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March 7, 2019

Ms. Toni Lee-Andrews
Director, Professional Ethics Division
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

GAO's Response to the American Institute of Certified Public Accountants' Professional Ethics Division's December 2018 Proposed Interpretation of the AICPA Code of Professional Conduct, Staff Augmentation Arrangements

Dear Ms. Lee-Andrews:

This letter provides GAO's comments on the proposed interpretation entitled *Staff Augmentation Arrangements*, which the American Institute of Certified Public Accountants' (AICPA) Professional Ethics Executive Committee (PEEC) prepared. GAO promulgates generally accepted government auditing standards (GAGAS), which provide professional standards for auditors of government entities in the United States. GAGAS provides a framework for conducting high-quality audits of government awards with competence, integrity, objectivity, and independence. Our comments reflect the importance we place on reinforcing the values promoted in both the AICPA *Code of Professional Conduct* and GAGAS. We anticipate that auditors of government entities may have to comply with both the interpretation and GAGAS.

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.

In addition, we believe that the proposed interpretation could benefit from the following:

- 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.

PEEC requested responses to the following questions. Our responses follow.

Response to Request for Specific Comments

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?

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*.

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.

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.

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.

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.

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.

We are not providing comments in response to this question.

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

We do not foresee any hardships or regulatory issues that are created by the proposal.

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.

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. 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.

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

We believe that the factors listed in the proposed interpretation for evaluating the appearance of prohibited employment are sufficient.

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

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.

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.

Thank you for the opportunity to comment on these important issues. If you have questions about this letter or would like to discuss any of the matters it addresses, please contact me at (202) 512-3133 or dalkinj@gao.gov.

Sincerely yours,

A handwritten signature in black ink, appearing to read "James R. Dalkin". The signature is fluid and cursive, with a prominent initial "J" and a long horizontal stroke at the end.

James R. Dalkin
Director
Financial Management and Assurance