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Independence compliance : checklists and tools for complying with AICPA, SEC, and PCAOB independence requirements;

Catherine R. Allen

Karin Glupe

Robert Durak

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**AICPA Audit and Accounting
Practice Aid Series**

**Independence Compliance:
Checklists and Tools for
Complying With AICPA, SEC,
and PCAOB Independence
Requirements**

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS



**AICPA Audit and Accounting
Practice Aid Series**

**Independence Compliance:
Checklists and Tools for
Complying With AICPA, SEC,
and PCAOB Independence
Requirements**

Written and Developed by
Catherine Allen, CPA

Edited by
Karin Glupe, CPA
Technical Manager

and
Robert Durak, CPA
Director

Accounting and Audit Publications

Notice to Readers

This publication, *Independence Compliance: Checklists and Tools for Complying With AICPA, SEC, and PCAOB Independence Requirements*, is a practice aid that helps practitioners comply with independence rules that apply if a practitioner is engaged to perform an attestation engagement for a public company. This practice aid covers both AICPA independence requirements that apply to all attestation engagements, and Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB) independence requirements that apply to attest services provided to public companies and other entities whose financial information is filed with the SEC.

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This publication was developed in October 2006 and the content herein reflects the AICPA, SEC, and PCAOB independence rules that were in effect at that time. AICPA, SEC, and PCAOB independence rules may have changed since this publication was developed. Practitioners should be aware of and comply with current AICPA, SEC, and PCAOB independence rules.

Written and Developed by
Catherine Allen, CPA
Edited by Karin Glupe, CPA, and
Robert Durak, CPA

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About the Author

Catherine Allen has many years of experience working with the accounting profession's ethics standards, as a senior staff member of the American Institute of Certified Public Accountants' (AICPA) Professional Ethics Division and Director of Independence for two of the "big four" accounting firms. Since 1992, Ms. Allen has been extensively involved in counseling, teaching, and developing rules, policies, training courses, and practice tools on ethics and independence. She formed a consulting firm, AUDIT CONDUCT, in 2005 to provide guidance on auditor independence, ethics, and related compliance matters for CPA firms, professional organizations, corporate governance bodies and their advisers, law firms, and other stakeholders of the accounting profession. Ms. Allen has also taught accounting principles at the City University of New York's Queens and Bernard M. Baruch Colleges.

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INTRODUCTION

U.S. auditor independence rules have undergone many significant changes in the last decade and the rules continue to evolve. With rules covering many situations in which independence might be impaired, from business relationships and services to fee arrangements and other relationships, it has become increasingly difficult for practitioners to keep up with the standards. This Practice Aid will assist practitioners and firms in identifying and addressing independence matters to help ensure their compliance with applicable AICPA Professional Standards and Securities and Exchange Commission (SEC) Independence Rules, including rules of the Public Company Accounting Oversight Boards (PCAOB) and Independence Standards Board (ISB), where applicable. SEC, PCAOB, and ISB rules will collectively be referred to as *SEC independence rules*.

SCOPE OF THIS PRACTICE AID

This Practice Aid addresses two diverse sets of auditor independence rules. First, the independence compliance tool (the Compliance Tool) addresses requirements of Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.01), of the AICPA Code of Professional Conduct (the Code) and its related rulings and Interpretations. This rule applies to all engagements requiring independence under AICPA Professional Standards. Some examples are the following:

- Audits and reviews of financial statements
- Compilations of financial statements in which the firm does not disclose a lack of independence
- Reports issued under Statements on Auditing Standards (SAS) No. 70, *Service Organizations* (AICPA, *Professional Standards*, vol. 1, AU sec. 324), as amended
- Other attestation services, such as agreed upon procedures

The Compliance Tool also addresses the SEC independence rules, which apply to audits, reviews, and other attest services provided to public companies and other entities whose financial information is filed with the SEC. These engagements are also subject to the AICPA rules described in the Compliance Tool. To streamline the compliance process, the Compliance Tool will address SEC independence rules only to the extent that they exceed the AICPA requirements. Hence, completing the entire Compliance Tool serves to address both sets of rules.

If an engagement is not subject to SEC independence rules, only the AICPA portion of the Compliance Tool should be completed.¹

¹ Practitioners should also be aware of various other regulations that may apply to engagements. See Appendix C, "Sources of Guidance," and Appendix F, "Other Independence Rules and Issues," for further information.

HOW TO USE THIS PRACTICE AID

To assess independence:

1. Determine which parts of the Compliance Tool apply to your attest client (i.e., AICPA only or AICPA plus SEC).
2. Read all portions of the Practice Aid applicable to your client.
3. Complete the relevant questions in the Compliance Tool.
4. For SEC engagements, complete both the AICPA and SEC questions.
5. Review the follow-up section(s) for all *yes* answers, or if an answer is not known.
6. Review the appendixes for additional information that may be relevant for your client.

THE AICPA AND SEC INDEPENDENCE COMPLIANCE TOOL

The Compliance Tool is a mechanism to help you consider whether your firm is independent to perform an attest engagement under the relevant rules. The Compliance Tool is divided into two equally important parts.

Part I, “Questionnaire,” (the Questionnaire) of the Compliance Tool is a series of questions designed to help you identify potential independence issues. You should answer all of the AICPA questions listed in Part I. If your client is subject to SEC Independence Rules, you should answer the SEC questions in Part I as well. (Questions and rule citations that relate exclusively to practitioners applying SEC independence rules are shown in *italics*.) The response to each question will be *yes* or *no*, although certain questions allow for a *N/A* (not applicable) response. Refer to the glossaries in Appendixes A, “AICPA Independence Terms,” and B, “SEC Independence Terms.”

Be sure that you fully understand the terms used in each question before providing your answer. Defined terms are shown in boldface type each time they appear in the Questionnaire. Then, determine the proper reply to the question, asking the appropriate person(s) in your firm, as needed.

It is important to note that the Questionnaire summarizes the most frequently encountered independence rules; accordingly, the questions do not identify *all* the possible factors that determine whether independence under the applicable rules is achieved. Further, some areas of the rules are very fact-specific and may not be fully addressed with a simple *yes* or *no* answer. Therefore, you should not assume that all *yes* answers indicate an infraction of the rules; but rather that further consideration of the rules themselves and additional advice and counsel may be needed to determine whether there is an issue.

If you answer *yes* to any of the questions or you are unable to answer a question, you should also review Part II, “Resolution of Potential Independence Issues,” of the Compliance Tool. Part II will help you to address and, if necessary, document any potential independence issues that have been identified in Part I. Part II suggests possible follow-up actions that you and your firm may wish to consider and apply in addressing an independence issue. (As in Part I, information applying exclusively to practitioners applying SEC independence rules is shown in *italics*.) However, applying the suggested follow-up actions may or may not avoid a violation of the Code or the SEC independence rules. Only the AICPA Professional Ethics Executive Committee (PEEC) has the authority to interpret the Code. Similarly, the SEC Office of the Chief Accountant (Professional Practice Group) manages the resolution of independence matters relevant to SEC independence rules.

To be effective, you should use the Compliance Tool(s) in a timely manner. The following scenarios illustrate the meaning of “timely.”

Scenario 1: The engagement is a new audit, review, or other attest engagement.

You should utilize the Compliance Tool *prior* to accepting an attest engagement or performing any attest work for the client. In a number of cases, this will allow the firm to resolve issues that surface as a result of the review. *Prior* to issuing your report, you should review your previous results to confirm that no changes have occurred since your initial assessment and that any matters identified during the initial assessment have been appropriately addressed, resolved, and documented.

Scenario 2: The engagement is an ongoing audit, review, or other attest engagement.

You should use the Compliance Tool early in the audit planning stage, and at other times throughout the year, as needed. *Prior* to issuing your report, you should review the previous results to confirm that no changes have occurred since your initial assessment and that any matters identified during the initial assessment have been appropriately addressed, resolved, and documented.

INDEPENDENCE COMPLIANCE TOOL: AICPA AND SEC INDEPENDENCE RULES

AICPA RULES

AICPA professional standards require a firm, its partners, and professional employees to be independent in accordance with AICPA Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.01), of the Code whenever a firm performs an attest service for a client. Attest services include:

- Financial statement audits
- Financial statement reviews
- Other attest services as defined in the Statements on Standards for Attestation Engagements (SSAEs)

Performing a compilation of a client's financial statements does not require independence. However, if a firm that is not independent issues a compilation report, the report must state, "I am (we are) not independent with respect to XYZ Company." If the firm does not include this disclosure in the compilation report, it must maintain independence under Rule 101.

The Questionnaire addresses five general categories under AICPA and SEC independence rules:

1. Personal financial interests and relationships
2. Employment and business relationships
3. Nonattest services engagements
4. Fee arrangements
5. Miscellaneous

SEC INDEPENDENCE RULES

The SEC regulates public companies² and establishes the qualifications of independent auditors under Regulation S-X of the Securities Exchange Act of 1934, specifically, Rule 2-01(b), *Qualifications and Reports of Accountants*. The rule does not purport to describe all of the circumstances that raise independence concerns. Accordingly, the SEC will not recognize an accountant as independent with respect to an attest client if the accountant is not capable of exercising

² Companies that are registered with or are otherwise regulated by the SEC or that file audited financial statements with the SEC, including foreign filers, are considered public companies.

objective and impartial judgment on all issues encompassed within the engagement. The practitioner must also consider whether a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is independent.³

The SEC oversees the PCAOB, a private standards-setting body, which is authorized to, among other things, set auditing, quality control, ethics and independence standards for accounting firms that audit public companies. The PCAOB adopted interim ethics standards based on the provisions of the AICPA *Code of Professional Conduct*, Rule 102, *Integrity and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 102.01); Rule 101, *Independence*; and Interpretations and rulings under those rules as of April 16, 2003. The PCAOB also adopted Independence Standards Board Standards. To the extent that the SEC independence rules are more restrictive than the PCAOB interim independence standards, registered public accounting firms must comply with the more restrictive requirements. The Compliance Tool is designed to help you consider the most restrictive rules that apply to your client.

A citation to the applicable AICPA or SEC independence rule or related guidance follows each question. You should refer directly to the rules if you do not understand the question or need further information. (Also see Appendix C.) Words appearing in boldface type are defined in Appendix A, and Appendix B. It is very important that you understand the meaning of all terms used in the questions before you provide a response.

The independence rules are frequently augmented and amended. Consequently, the independence rules addressed and citations referred to in the Questionnaire may have changed after the time this Practice Aid was developed, which was October 2006. You should be aware of and comply with current independence rules.

³ The SEC will not recognize any person as a certified public accountant who is not duly registered and in good standing as such under the laws of the place of his or her residence or principal office. Also, under various state rules, the person and/or the accounting firm must be licensed to perform the work if the service is being performed in a state other than the state in which the person or firm is registered.

PART I: QUESTIONNAIRE

CATEGORY 1: PERSONAL FINANCIAL INTERESTS AND RELATIONSHIPS

The following are important points:

1. The time period you should consider for purposes of these questions is the **period of the professional engagement**. This period begins on the earlier of the date the firm (a) formally agrees to perform attest services for the client or (b) begins providing attest services. It continues until the firm or the client terminates the attest relationship, or the final report is issued, whichever is later.
2. The terms, **covered member** or *covered person*, are specific to the **client** or *audit client* being assessed.
3. For purposes of these questions, **covered member** or *covered person* includes the covered member's (or *covered person's*) **immediate family**, namely, his or her spouse, **spousal equivalent**, and **dependents**.
4. For SEC engagements, the term **covered member** includes all of the persons included in the term **covered person** (the term used in the SEC Independence Rules). However, the term **covered member** incorporates the **accounting firm** as a whole, whereas the term **covered person** does not. Therefore, where appropriate, the Questionnaire will address the rules for **covered persons** separately from those rules only applying to **accounting firms**.
5. The term **audit client** as used in the SEC Independence Rules includes **affiliates of the audit client** (see Appendix B, "SEC Independence Terms").⁴

Q1. Has a **covered member**⁵ had or been committed to acquire any **direct financial interest** in the **client**? [AICPA, Professional Standards, vol. 2, ET secs. 101.02 and 101.17; SEC, Regulation S-X, Rule 2-01(c)(1)(i)(A)]

Yes No

Q2. Has a **covered member** had a **direct financial interest** or a material **indirect financial interest** in the **client** through his or her participation in a retirement, savings, compensation, or similar plan? [AICPA, Professional Standards, vol. 2, ET secs. 101.02 and 101.17; SEC, Regulation S-X, Rule 2-01(c)(1)(i)(A)]

Yes No

⁴ The SEC defines *affiliate of the audit client* broadly; those unfamiliar with the term should review it carefully before proceeding with the Questionnaire.

⁵ Please note that for AICPA purposes, the term *covered member* includes the firm.

Q3. Has a **covered member** had an insurance policy that had an investment option which provided the **covered member** a **direct financial interest** or a material **indirect financial interest** in the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.17; *SEC, Regulation S-X, Rule 2-01(c)(1)(i)(A)*]

Yes No

Q4. Has a **covered member** had or been committed to acquire any material **indirect financial interest** in the **client**, other than an **indirect financial interest** held through a **diversified mutual fund**? [AICPA, Professional Standards, vol. 2, ET sec. 101.17; *SEC, Regulation S-X, Rule 2-01(c)(1)(i)(D)*]

Yes No

Q5. Has a **covered member** acquired a **direct financial interest** or material **indirect financial interest** in the **client** as a result of an unsolicited gift or inheritance? [AICPA, Professional Standards, vol. 2, ET sec. 101.17; *SEC, Regulation S-X, Rule 2-01(c)(1)(iii)(A)*]

Yes No

Q6. If the **client** is a Section 529 savings plan, has a **covered member** been an account owner in the plan? [AICPA, Professional Standards, vol. 2, ET sec. 101.17]

Yes No N/A

Q7. Has a **covered member** been the account owner of any Section 529 savings plan (including nonclient plans) that invested in the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.17]

Yes No

Q8. Has a **covered member** participated in an investment club that invested in the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 191.071-72]

Yes No

Q9. Has a **covered member** invested as a general partner in a partnership (or held another position that allowed the individual to control the partnership or participate in its investment decision-making), which invested in the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 191.158-59; *SEC, Regulation S-X, Rule 2-01(c)(1)(i)(A)*]

Yes No

Q10. Has a **covered member** invested as a limited partner in a partnership, which invested in the **client** and was material to the **covered member**? [AICPA, Professional Standards, vol. 2, ET sec. 191.162-63; *SEC, Regulation S-X, Rule 2-01(c)(1)(i)(A)*]

Yes No

(continued)

Q11. Has a **covered member** served as the manager of a limited liability company (LLC), or held another position that allowed the individual to control the LLC or participate in its investment decision-making, and that LLC invested in the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.17; SEC, Regulation S-X, Rule 2-01(c)(1)(i)(A)]

Yes No

Q12. Was a member of the **attest engagement team** aware that a **close relative** had or was committed to acquire a material **financial interest** in the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.02]

Yes No N/A

Q13. Did a **close relative** of a member of the **attest engagement team** have the ability to exercise **significant influence** over the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.02]

Yes No N/A

Q14. Did a **close relative** of (a) a **partner** or manager providing nonattest services to the **client** or (b) a **partner** in the **office** of the lead **audit partner** for this engagement have a financial interest that was both material to the **close relative** and allowed the **close relative** to exercise **significant influence** over the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.02]

Yes No

Q15. Has a **covered member** served as a trustee of a trust that had or was committed to acquire a **direct financial interest** or material **indirect financial interest** in the **client** such that (a) the **covered member** (individually or with others) had the authority to make investment decisions for the trust; or (b) the trust owned or was committed to acquire more than 10 percent of the client's outstanding equity securities or other ownership interests; or (c) the value of the trust's holdings in the **client** exceeded 10 percent of the total assets of the trust? [AICPA, Professional Standards, vol. 2, ET sec. 101.02; SEC, Regulation S-X, Rule 2-01(c)(1)(i)(C)]

Yes No

Q16. Has a **covered member** been the grantor of a trust that had or was committed to acquire a **direct financial interest** or material **indirect financial interest** in the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.17; SEC, Regulation S-X, Rule 2-01(c)(1)(i)(A)]

Yes No

Q17. Has a **covered member** been a beneficiary of a trust that had or was committed to acquire a material **indirect financial interest** in the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.17; SEC, Regulation S-X, Rule 2-01(c)(1)(i)(A)] Yes No

Q18. Has a **covered member** been the beneficiary of a trust who was able to control or participate in investment decision-making for the trust, and such trust had or was committed to acquire a **financial interest** in the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.17; SEC, Regulation S-X, Rule 2-01(c)(1)(i)(A)] Yes No

Q19. Has a **covered member** been a beneficiary of a blind trust that had or was committed to acquire a **financial interest** in the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.17] Yes No

Q20. Has a **covered member** actually served as an executor of an estate that had or was committed to acquire a **direct financial interest** or material **indirect financial interest** in the client? [AICPA, Professional Standards, vol. 2, ET sec. 191.021-022; SEC, Regulation S-X, Rule 2-01(c)(1)(i)(C)] Yes No

Q21. Has a **covered member** had a **joint closely held investment** that was material to the **covered member's** net worth? [AICPA, Professional Standards, vol. 2, ET sec. 101.02] Yes No

Q21a. Has a covered person had any joint closely held investment with the audit client? [SEC, Regulation S-X, Rule 2-01(c)(3)] Yes No

Q22. Has a **covered member** had a **loan** (other than a **grandfathered** or a **permitted** loan) to or from the **client**, any officer or director of the **client**, or any individual owning 10 percent or more of the **client's** outstanding equity? [AICPA, Professional Standards, vol. 2, ET sec. 101.07] Yes No

(continued)

*Q22a. Has a **covered person** or the **accounting firm** had a **loan** (including a margin loan) to or from the **audit client**, or the **audit client's** officers, directors, or record or beneficial owners of more than 10 percent of the **audit client's** equity securities other than the following loans obtained from a **financial institution** under its **normal lending procedures, terms, and requirements**: (1) a **permitted loan**; or (2) a grandfathered mortgage loan collateralized by the borrower's primary residence? [SEC, Regulation S-X, Rules 2-01(c)(1)(ii)(A) and 2-01(e)]*

Yes No

Q23. Has a **covered member** had a **loan** with a nonclient subsidiary of the **client** that was neither a **grandfathered loan** nor a **permitted loan**? [AICPA, Professional Standards, vol. 2, ET sec. 191.196-197]

Yes No

Q24. Has a **partner** or professional employee of the **firm**, or his or her **immediate family**, or a group of such persons acting together, owned more than 5 percent of the **client's** outstanding equity securities, or similar interests? [AICPA, Professional Standards, vol. 2, ET sec. 101.02]

Yes No

*Q24a. Did the **immediate family** of any **partner** or **professional employee** of the **accounting firm** file a Schedule 13D or 13G (17 CFR 240.13d-101 or 240.13d-102) with the SEC indicating beneficial ownership of more than 5 percent of the **audit client's** equity securities, or did such person control the **audit client**? [SEC, Regulation S-X, Rule 2-01(c)(1)(i)(B)]*

Yes No

*Q24b. Did the **close relative** of a **covered person** in the **accounting firm** file a Schedule 13D or 13G (17 CFR 240.13d-101 or 240.13d-102) with the SEC indicating beneficial ownership of more than 5 percent of the **audit client's** equity securities, or did such relative control the **audit client**? [SEC, Regulation S-X, Rule 2-01(c)(1)(i)(B)]*

Yes No

*Q24c. Did any group of the persons indicated in Questions 24a and 24b (directly above) file a Schedule 13D or 13G (17 CFR 240.13d-101 or 240.13d-102) with the SEC indicating beneficial ownership of more than 5 percent of the **audit client's** equity securities, or did such group of persons control the **audit client**? [SEC, Regulation S-X, Rule 2-01(c)(1)(i)(B)]*

Yes No

Q24d. Did the close relative of a partner in the accounting firm control the audit client? [SEC, Regulation S-X, Rule 2-01(c)(1)(i)(B)]

Yes No

Q25. Did the firm hire professional staff or admit a partner who was a covered member with respect to the client and who had (1) a loan with the client that was neither grandfathered nor permitted or (2) a direct financial interest or material indirect financial interest in the client? [AICPA, Professional Standards, vol. 2, ET sec. 101.02; SEC, Regulation S-X, Rule 2-01(c)(1)(i)(A)]

Yes No

Q26. If the client is a financial institution, has a covered member had a depository account (checking, savings, money market, certificate of deposit) with a client holding funds that were not fully insured by a federal or state agency (such as Federal Deposit Insurance Corporation [FDIC]) or other insurer and were material to the covered member's net worth? [AICPA, Professional Standards, vol. 2, ET sec. 191.140-41]

Yes No N/A

Q26a. If the audit client is a financial institution, has a person in the firm who was a covered person had a savings, checking, or similar account with the audit client holding funds that were not fully insured by the FDIC (or another insurer)? [SEC, Regulation S-X, Rule 2-01(c)(1)(ii)(B)]

Yes No N/A

Q26b. If the audit client is a financial institution, has the accounting firm had a savings, checking, or similar account with a financial institution audit client, which (1) held funds that were not fully insured by the FDIC (or another insurer) and (2) the likelihood of the audit client experiencing financial difficulties was more than remote? [SEC, Regulation S-X, Rule 2-01(c)(1)(ii)(B)]

Yes No N/A

Q26c. If the audit client is an insurance company, has a person in the accounting firm, while a covered person, obtained an insurance policy with the audit client? [SEC, Regulation S-X, Rule 2-01(c)(1)(ii)(F)]

Yes No N/A

(continued)

Q26d. If the **audit client** is an insurance company, has a person in the **accounting firm**, while a **covered person**, amended an existing insurance policy that required new underwriting by the **audit client**? [SEC, Regulation S-X, Rule 2-01(c)(1)(ii)(F)]

Yes No N/A

Q27. If the **audit client** is a broker-dealer, has a **covered member** had a margin loan with the **audit client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.07; SEC, Regulation S-X, Rule 2-01(c)(1)(ii)(A)]

Yes No N/A

Q27a. If the **audit client** is a broker-dealer, has a **covered member** had a brokerage account that: (1) included any asset other than cash or securities or (2) was not insured (i.e., exceeded the amount provided for under the Securities Investor Protection Act of 1970)? [SEC, Regulation S-X, Rule 2-01(c)(1)(ii)(C)]

Yes No N/A

Q28. Has a **covered member** invested in an entity that had **significant influence** over the **client** and that was material to the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.10; SEC, Regulation S-X, Rule 2-01(c)(1)(ii)(E)]

Yes No

Q29. Has a **covered member** invested in an entity over which the **client** had **significant influence** and the entity was material to the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.10; SEC, Regulation S-X, Rule 2-01(c)(1)(ii)(E)]

Yes No

Q30. Has a **covered member** had an investment or other relationship with an entity that gave the **covered member** **significant influence** over the entity, and such entity had **significant influence** over the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.10; SEC, Regulation S-X, Rule 2-01(c)(1)(ii)(E)]

Yes No

Q31. Has a member of the **attest engagement team** accepted a gift from the **client** that would be considered to be more than clearly insignificant? [AICPA, Professional Standards, vol. 2, ET sec. 191.228-229]

Yes No

CATEGORY 2: EMPLOYMENT AND BUSINESS RELATIONSHIPS

The following are important points:

1. The time period you should consider for purposes of these questions is the **period of the professional engagement** and the period covered by the financial statements (or other subject matter of the attest engagement).
2. Unless noted otherwise, the term **audit client** as used in the SEC Independence Rules includes **affiliates of the audit client** (see Appendix B, "SEC Independence Terms").

Q1. Has a **partner** or professional employee served as a director, officer, or in any other managerial position (e.g., general counsel or promoter) for the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.02; SEC, Regulation S-X, Rule 2-01(c)(2)(i)]

Yes No

Q2. Has a **partner** or professional employee served the **client** or the **client's** pension or profit-sharing trust as a promoter, underwriter, or voting trustee? [AICPA, Professional Standards, vol. 2, ET sec. 101.02; SEC, Regulation S-X, Rule 2-01(c)(2)(i)]

Yes No

Q3. Has the **close relative** of a **covered member** (other than an individual who is a **covered member** solely because he or she provided nonattest services) or the **immediate family** of such **covered member** been employed in a **key position** by the **client**? [AICPA, Professional Standards, vol. 2, ET secs. 101.02 and 92.17]

Yes No

Q3a. Has the **close relative** of a **covered member** or the **immediate family** of such **covered member** been employed by the **audit client** in an **accounting role** or a **financial reporting oversight role**? [SEC, Regulation S-X, Rule 2-01(c)(2)(ii)]

Yes No

Q4. Did the **firm** hire professional staff or admit a **partner** who was associated with a **client** and who served on that **client's attest engagement team**, or was an individual in a position to influence the **attest engagement**? [AICPA, Professional Standards, vol. 2, ET sec. 101.02; SEC, Regulation S-X, Rule 2-01(c)(2)(iv)]

Yes No

(continued)

Q5. Did a **partner** or professional employee who resigned or retired from the **firm** and assumed a **key position** with the **client** have (a) an arrangement to be paid amounts due him or her (for a previous interest in the **firm** or retirement benefits) calculated on a variable formula, (b) amounts due him or her (per item a) that were material to the **firm**, or (c) continuing business relationships with the **firm** (e.g., consulting arrangements or other associations)? [AICPA, Professional Standards, vol. 2, ET sec. 101.04]

Yes No

Q5a. Did a former **partner** or professional employee of the **accounting firm** assume a **financial reporting oversight role** or **accounting role** with the **audit client** and have a capital balance with the **accounting firm** or any financial arrangement with the **firm** that was dependent on the **firm's** revenues, profits, or earnings?⁶ [SEC, Regulation S-X, Rule 2-01(c)(2)(iii)]

Yes No

Q5b. If the **audit client** is an **issuer** or a subsidiary of an **issuer**, has a former member of the **audit engagement team**⁷ assumed a **financial reporting oversight role** with the **issuer** during the past year? [SEC, Regulation S-X, Rule 2-01(c)(2)(i), Application of the SEC's Rules on Auditor Independence—Frequently Asked Questions, "Cooling Off" Period, Question 1 (issued August 13, 2003)]

Yes No N/A

Q6. Did the **firm** and the **client** participate in a cooperative arrangement (e.g., joint venture, subcontracting arrangement, distribution, or marketing arrangement) that was material to the **firm** or to the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.14]

Yes No

⁶ Excludes a former professional employee who: (1) was not a **partner**, principal, or shareholder of the **accounting firm**; (2) disassociated from the **accounting firm** more than five years ago; and (3) had a fixed financial arrangement with the **accounting firm** that was immaterial to the former professional employee and was not dependent upon the **firm's** earnings, revenues, or profits.

⁷ Excludes individuals (other than the lead or concurring review **partner**) who spent a de minimis amount of time on the engagement team.

*Q6a. Other than an ordinary consumer relationship in which transactions were made on an arm's length basis, did the **accounting firm** or any **covered member** in the **accounting firm** have a direct or material indirect business relationship with the **audit client** or its officers, directors, or substantial shareholders (e.g., joint venture, limited partnership, investment in supplier or customer companies, certain leasing interests, or sale by the **accounting firm** of items other than professional services)?*
 [SEC, Regulation S-X, Rule 2-01(c)(3), Application of the SEC's Rules on Auditor Independence—Frequently Asked Questions, Other Matters, Question 2 (issued January 16, 2001, revised 2004)]

Yes No N/A

Q7. Did a member of the attest engagement team or an individual in a position to influence the attest engagement negotiate a potential employment position with the client?
 [AICPA, Professional Standards, vol. 2, ET sec. 101.04; ISB Standard No. 3, Employment With Audit Clients, para. 2(a)]

Yes No

CATEGORY 3: NONATTEST SERVICES ENGAGEMENTS

The following are important points:

1. Before answering the questions in this category, you should determine whether your firm provided any nonattest services for the client (*for SEC purposes, this includes **affiliates of the audit client***) during the period described in item 3 below. If no nonattest services engagements were performed for the client, this section may be skipped.
2. For purposes of questions in this category, the terms **firm** and **accounting firm** include all professionals performing services on the firm's behalf.
3. The time period you should consider for purposes of these questions is the **period of the professional engagement** and the period covered by the financial statements (or other subject matter of the attest engagement).
4. The term **audit client** as used in the SEC Independence Rules includes **affiliates of the audit client** (see Appendix B, SEC Independence Terms).

(continued)

Q1. Did the **firm** perform any management functions or make managerial decisions for the **client** in connection with nonattest services? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*]

Yes No

Q2. Were there any instances in which the **client** was unable (i.e., lacked the competence) or unwilling to oversee the **firm's** nonattest services (i.e., perform management functions, set the scope of the services, evaluate and accept responsibility for the results of the services, and establish and maintain internal controls)? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; AICPA Guidance is available at http://www.aicpa.org/download/ethics/101-3_Competency_Guidance.pdf]

Yes No

Q3. Were there any instances in which an understanding between the **firm** and the **client** (i.e., engagement objectives, nonattest services to be performed, **client's** acceptance of its responsibilities, **firm's** responsibilities, and engagement limitations, if any) was *not* reached and documented in the **firm's** files? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; AICPA Guidance is available at http://www.aicpa.org/download/ethics/Int_101-3_documentation_guidance.pdf]

Yes No

Q4. Did the **firm** at any time have custody of the **client's** assets (e.g., handle **client** cash, checks, or other financial instruments, or otherwise take responsibility for the safekeeping of assets)? [AICPA, Professional Standards, vol. 2, ET sec. 101.05]

Yes No

Q5. Did the **firm** at any time assume responsibility for making payments on behalf of the **client** (electronically or otherwise)? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*]

Yes No

Q6. Did the **firm** at any time assume responsibility for signing or cosigning **client** checks? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*]

Yes No

Q7. Did the **firm** at any time maintain a bank account on behalf of the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*]

Yes No

Q8. Did the **firm** at any time sign payroll tax returns on behalf of the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*] Yes No

Q9. Did the **firm** at any time authorize, execute, or consummate transactions on behalf of the **client** (e.g., approve vendor invoices for payment, hire or terminate employees, commit the client to employee compensation or benefit arrangements)? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*] Yes No

Q10. Did the **firm** at any time prepare **source documents** that evidenced accounting transactions (e.g., invoices, purchase orders, or payroll timecards) for the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*] Yes No

Q11. Did the **firm** at any time supervise or appear to supervise the **client's** employees in their daily activities? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*] Yes No

Q12. Did the **firm** at any time lend its professional staff to the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.02 and 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*] Yes No

Q13. Did the **firm** at any time report to the board of directors (or other governing body) on behalf of management? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*] Yes No

Q14. Did the **firm** at any time design or implement policies or procedures for the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*] Yes No

Q15. Did the **firm** at any time serve as the **client's** escrow agent, stock transfer agent, registrar, general counsel, or in a similar capacity? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*] Yes No

(continued)

Q16. Did the **firm** at any time serve as a fiduciary to the **client** (e.g., Benefit Plan Administrator under Department of Labor regulations)? [AICPA, Professional Standards, vol. 2, ET secs. 101.05 and 102.03; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*] Yes No

Q17. Did the **firm** at any time make investment decisions for the **client** or have discretionary authority over **client** investments? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*] Yes No

Q18. Did the **firm** at any time execute transactions to buy or sell investments on behalf of the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(viii)*] Yes No

Q19. Did the **firm** at any time negotiate or appear to negotiate transactions on behalf of the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*] Yes No

Q20. Did the **firm** at any time commit the **client** to the terms of an arrangement without the **client's** involvement or advanced agreement to the terms? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*] Yes No

Q21. Did the **firm** perform any ongoing compliance or quality control functions for the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; *SEC, Regulation S-X, Rule 2-01(c)(4)(vi)*] Yes No

Q22. Did the **firm** perform bookkeeping services for the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.05] Yes No

Q23. Did the **firm** determine or change journal entries without obtaining **client** approval? [AICPA, Professional Standards, vol. 2, ET sec. 101.05] Yes No

Q24. Did the **firm** change **source documents** or account codings on transactions without **client** approval? [AICPA, Professional Standards, vol. 2, ET sec. 101.05] Yes No

Q25. Did the **firm** determine the assumptions underlying journal entries (e.g., useful lives, bad-debt percentages) for the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.05] Yes No

Q25a. Did the **accounting firm** maintain or prepare the **audit client's** accounting records (e.g., payroll), or prepare or originate source data underlying the financial statements (e.g., contracts, shipping forms, or invoices), which form the basis of financial statements, or in any other manner prepare the client's financial statements that are filed with the SEC? [SEC, Regulation S-X, Rule 2-01(c)(4)(vi)]

Yes No

Q26. Did the **firm** design or develop a financial information system for the **client** (including selling or licensing software that the firm designed or developed)? [AICPA, Professional Standards, vol. 2, ET sec. 101.05]

Yes No

Q26a. Did the firm license or sell software (such as tax preparation software) to the **audit client**, which aggregated source data or generated information that was used in preparing the audit client's financial statements or that helped form the basis of such statements? [SEC, Regulation S-X, Rule 2-01(c)(4)(ii), Application of the SEC's Rules on Auditor Independence—Frequently Asked Questions, Prohibited and Non-audit Services, Question 6 (issued August 13, 2003)]

Yes No

Q26b. Did the **accounting firm** design or implement a hardware or software system that aggregated source data underlying the financial statements or generated information that was significant to the **audit client's** financial statements? [SEC, Regulation S-X, Rule 2-01(c)(4)(ii)]

Yes No

Q27. Did the **firm** modify the source code underlying the **client's** financial information system (excluding insignificant modifications)? [AICPA, Professional Standards, vol. 2, ET sec. 101.05]

Yes No

Q28. Did the **firm** manage or operate the **audit client's** local area network (LAN)? [AICPA, Professional Standards, vol. 2, ET sec. 101.05; SEC, Regulation S-X, Rule 2-01(c)(4)(ii)]

Yes No

Q29. Did the **firm** provide valuation or appraisal services to the **client**, which was subject to significant subjectivity and whose results were material to the financial statements? [AICPA, Professional Standards, vol. 2, ET sec. 101.05]

Yes No

(continued)

Q29a. Did the **accounting firm** perform any appraisal service, valuation service, or any service involving a fairness opinion or contribution-in-kind report for the **audit client**? [SEC, Regulation S-X, Rule 2-01(c)(4)(iii)]

Yes No

Q30. Did the **firm** perform an actuarial valuation for the **client** (except for those related to the **client's** pension or postemployment benefit obligations), which was material to the financial statements? [AICPA, Professional Standards, vol. 2, ET sec. 101.05]

Yes No

Q30a. Did the **accounting firm** perform any actuarial advisory service involving the determination of amounts recorded in the financial statements and related accounts for the **audit client**?⁸ [SEC, Regulation S-X, Rule 2-01(c)(4)(iv)]

Yes No

Q31. Did the **firm** provide internal audit services to the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.05] (If the answer is *no*, skip questions 32 through 36.)

Yes No

Q32. Did the **firm** manage internal audit activities for the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.05]

Yes No

Q33. Did the **firm** determine the scope, risk, or frequency of internal audit activities for the **client**, including those performed by the firm (e.g., prepare or approve the audit work plan)? [AICPA, Professional Standards, vol. 2, ET sec. 101.05]

Yes No

Q34. Did the **firm** evaluate the findings of internal audit activities, including those performed by the **firm**? [AICPA, Professional Standards, vol. 2, ET sec. 101.05]

Yes No

Q35. Did the **firm** determine the adequacy of internal audit activities, including those performed by the **firm**? [AICPA, Professional Standards, vol. 2, ET sec. 101.05]

Yes No

Q36. Did the **firm** report internal audit findings to the board of directors or other governing body on behalf of the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.05]

Yes No

⁸ Excludes services in which the **accounting firm** solely helped the client understand the methods, models, assumptions, and inputs used in computing the amounts that were determined by the client or another party (unrelated to the **accounting firm**).

Q37. Did the **accounting firm** search for prospective candidates for managerial, executive, or director positions for the **audit client**? [SEC, Regulation S-X, Rule 2-01(c)(4)(vii)(A)] Yes No

Q38. Did the **accounting firm** conduct formal testing (e.g., psychological testing) or evaluation programs of prospective employment candidates for the **audit client**? [SEC, Regulation S-X, Rule 2-01(c)(4)(vii)(B)] Yes No

Q39. Did the **accounting firm** perform reference checks of prospective employment candidates for the **audit client**? [SEC, Regulation S-X, Rule 2-01(c)(4)(vii)(C)] Yes No

Q40. Did the **accounting firm** recommend that the **audit client** hire a specific candidate for a specific job?⁹ [SEC, Regulation S-X, Rule 2-01(c)(4)(vii)(E)] Yes No

Q41. Did the **accounting firm** act as broker-dealer (registered or unregistered) for the **audit client**? [SEC, Regulation S-X, Rule 2-01(c)(4)(viii)] Yes No

Q42. Did the **accounting firm** provide any legal services to the **audit client**, that in the jurisdiction in which the service was provided, required the service providers to be licensed, admitted, or otherwise qualified to practice law? [SEC, Regulation S-X, Rule 2-01(c)(4)(ix)] Yes No

Q43. Did the **accounting firm** provide an expert opinion or other expert service for the **audit client** or the **audit client's** legal counsel for the purpose of advocating the client's interests in litigation or in a regulatory or administrative proceeding or investigation?¹⁰ [SEC, Regulation S-X, Rule 2-01(c)(4)(x)] Yes No

Q44. Except for a power of attorney limited to tax-related activities, did the **firm** obtain a power of attorney to act on behalf of the **client**? [AICPA, Professional Standards, vol. 2, ET sec. 101.05] Yes No

(continued)

⁹ When requested by the **audit client**, excludes interviewing candidates and advising the client on the competency of individuals for accounting, administrative, or control positions.

¹⁰ Excludes situations in which the accounting firm provides factual accounts (including in testimony) to explain positions it took in connection with previously rendered services.

Q45. Did the **accounting firm** provide personal tax services to persons who were in **financial reporting oversight roles** at the **audit client** or their **immediate families**?¹¹ [PCAOB, Rule 3523, Tax Services Provided to Persons in Financial Reporting Oversight Roles]¹²

Yes No

Q46. Did the **accounting firm** provide services to the **audit client**, which involved marketing, planning, or opining in favor of a **confidential transaction** or an **aggressive tax position** (including **listed transactions**)? [PCAOB, Rule 3522, Tax Transactions]¹³

Yes No

Q47. Has the **accounting firm** been engaged to perform or performed services that the **audit committee** has not preapproved? [SEC, Regulation S-X, Rule 2-01(c)(7)]

Yes No

Q48. With respect to tax services subject to preapproval by the **audit committee** on an engagement-by-engagement basis, has the **accounting firm** provided tax services that did not meet PCAOB preapproval requirements for permitted tax services? [PCAOB, Rule 3524, Audit Committee Pre-Approval of Certain Tax Services]¹⁴

Yes No

Q49. With respect to tax services subject to preapproved by the **audit committee** under the **audit committee's** policies and procedures, has the **accounting firm** provided tax services that did not meet PCAOB preapproval requirements for permitted tax services? [PCAOB, Rule 3524, Audit Committee Pre-Approval of Certain Tax Services]¹⁵

Yes No

Q50. If services related to internal controls were performed for the client, did the **audit committee** specifically preapprove the services? [PCAOB Auditing Standard No. 2, An Audit of Internal Control over Financial Reporting Performed in Conjunction with An Audit of Financial Statements, para. 33.]

Yes No N/A

¹¹ Excludes persons who are in financial reporting oversight roles solely because the person served on the client's board of directors, board committee, or similar governance body.

¹² See PCAOB Release 2006-006 for information about transition / implementation dates.

¹³ Excludes tax services provided on or before June 18, 2006.

¹⁴ Excludes tax services pre-approved on or before June 18, 2006.

¹⁵ Excludes tax services provided on or before April 20, 2007.

CATEGORY 4: FEE ARRANGEMENTS

The following are important points:

1. The time period you should consider for purposes of these questions is the **period of the professional engagement** and the period covered by the financial statements.
2. The term **audit client** as used in the SEC Independence Rules includes **affiliates of the audit client** (see Appendix B, "SEC Independence Terms").

Q1. Except for a **client** that is currently in bankruptcy, does (or will) the **client** owe fees to the **firm** for services rendered more than one year prior to the date of the current year's report?

[AICPA, Professional Standards, vol. 2, ET sec. 191.103-104]

Yes No

*Q1a. Does the **audit client** owe the **accounting firm** fees from previously rendered services for an extended period of time that are material in relation to the current year audit engagement?*

[SEC, Codification of Financial Reporting Policies, Independence Matters, 602.02.b.iv, Unpaid Prior Professional Fees]

Yes No

Q2. Did the **firm** provide any of the following services for the **client**:

1. Financial statement audit or review;
2. Financial statement compilation in which the **member** expected third-party reliance and the **member** did not disclose a lack of independence in the report; or
3. An examination of prospective financial information?
[AICPA, Professional Standards, vol. 2, ET sec. 302.01]

(If the answer is *no*, skip questions 3 to 7.)

Yes No

Q3. Did the **firm** also provide any service, other than tax services, for a **contingent fee**, which was not fixed by a court or other public authority? [AICPA, Professional Standards, vol. 2, ET sec. 302.01]

Yes No

(continued)

Q4. Did the **firm** provide tax services for the **client** for a **contingent fee**, such that the **firm** did *not* have a reasonable expectation that the fee would be determined based on the results of judicial proceedings or the findings of governmental agencies? [AICPA, Professional Standards, vol. 2, ET sec. 302.02]

Yes No

Q5. Did the **firm** sell goods or services to the **client** for a **commission**? [AICPA, Professional Standards, vol. 2, ET sec. 503.01]

Yes No

Q6. Did the **firm** receive a **commission** for recommending or referring the **client** to a third party to purchase goods or services (excluding services provided by a CPA)? [AICPA, Professional Standards, vol. 2, ET sec. 503.01]

Yes No

Q7. Did the **firm** receive a **commission** for recommending or referring a third party to the **client** to purchase goods or services (excluding services provided by a CPA)? [AICPA, Professional Standards, vol. 2, ET sec. 503.01]

Yes No

Q8. Did the **accounting firm** provide a product or service to the **audit client** for a **commission** or **contingent fee** or receive a **commission** or **contingent fee** either directly from the **audit client** or indirectly from a party other than the **audit client**?¹⁶ [PCAOB rule 3521, Contingent Fees]

Yes No

Q9. Except for partners in accounting firms with ten or fewer partners or five or fewer SEC audit clients, did an **audit partner** (other than a **specialty partner**) earn or receive compensation based on selling nonaudit services to the **audit client**? [SEC, Regulation S-X, Rule 2-01(c)(8)]

Yes No N/A

¹⁶ Excludes **contingent fee** arrangements that were paid in their entirety, converted to fixed fee arrangements, or otherwise unwound before June 18, 2006. This question also excludes fees that were determined by a court or other public authority acting in the public interest that were not contingent upon the findings or results of the **accounting firm's** services.

CATEGORY 5: MISCELLANEOUS

The following are important points:

1. The time period you should consider for purposes of these questions is the **period of the professional engagement** and the period covered by the financial statements.
2. *Unless noted otherwise, the term **audit client** as used in the SEC Independence Rules includes **affiliates of the audit client** (see Appendix B, “SEC Independence Terms”).*

Q1. Does the engagement letter for this audit or other attest service include a provision that indemnifies a **member** or the **member’s firm** for situations other than knowing misrepresentations made by **client** management? [AICPA, Professional Standards, vol. 2, ET sec. 191.188-189]¹⁷

Yes No

Q1a. *Do the **accounting firm** and the **audit client** have an agreement whereby the client would indemnify **the accounting firm** for any losses, claims, damages, or liabilities the firm may incur as a result of litigation with the **audit client** related to the engagement, including provisions that indemnify the firm for losses relating to knowing misrepresentations by **audit client** management? [SEC, Codification of Financial Reporting Policies, Independence Matters, 602.02.f.i, Indemnification by Client, Application of the SEC’s Rules on Auditor Independence—Frequently Asked Questions, Other Matters, Question 4, (issued December 13, 2004)]¹⁸*

Yes No

Q1b. *Do the **accounting firm** and the **audit client** have an agreement whereby the **accounting firm’s** liability is limited to a certain dollar amount in the event the firm is found to be liable for losses, claims, or damages related to the engagement?*¹⁹

Yes No

(continued)

¹⁷ The AICPA Professional Ethics Executive Committee (PEEC) is considering changes to this rule.

¹⁸ *If affiliates of the **accounting firm** have issued separate engagement letters relating to the audits of subsidiaries, these engagement letters also should be reviewed for compliance with the rule.*

¹⁹ *If foreign affiliates of the **accounting firm** have issued separate engagement letters relating to the audits of foreign subsidiaries, these engagement letters also should be reviewed for compliance with the rule.*

Q2. Has there been any actual or threatened litigation between the **client** and the **firm** involving amounts that would be considered material to either party? [AICPA, Professional Standards, vol. 2, ET sec. 101.08]

Yes No

*Q2a. Has there been any actual or threatened litigation between the **accounting firm** and the **audit client** regarding audit or other attestation work, which has caused the firm and the client to become adversarial? [SEC, Codification of Financial Reporting Policies, Independence Matters, 602.02.f.ii, Litigation]*

Yes No

*Q2b. Has there been any actual or threatened litigation between the **accounting firm** and the **audit client** regarding audit or other attestation work, which has caused the interests of the firm and the client to be inappropriately aligned? [SEC, Codification of Financial Reporting Policies, Independence Matters, 602.02.f.ii, Litigation]*

Yes No

Q3. Has a **covered member** accepted entertainment (e.g., dinner or events) *from* the **client** that would not be considered reasonable under the circumstances (e.g., gifts or events that were lavish or extravagant, not consistent with the occasion, or otherwise inappropriate under the circumstances)? [AICPA, Professional Standards, vol. 2, ET sec. 191.226-27]

Yes No

Q4. Has a **covered member** given gifts or entertainment (e.g., dinner, events) *to* the **client** that would not be considered reasonable under the circumstances (e.g., gifts that were lavish or extravagant, not consistent with the occasion, or otherwise inappropriate under the circumstances)? [AICPA, Professional Standards, vol. 2, ET sec. 191.226-27]

Yes No

Q5. Has a **covered member** or other party in the **firm** identified a potential conflict of interest (i.e., a relationship with another person, entity, product, or service that could be viewed by the **client** or other appropriate parties as impairing his or her objectivity) but he or she failed to obtain consent from the client (or other appropriate parties) to perform the service? [AICPA, Professional Standards, vol. 2, ET sec. 102.03]

Yes No N/A

*Q6. Except for partners in **accounting firms** with ten or fewer partners or five or fewer **SEC audit clients**, has a lead or concurring **audit partner** served on the **audit engagement team** for more than five years? [SEC, Regulation S-X, Rule 2-01(c)(6)]*

Yes No N/A

*Q7. Except for partners in **accounting firms** with ten or fewer partners or five or fewer **SEC audit clients**, has an **audit partner** who is not a lead or concurring **audit partner** (e.g., relationship partner or other partner supporting an engagement besides a **specialty partner**) served on the **audit engagement team** for more than seven years? [SEC, Regulation S-X, Rule 2-01(c)(6), Application of the SEC's Rules on Auditor Independence—Frequently Asked Questions, Audit Partner and Partner Rotation, Question 2,(issued August 13, 2003)]*

Yes No N/A

PART II: RESOLUTION OF POTENTIAL INDEPENDENCE ISSUES

Please review the following categories carefully for any *yes* response you provided in the “Questionnaire” and for any questions that you were unable to answer. An illustration of a documented independence matter appears in Appendix D, “Documenting Independence Matters.” In 2006, the AICPA adopted the *Conceptual Framework for AICPA Independence Standards* (the Framework), which is effective for all independence decisions made after April 30, 2007. The Framework employs a risk-based approach to analyzing independence matters. Its purpose is twofold:

1. It provides a framework used by the AICPA Professional Ethics Executive Committee (PEEC) to set independence standards.
2. It provides a means for users of the *Code of Professional Conduct* (the Code) to evaluate and resolve matters that the Code does not specifically address. See www.aicpa.org/about/code/et_100.html for further information.

CATEGORY 1: PERSONAL FINANCIAL INTERESTS AND RELATIONSHIPS

Prohibitions on personal financial interests and relationships apply during the period of the professional engagement; hence, caught early, timely actions may avoid an independence issue. The following facts, though not all-inclusive, should be gathered and considered:

- The nature of the financial interest or relationship
- The applicable time period(s), e.g., the period of professional engagement and how long the interest was held
- When the individual became a covered member (*or covered person*) and why he or she is a covered member (*or covered person*) under the rules
- The nature of the attest work, e.g., audit, review, agreed-upon procedures²⁰
- Who was aware of the financial interest and when they became aware of it
- Whether the interest is a(n) direct or indirect financial interest (See Appendix A, “AICPA Independence Terms.”)

²⁰ See Appendix E, “Modified AICPA Independence Requirements for Certain SSAE Engagements,” for specific guidance on agreed-upon procedures engagements.

- Whether a financial interest is indirect, or, if otherwise provided for in the rules, whether the interest was material to the net worth of the individual(s) involved
- Whether the interest was held in a retirement or similar employee benefit plan, whether the plan participant is the covered member or his or her immediate family, and whether the plan participant is currently employed by the plan sponsor
- Whether the interest arose as a result of an unsolicited inheritance or gift (See ET Section 101.17, “Unsolicited Financial Interests,” [AICPA, Professional Standards, vol. 2, ET sec. 101.17].)

For matters involving loans, the following facts, though not all-inclusive, should be gathered and considered:

- When the loan was obtained and by whom
- Whether the loan was obtained from a financial institution
- Whether the loan was obtained from the client or from a person or entity associated with the client (e.g., officer, director, significant shareholder, or nonclient parent corporation)
- Whether the borrower was a covered member (or *covered person*) at the time the loan was obtained
- Whether the lender was an attest client when the loan was obtained
- Whether the loan met requirements for grandfathering
- The type of loan
- Specifics surrounding loan renewals and revisions
- Whether the loan is secured by property, and, if so, the proportion of the loan that is secured and whether the unsecured portion is material to the covered member’s net worth

Possible follow-up actions are:

- Remove the individual whose interest or relationship caused the independence issue from the engagement team.
- Dispose of the financial interest or relationship (e.g., loan, checking account) that caused the independence issue.
- Discuss the matter with the client’s governance board (e.g., board of directors, audit committee, or other equivalent body) to determine the board’s views on the matter, especially with respect to the appearance of independence.
- Review the work of the individual whose interest or relationship caused an independence issue.

- Reperform the audit procedures performed by an individual deemed to have caused the independence issue.
- Decline to perform the audit for the affected period(s).
- When appropriate, consider AU section 561, *Subsequent Events*, (AICPA, Professional Standards, vol. 1, AU sec. 561).

CATEGORY 2: EMPLOYMENT AND BUSINESS RELATIONSHIPS

Employment and business relationships are prohibited during the period of the professional engagement *and* the period covered by the financial statements. Restrictions on employment and business relationships also generally apply to more people in the firm, i.e., all partners and professional staff, than the restrictions on financial interests and relationships, which, with some exceptions, apply only to covered members (or *covered persons*) and certain family members. As such, they can be more difficult to address than issues arising from financial interests and relationships. The following facts, though not all-inclusive, should be gathered and considered:

- The nature of the employment or business relationship
- Individuals who held (hold) the position and their relationship to the firm or a member of the firm
- If a relative has an employment or business relationship, the nature of the relationship with the firm member and the firm member's position in the firm
- The applicable time frames, e.g., period of professional engagement, period covered by financial statements, period of the employment or business relationship
- For former partners or professional staff, actions taken to disassociate from the firm
- For former partners or professional staff of the firm, pending relationships with the firm
- For persons formerly associated with the client, actions taken to disassociate from the client
- For persons formerly associated with the client, pending interests or relationships with the client
- *Whether a business relationship was limited to purchasing goods or services from the audit client in an arm's length transaction*
- *For persons in the accounting firm who accepted employment with an audit client and may be subject to the "cooling off" provision:*
 - *A description of the position assumed and the position's impact on the consolidated financial statements of the audit client*

- *The individual's role on the audit engagement team, e.g., lead or concurring partner*
- *Other than the lead and concurring review partners, the amount of time spent on the audit engagement team*
- *Dates the individual served on the audit engagement team and in what capacity*
- *The applicable SEC filing dates (quarterly and annual report dates) covering the individual's service on the audit engagement team and employment with the audit client*
- *Whether the individual became employed by the audit client or an affiliate of the audit client*
- *Whether the employment resulted from a merger or acquisition that was not contemplated by the individual*
- *When the individual became employed by the audit client*
- *Whether the matter has been discussed with the audit committee and, if so, the substance of that discussion*

Possible follow-up actions are:

- Cease the employment or business relationship that caused the independence issue.
- Review the work of the individual whose relationship caused the independence issue.
- Reperform audit procedures performed by the individual deemed to have caused the independence issue.
- Decline to perform the audit for the affected period(s).
- When appropriate, consider AU section 561, *Subsequent Events*.
- Discuss the matter with the client's governance board (e.g., board of directors, audit committee, or other equivalent body) to determine the board's views on the matter, especially with respect to the appearance of independence.
- *Discuss the matter with the audit client's governance board (e.g., board of directors, audit committee, or other equivalent body) to determine whether, due to an emergency or other unusual situation, it is in the best interest of investors to permit the employment. [SEC, Release No. 33-8183, *Strengthening the Commission's Requirements Regarding Auditor Independence, II. Discussion of Rules*]*

CATEGORY 3: NONATTEST SERVICES ENGAGEMENTS

Like employment and business relationships, restrictions on certain nonattest services apply during the period of the professional engagement and the period covered by the financial statements. The following facts, though not all-inclusive, should be gathered and considered:

- The nature of the work or other activities performed
- The nature of the attest work, e.g., audit, review, agreed-upon procedures
- The applicable time frames, e.g., the period of professional engagement, the period covered by the financial statements, and the period during which services or activities were performed
- The individuals who performed the services or activities and their relationship, if any, to the attest engagement team
- The individual associated with the client who was designated to oversee the firm's work, and that person's title, background, and experience
- Whether an agreement on the firm's and the client's respective roles was reached prior to performing the services
- Whether the agreement on the firm's and the client's respective roles was documented prior to performing the services
- *Whether for the following nonaudit services (bookkeeping, internal audit outsourcing, appraisal, valuation and actuarial, and financial information systems design and implementation):*
 - *Services were provided to the audit client or to an affiliate of the audit client, and*
 - *If services were provided to an affiliate of the audit client, it is reasonable to conclude that the results of these services would not be subject to audit procedures during the audit of the client's financial statements [SEC, Regulation S-X, Rule 2-01(c)(4); Application of the SEC's Rules on Auditor Independence—Frequently Asked Questions, Prohibited and Non-audit Services, Question 4 (issued August 13, 2003)]*
- *Whether services or other activities performed for the audit client were inconsistent with the principles underlying the SEC independence rules, i.e., created a mutual or conflicting interest between the accounting firm and the audit client; placed the accounting firm in a position in which it subsequently audited its own work; resulted in the accounting firm acting as management or as an employee of the audit client; or placed the accounting firm in a position in which it acted as an advocate for the audit client.*

- *With regards to personal tax services provided to persons in financial reporting oversight roles:*
 - *A description of the person’s position with the audit client*
 - *The effect of the person’s responsibilities, if any, on the audit client’s consolidated financial statements*
 - *Whether the person was in a financial reporting oversight role solely because he or she was a member of the board of directors or a committee of the board*
 - *Whether the person was in a financial reporting oversight role solely because he or she was hired or promoted by the audit client and, if so, the applicable time frames*
 - *The nature of the services provided by the accounting firm*
- *With regards to legal services, whether services that were provided to audit clients residing outside the United States satisfied criteria in the SEC staff’s guidance on applying the SEC independence rules. [Frequently Asked Question No. 1, Application of the SEC’s Rules on Auditor Independence—Frequently Asked Questions, Prohibited and Non-audit Services, Question 1, (issued January 16, 2001)]*
- *With regards to services relating to tax transactions:*
 - *A description of the tax service*
 - *A description of the tax transaction*
 - *A description of the terms relating to the transaction (e.g., confidentiality)*
 - *Whether the transaction was marketed by an entity other than the accounting firm, and, if so, a description of the relationship and the financial arrangement between the accounting firm and the other entity*
 - *Whether the tax transaction is a “listed transaction” (or is substantially similar to a listed transaction) that has been publicized by the Internal Revenue Service (IRS), the publication date of the listing, and when the accounting firm became aware of the listing*
 - *Whether the accounting firm concluded at the time the services were performed that the transaction met the “more likely than not” standard described in the Internal Revenue Code (IRC)*
- *Whether services requiring pre-approval met criteria for a waiver [SEC, Regulation S-X, Rule 2-01(c)(7)(i)(C)]*
- *With regards to tax services that were not pre-approved in accordance with PCAOB Rule 3524, a description of the procedures followed by the accounting firm in obtaining preapproval for the applicable services*

- *With regards to internal control related services that were not specifically preapproved by the audit committee, a description of the procedures followed by the accounting firm in obtaining preapproval for the applicable services*

Possible follow-up actions are:

- Discuss the matter with the client's governance board (e.g., board of directors, audit committee, or other equivalent body) to determine the board's views on the matter, especially with respect to the appearance of independence.
- Cease performing the prohibited services or activities.
- Decline to perform the audit (or other attest) engagement for the affected period(s).
- Have an independent third party reperform the nonattest services that gave rise to an independence issue.²¹
- When appropriate, consider AU section 561, *Subsequent Events*.

CATEGORY 4: FEE ARRANGEMENTS

Unpaid Fees

An AICPA ethics ruling states that fees outstanding for any previously rendered professional services exceeding 12 months that remain unpaid at the date of the attest report impair a firm's independence. The following facts, though not all-inclusive, should be considered to address unpaid fee issues:

- The length of time the fees have been outstanding
- Whether the client has the financial means and is willing to pay the outstanding fees in full prior to issuance of the report
- Whether the client has committed to pay the prior year fees in full prior to issuance of the current year report
- Whether the firm is willing to compromise on previously owed amounts, including forgiving the debt in full
- *Whether unpaid fees for previously rendered services are material in relation to the fee expected to be paid for the current year audit*
- *The type of attest engagement involved, e.g., annual audit or registration of securities*

²¹ Readers should note that the AICPA and SEC independence rules contain no provisions relating to reperformance of prohibited non-audit services. Such actions are best considered in concert with the client's governance committee and advice of the appropriate regulatory or standard-setting bodies.

- *Whether the accounting firm is reasonably assured that the audit client has committed to pay current year fees in full before next year's audit engagement is commenced*

Possible follow-up actions are:

- Obtain assurance from the client that all fees will be paid in full prior to issuance of the report for the current year.
- Forgive all or part of the client's fees to enable the attest engagement to be performed (provided there will be no remaining balance).
- Decline to perform the current year attest engagement if the unpaid fees will remain unpaid at the report date.
- When appropriate, consider AU section 561.
- *Obtain commitment from the audit client to pay current year audit fees in full before next year's audit engagement may be commenced.*

Commissions and Contingent Fees

The AICPA prohibition on commissions and contingent fees applies during the period in which a member or member's firm is engaged to perform any of the four listed services and the period covered by any historical financial statements involved in any of the four listed services. SEC rules prohibit both commissions and contingent fees, whether received directly from the audit client or indirectly from a party other than the audit client during the same period. The SEC rules also apply to any audit client (that is, a client for whom the accounting firm provides audit, review, or *any* attest services). The following facts, though not all-inclusive, should be gathered and considered:

- The applicable time period(s)
- The nature of the service, e.g., audit or review of financial statements, or other listed service
- The amount of the contingent fee and whether the contingent fee was material to the member or the member's firm²²
- The significance of the result of the service to the client²³
- The specific terms of the fee arrangement, such as a description of the contingency event, the parties involved, or, for a commission arrangement, the name of the purchaser or supplier of the product or service and a description of the client relationship

²² Please note that the AICPA and SEC rules do not include any allowances for these factors.

²³ Please note that the AICPA and SEC rules do not include any allowance for this factor.

- Whether fees were fixed by the courts or another public authority, and, if so, a description of the entity
- Whether at the time the fee arrangement was made, the member or member's firm had a reasonable expectation that the fees related to a tax matter would be determined on the basis of judicial proceedings or the findings of a governmental agency, and the justification for such expectation
- Whether services relating to the fee arrangement have already been provided
- *Whether fees were paid directly (i.e., by the audit client) or indirectly (i.e., by a party or entity other than the audit client)*

Possible follow-up actions are:

- Restructure the contingent fee arrangement so that it is not *contingent* (e.g., set a fixed fee for the engagement or a fixed hourly rate plus expenses) as defined in ET Section 302, "Contingent Fees," (AICPA, *Professional Standards*, vol. 2, ET sec. 302).
- Cancel commission agreements involving an attest client purchaser or an attest client supplier.
- Decline to perform the services outlined in ET Sections 302 and 503, "Commissions and Referral Fees," (AICPA, *Professional Standards*, vol. 2, ET sec. 503), covering the period of any historical financial statements during which prohibited commissions or contingent fees were received.
- Discuss the matter with the client's governance board (e.g., board of directors, audit committee, or other equivalent body) to determine the board's views on the matter, especially with respect to the appearance of independence.
- When appropriate, consider AU section 561, *Subsequent Events*.
- *Decline to perform the audit, review or other attest engagement for the affected period(s).*

Partner Compensation

The following facts, though not all-inclusive, should be gathered and considered:

- *Whether the audit client is a broker-dealer or an investment adviser, i.e., not an issuer, which may exempt the engagement from partner rotation and compensation requirements [Application of the SEC's Rules on Auditor Independence—Frequently Asked Questions, Broker-Dealers and Investment Advisers, Question 1, (issued August 13, 2003)]*
- *A description of any arrangements to compensate audit partners that are tied to selling nonaudit services*

- *Whether the partner meets the definition of “audit partner” in the SEC Independence Rules [SEC, Regulation S-X, Rule 2-01(c)(8)]*

Possible follow-up actions are:

- *Amend partner compensation practices to be consistent with SEC Independence Rules.*
- *Discuss the matter with the client’s governance board (e.g., board of directors, audit committee, or other equivalent body) to determine the board’s views on the matter, especially with respect to the appearance of independence.*
- *Decline to perform the audit (or other attest) engagement for the affected period(s).*
- *When appropriate, consider AU section 561, Subsequent Events*

CATEGORY 5: MISCELLANEOUS

Considerations and follow-up for items falling into the miscellaneous category will vary but are similar to categories 1 to 4. Additional follow-up actions, though not all-inclusive, include:

- With regard to any indemnification agreement to limit the auditor’s liability in connection with an audit or other attest engagements, revoke the indemnification provision.
- Gifts given to the auditor from the client can be returned to the client. Alternatively, the client can be reimbursed for gifts or entertainment.
- With regard to conflicts of interest, if services have not yet been performed or completed, discuss the matter with the appropriate parties and request their consent to perform or continue performing the services.
- Discuss conflicts of interest matters with the client’s governance board (e.g., board of directors, audit committee, or other equivalent body) to determine the board’s views on the matter, especially with respect to the appearance of independence.
- Decline to perform the audit (or other attest) engagement for the affected period(s).
- When appropriate, consider AU section 561, *Subsequent Events*.

APPENDIX A: AICPA INDEPENDENCE TERMS

Attest engagement. An attest engagement is an engagement that requires independence as defined in *AICPA Professional Standards*.

Attest engagement team. The attest engagement team consists of individuals participating in the attest engagement, including those who perform concurring and second-partner reviews. The attest engagement team includes all employees and contractors retained by the firm who participate in the attest engagement, irrespective of their functional classification (for example, audit, tax, or management consulting services). The attest engagement team excludes specialists as discussed in AU section 336, *Using the Work of a Specialist* (AICPA, *Professional Standards*, vol. 1, AU sec. 336), and individuals who perform only routine clerical functions, such as word processing and photocopying.

Client. A client is any person or entity, other than the member's employer, that engages a member or a member's firm to perform professional services, or that engages a person or entity with respect to which professional services are performed. For purposes of this paragraph, the term *employer* does not include:

1. Entities engaged in the practice of public accounting; or
2. Federal, state, and local governments or component units thereof, provided the member performing professional services with respect to those entities:
 - a. Is directly elected by voters of the government or component unit thereof with respect to the professional services that are performed; or
 - b. Is an individual who is (1) appointed by a legislative body and (2) subject to removal by a legislative body; or
 - c. Is appointed by someone other than the legislative body, so long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body.

Close relative. A close relative is a parent, sibling, or nondependent child.

Commission. A commission is any compensation for recommending or referring a product or service to a third party. The term *commission* excludes a referral fee paid for the services of a CPA to any person.

Contingent fee. A contingent fee is a fee established for the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such service.

Covered member. A covered member is:

1. An individual on the attest engagement team;
2. An individual in a position to influence the attest engagement;
3. A partner or manager who provides nonattest services to the attest client beginning once he or she provides 10 hours of nonattest services to the client within any fiscal year and ending on the later of the date (a) the firm signs the report on the financial statements for the fiscal year during which those services were provided or (b) he or she no longer expects to provide 10 or more hours of nonattest services to the attest client on a recurring basis;
4. A partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement;
5. The firm, including the firm's employee benefit plans; or
6. An entity whose operating, financial, or accounting policies can be controlled (as defined by generally accepted accounting principles [GAAP] for consolidation purposes) by any of the individuals or entities described in items 1 through 6 or by two or more such individuals or entities if they act together.

Dependent. Generally, a dependent is an individual who receives more than half of his or her financial support from the covered member.

Direct financial interest. A direct financial interest is:

- Owned directly by an individual or entity (including those managed on a discretionary basis by others); or
- Under the control of an individual or entity (including those managed on a discretionary basis by others); or
- Beneficially owned through an investment vehicle, estate, trust, or other intermediary when the beneficiary:
 - Controls the intermediary; or
 - Has the authority to supervise or participate in the intermediary's investment decisions.

A financial interest is beneficially owned if an individual or entity is not the record owner of the interest but has a right to some or all of the underlying benefits of ownership. These benefits include the authority to direct the voting or the disposition of the interest or to receive the economic benefits of the ownership of the interest.

Diversified mutual fund. A diversified mutual fund is a mutual fund that meets the requirements of Section 5(b)(1) of the Investment Company Act of 1940 (the Act). In addition, a mutual

fund's prospectus will indicate if a fund is *not* diversified and may be used to determine whether a mutual fund is a diversified mutual fund meeting the Act's criteria.

Financial institution. A financial institution is considered to be an entity that, as part of its normal business operations, makes loans or extends credit to the general public. In addition, for automobile leases addressed under AICPA Interpretation 101-5, *Loans From Financial Institution Clients* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.07), an entity would be considered a financial institution if it leases automobiles to the general public.

Financial interest. A financial interest is an ownership interest in an equity or a debt security issued by an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.

Firm. A firm is a form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the American Institute of Certified Public Accountants that is engaged in the practice of public accounting. Except for purposes of applying AICPA Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.01), the firm includes the individual partners thereof.

Grandfathered loan. Grandfathered loans (unsecured loans that are not material to a covered member's net worth, and home mortgages, and other secured loans) must meet the following conditions:

1. They were obtained from a financial institution under that institution's normal lending procedures, terms, and requirements,
2. After the borrower becomes a covered member, they are kept current as to all terms at all times and those terms do not change in any manner not provided for in the original loan agreement, and
3. They were obtained from a financial institution:
 - a. Prior to its becoming a client requiring independence; or
 - b. For which independence was not required and were later sold to a client for which independence is required; and
4. They complied with the applicable independence requirements in place at the time the loan was obtained.

Immediate family. Immediate family is a spouse, spousal equivalent, or dependent (whether or not related).

Indirect financial interest. An indirect financial interest is a financial interest beneficially owned through an investment vehicle, estate, trust, or other intermediary, such that the

beneficiary neither controls the intermediary nor has the authority to supervise or participate in the intermediary's investment decisions.

A financial interest is **beneficially owned** if an individual or entity is not the record owner of the interest but has a right to some or all of the underlying benefits of ownership. These benefits include the authority to direct the voting or the disposition of the interest or to receive the economic benefits of the ownership of the interest.

Individual in a position to influence the attest engagement. An individual in a position to influence the attest engagement is one who:

1. Evaluates the performance or recommends the compensation of the attest engagement partner;
2. Directly supervises or manages the attest engagement partner, including all successively senior levels above that individual through the firm's chief executive;
3. Consults with the attest engagement team regarding technical or industry-related issues specific to the attest engagement; or
4. Participates in or oversees, at all successively senior levels, quality control activities, including internal monitoring, with respect to the specific attest engagement.

Joint closely held investment. A joint closely held investment is an investment in an entity or property by the member and the client (or the client's officers or directors, or any owner who has the ability to exercise significant influence over the client) that enables them to control (as defined by GAAP for consolidation purposes) the entity or property.

Key position. A key position is a position in which an individual:

1. Has primary responsibility for significant accounting functions that support material components of the financial statements;
2. Has primary responsibility for the preparation of the financial statements; or
3. Has the ability to exercise influence over the contents of the financial statements, including when the individual is a member of the board of directors or similar governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

For purposes of attest engagements not involving a client's financial statements, a key position is one in which an individual is primarily responsible for or able to influence the subject matter of the attest engagement, as described above.

Loan. A loan is a financial transaction, the characteristics of which generally includes but are not limited to an agreement that provides repayment terms and a rate of interest. A loan includes but is not limited to a guarantee of a loan, a letter of credit, a line of credit, or a loan commitment.

Manager. A manager is a professional employee of the firm who has either of the following responsibilities:

1. Continuing responsibility for the overall planning and supervision of engagements for specified clients.
2. Authority to determine that an engagement is complete subject to final partner approval if required.

Member. A member, associate member, or international associate of the American Institute of Certified Public Accountants.

Normal lending procedures, terms, and requirements. *Normal lending procedures, terms, and requirements* relating to a covered member's loan from a financial institution are defined as lending procedures, terms, and requirements that are reasonably comparable with those relating to loans of a similar character committed to other borrowers during the period the loan to the covered member is committed. Accordingly, in making such comparison and in evaluating whether a loan was made under "normal lending procedures, terms, and requirements," the covered member should consider all the circumstances under which the loan was granted, including:

1. The amount of the loan in relation to the value of the collateral pledged as security and the credit standing of the covered member
2. Repayment terms
3. Interest rate, including "points"
4. Closing costs
5. General availability of such loans to the public

Related prohibitions that may be more restrictive are prescribed by certain state and federal agencies having regulatory authority over such financial institutions. Broker-dealers, for example, are subject to regulation by the SEC.

Office. An office is 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, the expected regular personnel interactions and assigned reporting channels of an individual may well be more important than an individual's physical location.

Partner. A partner is a proprietor, shareholder, or equity or nonequity partner of the firm, or is any individual who assumes the risks and benefits of firm ownership or who is otherwise held out by the firm to be the equivalent of any of the aforementioned.

Period of the professional engagement. The period of the professional engagement begins if a member either signs an initial engagement letter or other agreement to perform attest services, or begins to perform an attest engagement for a client, whichever is earlier. The period lasts for the entire duration of the professional relationship (which could cover many periods) and ends with the formal or informal notification by either the member or the client of the termination of the professional relationship or by the issuance of a report, whichever is later. Accordingly, the period does not end with the issuance of a report and recommence with the beginning of the following year's attest engagement.

Permitted loan. Permitted loans are the following new loans and leases, obtained from a financial institution client. These loans and leases must be obtained under the institution's normal lending procedures, terms, and requirements and must, at all times, be kept current as to all terms, such as the following:

1. Automobile loans and leases collateralized by the automobile.
2. Loans fully collateralized by the cash surrender value of an insurance policy
3. Loans fully collateralized by cash deposits at the same financial institution (e.g., "passbook loans")
4. Aggregate outstanding balances from credit cards and overdraft reserve accounts that are reduced to \$10,000 or less on a current basis taking into consideration the payment due date and any available grace period

Significant influence. The term *significant influence* is as defined in Accounting Principles Board Opinion (APB) No. 18, *The Equity Method of Accounting for Investments in Common Stock*, and its interpretations.

Source document. Source documents are the documents upon which the evidence of an accounting transaction is initially recorded. Source documents are often followed by the creation of many additional records and reports, which do not, however, qualify as initial recordings. Examples of source documents are purchase orders, payroll timecards, and customer orders.

Spousal equivalent. A spousal equivalent designation should be made on a case-by-case basis considering factors such as the nature of the relationship, living and financial arrangements, and whether a common law marriage exists. However, it should be noted that the lack of a common law marriage under state law (or the lack of such law recognizing common law marriages in an individual's state of residence) does not mean that an individual is not a spousal equivalent if other factors lead to that conclusion.

APPENDIX B: SEC INDEPENDENCE TERMS

Accountant. A registered public accounting firm, certified public accountant, or public accountant performing services in connection with an engagement for which independence is required. References to the accountant include any accounting firm with which the certified public accountant or public accountant is affiliated.

Accounting firm. An organization (whether it is a sole proprietorship, incorporated association, partnership, corporation, limited liability company, limited liability partnership, or other legal entity) that is engaged in the practice of public accounting and furnishes reports or other documents filed with the SEC or otherwise prepared under the securities laws, and all of the organization's departments, divisions, parents, subsidiaries, and associated entities, including those located outside of the United States. The accounting firm also includes the organization's pension, retirement, investment, or similar plans.

Accounting role. A role in which a person is in a position to exercise or does exercise more than minimal influence over the contents of the accounting records or anyone who prepares them.

Affiliate of the audit client. Affiliates are defined as the following:

1. An entity that has control over the audit client, or over which the audit client has control, or which is under common control with the audit client, including the audit client's parents and subsidiaries;
2. An entity over which the audit client has significant influence, unless the entity is not material to the audit client;
3. An entity that has significant influence over the audit client, unless the audit client is not material to the entity; and
4. Each entity in the investment company complex when the audit client is an entity that is part of an investment company complex.

Aggressive tax position. Aggressive tax transactions include, but are not limited to, any transaction that is a listed transaction within the meaning of U. S. tax law (26 CFR Section 1.6011-4(b)(2)). An accounting firm indirectly recommends a transaction when the firm, including an affiliate of the firm or another tax adviser with which the firm has a formal agreement or other arrangement related to the promotion of such transactions, recommends engaging in the transaction.

Audit client. The entity whose financial statements or other information is being audited, reviewed, or attested and any affiliates of the audit client.

Audit committee. A committee (or equivalent body) as defined in section 3(a)(58) of the Securities Exchange Act of 1934 (15 USC 78c(a)(58)).

Audit engagement team. All partners, principals, shareholders and professional employees participating in an audit, review, or attestation engagement of an audit client, including audit partners and all persons who consult with others on the audit engagement team during the audit, review, or attestation engagement regarding technical or industry-specific issues, transactions, or events.

Audit partner. A partner or persons in an equivalent position (other than a partner who consults with others on the audit engagement team during the audit, review, or attestation engagement regarding technical or industry-specific issues, transactions, or events), who is a member of the audit engagement team who has responsibility for decision-making on significant auditing, accounting, and reporting matters that affect the financial statements, or who maintains regular contact with management and the audit committee and includes the following:

1. The lead or coordinating audit partner having primary responsibility for the audit or review (i.e., the *lead partner*);
2. The partner performing a second level of review to provide additional assurance that the financial statements subject to the audit or review are in conformity with GAAP and the audit or review and any associated report are in accordance with generally accepted auditing standards (GAAS) and rules promulgated by the SEC or the PCAOB (the *concurring or reviewing partner*);
3. Other audit engagement team partners who provide more than ten hours of audit, review, or attest services in connection with the annual or interim consolidated financial statements of the issuer or an investment company registered under section 8 of the Investment Company Act of 1940 (15 USC 80a-8); and
4. Other audit engagement team partners who serve as the lead partner in connection with any audit or review related to the annual or interim financial statements of a subsidiary of the issuer whose assets or revenues constitute 20 percent or more of the assets or revenues of the issuer's respective consolidated assets or revenues.

Chain of command. All persons who:

1. Supervise or have direct management responsibility for the audit, including all successively senior levels through the accounting firm's chief executive;
2. Evaluate the performance or recommend the compensation of the audit engagement partner;
or
3. Provide quality control or other oversight of the audit.

Commission. Any compensation for recommending or referring a product or service to a third party.

Confidential transactions. In general, a confidential transaction is a transaction that is offered to a taxpayer under conditions of confidentiality and for which the taxpayer has paid a fee to an adviser.

1. A transaction is considered to be offered to a taxpayer under conditions of confidentiality if the adviser who is paid the fee places a limitation on disclosure by the taxpayer of the tax treatment or tax structure of the transaction and the limitation on disclosure protects the confidentiality of that adviser's tax strategies. A transaction is treated as confidential even if the conditions of confidentiality are not legally binding on the taxpayer. A claim that a transaction is proprietary or exclusive is not treated as a limitation on disclosure if the adviser confirms to the taxpayer that there is no limitation on disclosure of the tax treatment or tax structure of the transaction.
2. For purposes of this definition, a fee includes all fees for a tax strategy or for services for advice (whether or not tax advice) or for the implementation of a transaction. These fees include consideration in whatever form paid, whether in cash or in kind, for services to analyze the transaction (whether or not related to the tax consequences of the transaction), for services to implement the transaction, for services to document the transaction, and for services to prepare tax returns to the extent that the fees exceed the fees customary for return preparation. For purposes of this definition, a taxpayer also is treated as paying fees to an adviser if the taxpayer knows or should know that the amount it pays will be paid indirectly to the adviser, such as through a referral fee or fee-sharing arrangement. A fee does not include amounts paid to a person, including an adviser, in that person's capacity as a party to the transaction. For example, a fee does not include reasonable charges for the use of capital or the sale or use of property.
3. Persons who bear a relationship to each other as described in section 267(b) or 707(b) of the Internal Revenue Code will be treated as the same person.

Contingent fee. Any fee established for the sale of a product or the performance of any service pursuant to an arrangement in which no fee will be charged unless a specified finding or result is attained, or in which the amount of the fee is otherwise dependent upon the finding or result of such product or service. Solely for the purposes of this definition, a fee is not a "contingent fee" if the amount is fixed by courts or other public authorities and not dependent on a finding or result.

Covered persons. The following partners, principals, shareholders, and employees of an accounting firm:

1. The audit engagement team;

2. The chain of command;
3. Any other partner, principal, shareholder, or managerial employee of the accounting firm who has provided ten or more hours of nonaudit services to the audit client for the period beginning on the date such services are provided and ending on the date the accounting firm signs the report on the financial statements for the fiscal year during which those services are provided, or who expects to provide ten or more hours of nonaudit services to the audit client on a recurring basis; and
4. Any other partner, principal, or shareholder from an office of the accounting firm in which the lead audit engagement partner primarily practices in connection with the audit.

Financial reporting oversight role. A role in which a person is in a position to exercise or does exercise influence over the contents of the financial statements or anyone who prepares them, such as when the person is a member of the board of directors or similar management or governing body, chief executive officer, president, chief financial officer, chief operating officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, or any equivalent position.

Investment company complex. This includes:

1. An investment company and its investment adviser or sponsor;
2. Any entity controlled by or controlling an investment adviser or sponsor in paragraph (f)(14)(i)(A) of this section, or any entity under common control with an investment adviser or sponsor in paragraph (f)(14)(i)(A) of this section if the entity:
 - a. Is an investment adviser or sponsor; or
 - b. Is engaged in the business of providing administrative, custodian, underwriting, or transfer agent services to any investment company, investment adviser, or sponsor; and
3. Any investment company or entity that would be an investment company but for the exclusions provided by Section 3(c) of the Investment Company Act of 1940 (15 U.S.C. 80a-3(c)) that has an investment adviser or sponsor included in this definition by either paragraph (f)(14)(i)(A) or (f)(14)(i)(B) of this section.

An investment adviser, for purposes of this definition, does not include a subadviser whose role is primarily portfolio management and is subcontracted with or overseen by another investment adviser.

A *sponsor*, for purposes of this definition, is an entity that establishes a unit investment trust.

Issuer. An issuer is an entity whose securities are registered under section 12 of the Exchange Act or that is required to file reports under section 15(d), or that files or has filed a registration

statement that has not yet become effective under the Securities Act and that it has not withdrawn.

Office. A distinct subgroup within an accounting firm, whether distinguished along geographic or practice lines.

Specialty partner. Partners who consult with others on the audit engagement team during the audit, review, or attestation engagements regarding technical, industry or other specific issues (e.g., tax partner).

APPENDIX C : SOURCES OF GUIDANCE

Readers may refer to www.aicpa.org/members/div/ethics/index.htm for comprehensive, helpful information about the AICPA and the independence rules of other standard setters and regulators.

AICPA guidance is as follows:

- The Web site address for information about the AICPA ethics standard-setting activities is www.aicpa.org/members/div/ethics/standard.htm.
- For resources related to understanding and applying nonattest services rules, see: http://www.aicpa.org/members/div/ethics/intr_101-3.htm
- The *AICPA Code of Professional Conduct* is available at <http://www.aicpa.org/about/code/index.html> (See ET Section 100 for independence, ET Section 300 for contingent fees, and ET Section 500 for commissions.)
- For independence inquiries by phone call (888) 777-7077. Send e-mail inquiries to ethics@aicpa.org.
- The AICPA interactive CD-ROM course on independence, entitled *Independence*, provides information on the AICPA's and SEC's independence rules and qualifies for CPE credit. See www.cpa2biz.com/CS2000/Products/CPA2BIZ/CPE+Self-Study/Sub+1/Independence.htm?cs_catalog=CPA2Biz.

SEC guidance is as follows:

- The SEC's January 2003 rules release regarding independence is available at www.sec.gov/rules/final/33-8183.htm.
- U.S. Securities & Exchange Commission, Office of the Chief Accountant
100 F Street, NE, Washington, DC 20549, 202-551-5300 (Phone), 202-772-9252 (Fax).

The PCAOB has established a Web site at www.pcaobus.org. Standards may be found at www.pcaobus.org/Standards/index.aspx.

Sources of other guidance are as follows:

Government Accountability Office (GAO) guidance is as follows:

- The GAO Yellow Book requirements are available at www.gao.gov/aac.html
- The answers to frequently asked independence questions can be obtained at www.gao.gov/govaud/d02870g.pdf

- A slide presentation on independence standards can be viewed at www.gao.gov/govaud/niaf021025.pdf
- Direct inquiries to Marcia Buchanan, Asst. Director—Financial Management and Assurance at (202) 512-9321 or e-mail buchananm@gao.gov or yellowbook@gao.gov

Sources of other guidance are as follows:

- DOL Regulation 2509.75-9, Interpretive Bulletin Relating to Guidelines on Independence of Accountant Retained by Employee Benefit Plan
- Direct inquiries to the Department of Labor at 1-866-4-USA-DOL
- Federal Deposit Insurance Corporation (FDIC), *The Annual Independent Audits and Reporting Requirements*, can be obtained at www.fdic.gov/regulations/laws/rules/2000-8500.html#2000part363
- State Boards of Accountancy Information is available at www.aicpa.org/states/info/index.htm

APPENDIX D: DOCUMENTING INDEPENDENCE MATTERS

Firms should ensure that they adequately document matters involving independence considerations in the audit working papers. An illustration of a fictional firm's documentation of an independence matter involving a fictional public company appears below.

Date: December 18, 2006

Client Name: Saltworth, Inc.

Lead Partner: B. Brown

Description of the Facts:

1. T. Morris is an audit partner in the Long Island, NY office of Zaita, Rose & Associates, CPAs (CPA Firm). T. Morris has no oversight responsibilities in the firm with regards to audit or other attestation engagements.
2. T. Morris has a daughter who is considering an employment offer from Saltworth Inc., a Long Island based electronics firm and attest client of the firm.
3. Saltworth is a publicly held company whose shares are traded on the NASDAQ "over the counter" stock exchange.
4. Since 1999, CPA Firm has performed all attestation and other services related to Saltworth's public filings with the SEC.
5. The lead engagement partner for this engagement is B. Brown, a Long Island office partner. B. Brown staffs and conducts the audit engagement in the Long Island office.
6. T. Morris' daughter would work in Saltworth's internal audit department as an Internal Audit Director with overall responsibility for Saltworth's financial and operational internal audit function including:
 - a. Setting project objectives, methodology, timeline and deliverables,
 - b. Identifying areas to be examined,
 - c. Documenting process flows,

- d. Performing interviews,
- e. Supervising staff,
- f. Evaluating the adequacy of internal controls associated with business processes and adherence to controls and processes,
- g. Analyzing data and forming recommendations, and
- h. Communicating findings and recommendations to management.

A copy of the job description and reporting lines are included as an attachment.

- 7. The position being considered is a “financial reporting oversight role” in that it would allow the daughter to exercise influence over the contents of the financial statements.
- 8. The daughter meets the definition of a close relative, i.e., nondependent child of T. Morris.
- 9. The SEC rules [SEC, Regulation S-X, Rule 2-01(c)(2)(ii)] say that a covered person (i.e., a partner residing in the same office as the lead audit partner conducting the engagement) whose close relative (i.e., nondependent child) has a financial reporting oversight role with the audit client impairs the firm’s independence.
- 10. The firm, B. Brown and T. Morris have agreed that, should the daughter plan to accept the employment offer, T. Morris will relocate to the New York City office of the firm, which is a separate and distinct office from the firm’s Long Island office (e.g., separate management and practice structures). Since T. Morris is not in the chain of command over this engagement, relocating to a separate office in the firm allows T. Morris to no longer be considered a covered person whose close relative’s position would impair the firm’s independence. Further, T. Morris would refrain from providing any services, whether attest or nonattest, to this client for any periods in which the firm is required to be independent of the client.

APPENDIX E: MODIFIED AICPA INDEPENDENCE REQUIREMENTS FOR CERTAIN SSAE ENGAGEMENTS

AICPA Rule 101, *Independence* (AICPA, Professional Standards, vol. 2, ET sec. 101.01), and its interpretations and rulings apply to all attest engagements. However, for purposes of performing engagements to issue reports under the Statements on Standards for Attestation Engagements (SSAEs) that are restricted to identified parties, only the specified covered members and their immediate families are required to be independent with respect to the responsible party in accordance with AICPA Rule 101. These covered members are individuals:

- Participating on the attest engagement team;
- Who directly supervise or manage the attest engagement partner; and
- Who consult with the attest engagement team regarding technical or industry-related issues specific to the attest engagement.

In addition, independence would be considered to be impaired if the firm had a financial relationship covered by AICPA Interpretation 101-1.A (AICPA, *Professional Standards*, vol. 2, ET sec. 101.02) with the responsible party that was material to the firm.

In cases in which the firm provides nonattest services to the responsible party that are proscribed under AICPA Interpretation 101-3, “Performance of Nonattest Services,” under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.05), and that do not directly relate to the subject matter of the attest engagement, independence would not be considered to be impaired.

In circumstances in which the individual or entity that engages the firm is not the responsible party or associated with the responsible party, individuals on the attest engagement team need not be independent of the individual or entity, but should consider their responsibilities under AICPA Interpretation 102-2, “Conflicts of Interest,” under Rule 102, *Integrity and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 102.03), with regard to any relationships that may exist with the individual or entity that engages them to perform these services.

This Interpretation does not apply to an engagement performed under the Statements on Auditing Standards (SAS) or Statements on Standards for Accounting and Review Services (SSARS), or to an examination or review engagement performed under the Statements on Standards for Attestation Engagements (SSAE).

Source: AICPA Interpretation 101-11, “Modified application of rule 101 for certain engagements to issue restricted-use reports under the Statements on Standards for Attestation Engagements” [AICPA, *Professional Standards*, vol. 2, ET sec. 101.11] of the AICPA Code of Professional Conduct.

APPENDIX F: OTHER INDEPENDENCE RULES AND ISSUES

STATE ACCOUNTANCY BOARDS

The states have independence rules that may be similar to the AICPA, SEC and PCAOB; however, some states have more restrictive rules. For example, the California accountancy board has a rule similar to the SEC's "cooling off" provision; however, the California board's rule applies to both public and nonpublic entities. Therefore, the accountancy board's rules pertaining to the state in which the audit or other attest service is being performed should be carefully reviewed. In addition, auditors holding individual licenses from other states should be mindful of their home state independence and ethics requirements whenever they perform audit or other attest services.

EUROPEAN UNION

Among other things, the European Union (EU) has recommended a rule that requires a two-year "cooling off" period for a key audit partner who joins an audit client as a chief executive officer, chief financial officer, chief accounting officer or equivalent position. The member states of the EU have adopted the EU recommendation, which may vary from state to state. These rules apply to EU-domiciled audit clients and subsidiaries of non-EU audit clients operating in the EU.

STOCK EXCHANGE LISTING REQUIREMENTS

Directorships at NYSE and NASD Listed Companies

The New York Stock Exchange (NYSE) and the National Association of Security Dealers (NASD) have adopted listing requirements that require directors to be independent. Although these rules do not affect the audit firm's independence, a client's failure to comply with them may jeopardize its listing on the related stock exchanges. For example, to be considered an independent director, among other things, a director must not be associated with the audit firm for a period of three years. In addition, directors are not independent if certain of their family members work for the audit firm.

General Accountability Office

The General Accountability Office (GAO) promulgates independence and ethics rules, which apply to financial statement audits, attestation services, and performance audits of government

entities, programs, and federal awards administered by contractors, nonprofit entities, and other nongovernmental entities. These rules appear in the Government Auditing Standards (GAS, also referred to as the Yellow Book). For example, performing an audit of a university that issues debt in the public marketplace and receives government funding would require independence under AICPA, SEC and GAO rules.

Federal Financial Institutions Examination Council (FFIEC)

The FFIEC comprises the Office of Thrift Supervision (OTS), the Treasury; the Board of Governors of the Federal Reserve System (Board); the Federal Deposit Insurance Corporation (FDIC); the National Credit Union Administration (NCUA); and the Office of the Comptroller of the Currency (OCC), Treasury. The FFIEC issues Financial Institution Letters (FILs), which are addressed to the chief executive officers of the financial institutions on the FIL's distribution list (generally, FDIC-supervised institutions). FILs may announce new regulations and policies, new FDIC publications, and a variety of other matters of principal interest to those responsible for operating a bank or savings association. FILs have addressed auditor conduct (e.g., internal audit outsourcing and use of indemnification clauses in engagement letters) in recent years.

Department of Labor

Auditors of employee benefit plans that file reports with the Department of Labor (DOL) should be aware of the DOL interpretive bulletin (29 CFR 2509.75-9), *Interpretive bulletin relating to guidelines on independence of accountant retained by Employee Benefit Plan*.

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