senior Manager Jennifer Clayton, Senior Manager* Michele Craig, Lead Manager* Summer Young, Lead Manager* Liese Faircloth, Manager* Iryna Klepcha, Manager* Jennifer Kappler, Manager*</p>	<p>Melissa Powell, Manager* Michael Schertzinger, Manager* April Sherman, Manager* John Wiley, Manager* Shannon Ziemba, Manager* Bob Dohrer, Chief Auditor* Michael Glynn, Senior Manager* Judith Sherinsky, Senior Manager* Henry Grzes, Lead Manager – Tax Practice & Ethics* Kristy Illuzzi, TIC Staff Liaison*</p>
<p><u>Guests:</u> Jeff Lewis, Chair, Independence/Behavioral Standards Subcommittee Ian Benjamin, Chair, Technical Standards Subcommittee Kelly Hnatt, External Counsel Catherine Allen, Audit Conduct Sonia Araujo, PwC Dan Dustin, NASBA Jason Evans, BDO Jennifer Kary, Crowe Horwath Nancy Miller, KPMG</p>	<p>Lindsey Fouts, KY SS* Elliot Lesser, NY SS* Kathy Meyer, MO SS* Jessica Mytrohovich, GA SS* Dora Burzenski, Deloitte* Debbie A. Cutler, Cutler Forensics* George Dietz, PwC* Jeremy "Hank" Farrah, RKO-CPAs* Kara Lomex* Karen Moncrieff, Ernst & Young* Christine Piche, CLA* Barbara Romer, PwC*</p>

Paula Tookey, Deloitte James Dalkin, GAO* Vassilios Karapanos, SEC* *Participated via phone	Anna Seto, TPRC/KMPG* Joan Sterling, BDO* Ivona Szady, Deloitte* Joseph Tapajna, TPRC/Deloitte* James West, BDO*
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1. **Welcome and Introductions**

Mr. Burke welcomed the Committee.

2. **Information Technology**

Hosting Services

The Committee discussed the hosting services FAQs and provided the following feedback to the Task Force:

- Members should not be required to terminate a client’s access to data or records in a portal prior to the effective date of the Hosting Services interpretation but that this should be done within a reasonable period of time as described in the third FAQ.
- The answer to the question regarding “whether having a third party’s general ledger software on the member’s server would result in the member providing hosting services to a bookkeeping client” should only explain when hosting services would be provided. The Committee did not believe the answer should also explain that the member would not be housing the attest client’s general ledger or data or records if the bookkeeping client has financial records in its possession in sufficient detail for a third party to perform a financial statement attest engagement.
- Helpful to draft a FAQ that would help members understand whether they would be providing hosting services if the member used software to facilitate the delivery of an otherwise permitted nonattest service such as payroll.

Information System Services

Ms. VanDyne reviewed the Task Force’s recommendations related to the feedback received on the “Information System Services” exposure draft. The Committee recommended certain editorial revisions and discussed the following subjects.

The Committee believed it was still unclear what the term “significantly” was intended to measure. The Committee suggested that it would be clearer that significance was intended to measure the impact on financial reporting matters as opposed to the significance of the management’s decisions if the phrase “about matters” was added after the phrase “decision making” to read as

“A system that gathers data that **is used in** assist management’s **decision** in making **that could significantly** decisions that directly impact **ing** financial reporting **matters, such as an analytical or reporting tool.**”

A Committee member suggested the Task Force consider developing an FAQ to highlight that a dashboard is an example of an analytical or reporting tool. The Task Force was also asked to add an example of a system that is used only in connection with controlling the efficiency and effectiveness of operations but could never be used as a financial information system.

Ms. Van Dyne asked the Committee for its thoughts on what a member's responsibility would be should they encounter a situation where they are asked to design a system that can be used two ways, one which would significantly impact financial reporting matters and the other which wouldn't. The Committee believed the member has a responsibility to consider not only how the system would be used but how the system could be used.

The Committee requested the Task Force consider whether the level of significance should also be a safeguard, and to clarify whether "routine and mechanical" or some other description would help explain what is meant by a "discrete" calculation. The Committee requested the Task Force consider whether such clarification should be done within the interpretation or in an FAQ that emphasizes that a member should apply judgement when determining if the tool performs a discrete calculation. To demonstrate the importance of professional judgement and that clear lines can't be drawn, it was suggested that the Task Force consider drafting an FAQ that discusses the vast range of complexity in tax provision software.

The Committee agreed that the client's designated hosting site could include a "cloud-based server". While the Committee believed this phrase would be well understood it did request the Task Force discuss whether there might be a clearer phrase.

The Committee also recommended the Task Force revise the last sentence of paragraph .09 to eliminate the use of the double negative. Two suggestions were made on how this could be done. The first suggestion was to replace the last sentence "For purposes of this interpretation, configuring a COTS FIS financial information system software solution does not 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 third-party vendor." with "If, however the member developed new software code or features that modify or alter the functionality of the COTS software solution, the member would not be providing configuration services." The second suggestion modified the first option slightly. In this option the last sentence would be modified instead of replaced as suggested in option 1 but then the to revise the last sentence to explain that configuration could include developing new software code or features to modify or alter the functionality of the COTS software, provided this was done in ways pre-defined by the vendor and then add the sentence suggested in option 1:

For purposes of this interpretation, ~~configuring a COTS FIS financial information system software solution does not involve~~ developing new software code or features to modify or alter the functionality of the COTS software solution **must be** in ways not pre-defined by the **third-party** vendor **in order to be considered configuring a COTS FIS software solution. If, however the member developed new software code or features that modify or alter the functionality of the COTS software solution, the member would not be providing configuration services.**

With respect to paragraphs .15 and .18 which discuss the use of an interface application, the Committee recommended it would be clearer if these paragraphs explained that the member would not be designing or developing code provided the interface application enables the COTS FIS to function as designed.

3. **External Directors**

Mr. McKeown presented the agenda materials to the Committee. The materials included draft FAQ for the Committee's review. The FAQ address the application of the independence requirements to external directors of a firm. Mr. Brackens noted that some firms have "quality councils" that are advisory in nature, and asked if the FAQ covered such bodies. Mr. McKeown noted that the FAQ are only intended to address members of the firm's board of directors or similar body, rather than advisory councils.

Mr. McKeown reviewed the four FAQ with the Committee. As noted in FAQ1, the extant Code applies certain provisions to any professional employee, and contains additional provisions for covered members. FAQ1 stipulated that such individuals should be subject to the same requirements as any individual that is a covered member or a professional employee. For example, as noted in FAQ1, if the individual performed any of the functions listed in the definition of an individual in a position to influence the attest engagement, but was not already a professional employee, the individual would be a covered member and subject to the applicable requirements. Mr. McKeown noted that FAQ2 addresses controlled entities and immediate family of a covered member, which are not exempt from the provisions applicable to covered members. Mr. McKeown pointed out that FAQ3 addresses recusal as an appropriate safeguard. FAQ4 addresses scenarios where the individual is not a covered member and not a professional employee, utilizing the Conceptual Framework approach for such scenarios.

The Committee discussed the FAQ, making the following points:

- Financial interest and employment relationships are likely the most common independence concerns in such situations.
- Mr. Denham noted that the Board of Directors normally would not perform the activities noted in the definition of "covered member," but if supervising the CEO and deciding compensation, the definition of an individual under the position to influence the attest engagement would make the person a covered member. Another member noted that the definition includes "all successive senior levels." Mr. McKeown noted that the firm should be able to determine who is in the chain of command.
- Mr. Benjamin asked why recusal would be appropriate here, but not elsewhere in the extant Code. Mr. McKeown responded that recusal removes the individual from the role that makes him/her a covered member with respect to the specific attest client. Mr. Denham asked what the member would be recusing from, and Mr. McKeown pointed out that, for example, the member should recuse from any evaluation or compensation related activities of the appropriate individuals.
- Ms. Snyder pointed out that the Code would apply the requirements upward in the chain of command, not necessarily by a specific client. Additionally, Ms. Dourdourekas noted that the individual may just participate in firm wide matters related to his/her own firm, that are not necessarily applicable to a specific client.

Ms. Snyder noted that the requirement to consider independence factors should apply to the appropriate individual at the firm rather than the individual board member, who might not be a member of the AICPA and would not be subject to AICPA jurisdiction. That is, the appropriate individual should evaluate threats and safeguards. Regarding the use of "should consider," Ms. Snyder cautioned that such language may be viewed as a requirement, which

may not be appropriate for a nonauthoritative FAQ. The consensus was that the FAQ should be revised in that regard.

Mr. Burke asked the Committee if it is in the public interest to have external directors, should the task force be looking at an exemption to certain provisions. For example, if the individual is not involved in certain matters, the individual is not subject to certain independence requirements. Mr. Burke cautioned that the guidance should remove burden rather than adding it. Mr. Denham agreed that the current approach in the FAQ should be revised to reflect the approach recommended by Mr. Burke to avoid discouraging the practice. Mr. Campbell noted that the task force should inquire as to what other agencies or bodies input is on the matter before doing an exemption, of the Committee pursued that route.

Mr. McKeown agreed that he would collaborate with Mr. Mercer to revise the FAQ and bring the revised document for the Committee's review at the May 2019 meeting.

4. Transfer of Client Files and Return of Client Records in Sale, Transfer or Discontinuance of Member's Practice

Ms. Sherman presented the agenda item to the committee. The agenda proposed an FAQ that clarified that the *Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance or Acquisition of a Practice* interpretation would apply in instances where a member sells his/her practice and remains an employee instead of an owner. The FAQ also clarifies that, if a member does retain ownership in the firm, the interpretation will not apply, regardless of the percentage of ownership. The Committee approved the FAQ.

Ms. Goria questioned how paragraph .05 of the interpretation (which requires a member purchasing a practice to be satisfied that the selling firm gained client consent) would apply if the selling firm was is a nonmember (and thus not required to obtain consent). The Committee believed this to be a separate issue for staff to discuss and address at the next Committee meeting.

5. References to Prior AICPA Code

Mr. Mercer presented the agenda item to the Committee. Mr. Mercer noted that when the Code was revised effective December 15, 2014, a section in the Preface indicated that cross-references to the location in the prior Code and Appendix D (Mapping Document) would be included in the revised Code for a period of four years, until December 15, 2018. Mr. Mercer noted that ethics staff still find the cross-references helpful for cross-referencing and researching historic positions that may impact inquiries or enforcement actions and requests that the Committee retain the cross references. The only required action would be to revise the Preface to indicate that the references would remain in the Code without a removal date. Such changes do not require exposure to membership for comment. PEEC unanimously carried a motion to have staff make the revisions to the Code to retain the references and the Mapping Document.

6. IESBA Update

Ms. Goria provide an update on the IESBA activities. She noted that IESBA finalized its Strategy and Work Plan (SWP) and the final document would be available shortly and that it included some projects that were currently underway like "Role and Mindset", "Fees" and "Consistency with ISAE 3000" as well as projects that were scheduled to begin shortly like

“Tax”. Ms. Gorla reported that IESBA is developing an e-code, which is expected to be launched during the second quarter of 2019. She also reported that IESBA would conduct a review of how and what challenges member bodies had implementing the NOCLAR and long association standards.

7. Staff Augmentation

Ms. Snyder noted that the comment letter deadline for the Staff Augmentation exposure draft is March 7, 2019 and that one comment letter came in prior to the meeting. The Task Force expects more comment letters to arrive by the deadline and will report on its comment letter review at the next Committee meeting.

8. State and Local Government

Ms. Miller reported that Staff is developing non-authoritative guidance to assist members with implementing the interpretation. She explained that the current plans include an implementation guide as well as a checklist but other materials may be developed once comments are received.

9. Independence and Selected Procedures

Mr. Mercer presented the agenda materials, which included background information and an explanation of the ask of PEEC, which is for feedback on questions presented by the ASB/ARSC task force addressing “Selected Procedures,” or engagements where there is no assertion made by the attest client and the client is not measuring or evaluating the subject matter against the specified criteria. In essence, the practitioner is measuring or evaluating the subject matter and reporting the results. During the comment letter process, questions were raised regarding the independence implications of such engagements. Mr. Mercer noted that PEEC and the Selected Procedures task force of PEEC previously communicated with the ASB/ARSC task force that independence from the subject matter was required, but that such engagements did not create additional threats to independence. Some members of PEEC and ASB held two conference calls recently to discuss the issues further, and it was determined that the prior PEEC positions as described in the agenda materials had not changed. However, most agreed that the positions of PEEC could be referenced in some manner by the standard or in some practice aid format regarding implementation. Mr. Lynch requested that examples may be needed to get better clarity on when these types of services are performed. Mr. Burke indicated that the May 2018 letter from PEEC to the ASB/ARSC task force had not changed. Staff agreed to formulate a final FAQ format document to address the ASB/ARSC questions and consider the FAQ at a subsequent meeting.

10. NOCLAR

Mr. Denham reported on task force activity since the November PEEC meeting. A joint task force consisting of an equal number of state board and AICPA members, while also being equally balanced between UAA members and PEEC members, will be formed in an effort to move forward in a collaborative manner. The purpose of this task force will be to develop a blueprint of the way forward with NOCLAR; specifically, to reach agreement on the major issues and determine where the issues should be addressed – the UAA or the Code of Conduct. Once such agreement is reached, the UAA Committee and PEEC NOCLAR Task Force will separately address language changes for their respective areas. Bob Denham (co-chair), Carlos Barrera, Stephanie Saunders, and Lisa Snyder will represent PEEC on the joint task force. Accordingly, the current PEEC NOCLAR Task Force will be suspending its

deliberations until the joint task force completes its work. At that time, this task force will resume discussions as to the applicable Code revisions.

11. Association Update

Ms. Coffey provided the Committee with an overall update of the Association.

12. Strategy and Work Plan

Ms. Lee-Andrews presented the agenda materials, which noted feedback received in previous outreach efforts to external and internal stakeholders regarding the types of issues PEEC should consider as part of its ongoing project agenda, in line with the Association Strategic Plan. Ms. Lee-Andrews requested that the Committee brainstorm and discuss any topics or issues that the PEEC Planning Subgroup and staff should consider in forming the PEEC Three-Year Project Agenda. The specific topics noted are listed below:

- *Modified independence for SSAE engagements*: As these engagements are based on the report being restricted use, are there any other services that should be included or excluded from the modified independence treatment in 1.297?
- *Business relationships*: Is there adequate guidance for subcontracting arrangements?
- *Cybersecurity, blockchain*: General awareness / education needed regarding the issue and obligations of members to report cybersecurity breaches.
- *De minimus provisions*: Should de minimus provisions extend to non-attest services? In addition, should areas such as unpaid fees or financial interests have similar provisions?
- *Gifts and Hospitality*: Should the AICPA converge with IESBA as it relates to gifts and hospitality?
- *Rules Comparison Tools*: Comparisons of AICPA and GAO/SEC/IESBA rules would be helpful to develop.
- *Marijuana Industry*: Does the Committee position on services provided to clients in the marijuana industry need to be updated or revised based on any state board or regulatory developments?
- *Additional Guidance for the following*:
 - o Outsourcing engagements
 - o Non-financial statement engagements (extant language focused on financial statement engagements, expanded guidance would be helpful)
 - o Financial interests in 529 Education Plans: challenging as it relates to identifying and evaluating the underlying investments.

Staff agreed to add the feedback to the comments previously obtained from stakeholders and work with the Planning Subgroup in working up the Committee's Three-Year Project Agenda.

13. Minutes of November 2018 Open Meeting

It was moved, seconded and unanimously agreed to adopt the minutes from the November 2018 open meeting.

The open meeting concluded at 4:00 p.m. on February 12, 2019.