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Independence compliance : checklists and tools for complying with AICPA and GAO independence requirements

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American Institute of Certified Public Accountants

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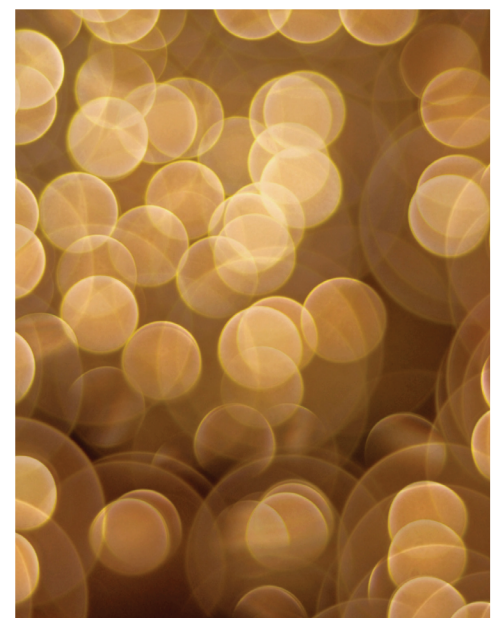


AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

P R A C T I C E A I D S E R I E S

Independence Compliance

*Checklists and Tools for Complying With AICPA and
GAO Independence Requirements*



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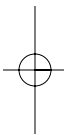
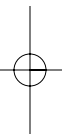
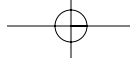
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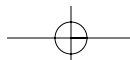


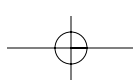
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Notice to Readers

This publication, *Independence Compliance: Checklists and Tools for Complying With AICPA and GAO Independence Standards*, is a practice aid that helps practitioners comply with AICPA and U.S. Government Accountability Office (GAO) independence rules that apply if a practitioner is engaged in an audit or attestation engagement.

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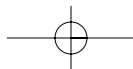
The first edition of this publication was developed in May 2006. This is the second edition of this publication and the content herein reflects the AICPA and GAO independence rules that were in effect in March 2009. AICPA and GAO independence rules may have changed since this publication was developed. Practitioners should be aware of and comply with current AICPA and GAO independence rules.

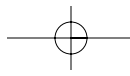
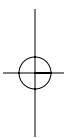
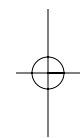
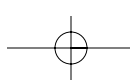
Written and Developed by Catherine Allen, CPA
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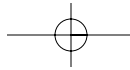
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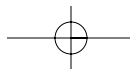


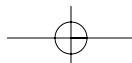
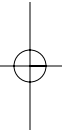
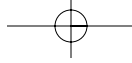




About the Author

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 the consulting firm AUDIT CONDUCT, LLC 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 many years of experience working with the accounting profession's ethics standards as a senior staff member of the AICPA's Professional Ethics Division and Director of Independence for two of the "big four" accounting firms. She also taught accounting principles at The City University of New York's Queens and Baruch Colleges.





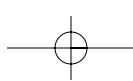
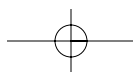
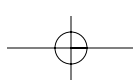


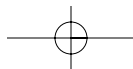
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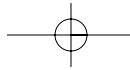
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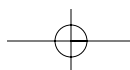


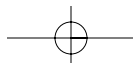
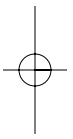
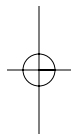
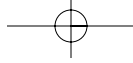
Introduction

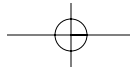
.01 U.S. auditor independence rules have undergone many significant changes in the last decade, and the rules continue to evolve. With rules covering many situations in which independence might be impaired, from business relationships and services to fee arrangements and other relationships, it has become 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 *Government Auditing Standards* (GAS, also known as the Yellow Book).

References to Professional Standards

.02 When referring to the professional standards, this technical practice aid cites the applicable sections as codified in AICPA *Professional Standards* and not the numbered statements, as appropriate. For example, Statement on Auditing Standards (SAS) No. 54, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1, AU sec. 317), is referred to as AU section 317 (AICPA, *Professional Standards*, vol. 1).







Scope of This Practice Aid

.03 This practice aid addresses two diverse sets of auditor independence rules and is categorized into two independence compliance tools. The first independence compliance tool (the compliance tool) addresses the requirements of Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .01), of the AICPA Code of Professional Conduct (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
- ▶ SAS No. 70 reports issued under AU section 324, *Service Organizations* (AICPA, *Professional Standards*, vol. 1)
- ▶ Other attestation services, such as agreed upon procedures

.04 The second compliance tool addresses the U.S. Government Accountability Office (GAO) independence rules, which apply to financial statement audits; attestation services; and performance audits of government entities, programs, and federal awards administered by contractors, not-for-profit entities, and other nongovernmental entities. These entities also are subject to the AICPA rules described in part I of the compliance tool. To streamline the compliance process, to the extent the AICPA rules are identical to the GAO rules, the GAO compliance tool generally will not repeat those questions. Rather, it will address only those matters that have not already been addressed in the AICPA compliance tool.

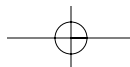
.05 If the client is privately owned and not subject to government audit standards, only the AICPA compliance tool should be completed.¹

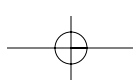
SEC and PCAOB Independence Rules

.06 This practice aid does not address the independence rules of the Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB). Auditors of issuers are required to comply with the SEC and PCAOB rules on auditor independence.²

1. Practitioners also should be aware of various other regulations that may apply to engagements. See appendix C, "Sources of Guidance," for further information.

2. For additional discussion on Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board rules on auditor independence, see *Independence Compliance: Checklists and Tools for Complying With AICPA, SEC, and PCAOB Independence Requirements*.





How to Use This Practice Aid

.07 To assess independence

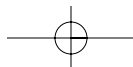
- ▶ determine which compliance tools apply to your attest client (that is, AICPA only or AICPA plus GAO).
- ▶ read all portions of the practice aid applicable to your client.
- ▶ complete the relevant questionnaire(s) found in part I of the compliance tool(s).
- ▶ review the follow-up section(s) for all “Yes” answers or if an answer is not known.
- ▶ complete both the AICPA and GAO compliance tools for GAO engagements.
- ▶ review the appendixes for additional information that may be relevant for your client.

The AICPA and GAO Independence Compliance Tools

.08 Each 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 tools are divided into two equally important parts.

.09 Part I of the compliance tool is a series of questions designed to help you identify potential independence issues. You should answer all of the questions listed in part I of the compliance tool. The response to each question will be “Yes” or “No,” although certain questions allow for an “N/A” (not applicable) response. Refer to the glossaries in appendix A, “AICPA Independence Terms,” and appendix B, “GAO Independence Terms,” to ensure that you fully understand the terms used in the question before providing your answer. Defined terms are shown in *italics* each time they appear in the compliance tools. Then, ask the appropriate person(s) in your firm to determine the proper reply to the question.

.10 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 if an issue exists.



.11 If you answer “Yes” to any of the questions or you are unable to answer a question, you also should review part II 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. However, applying the suggested follow-up actions may or may not avoid a violation of the code. Only the AICPA Professional Ethics Executive Committee has the authority to interpret the code.

.12 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.

.13 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.

.14 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 Independence Rules

.15 AICPA professional standards require a firm, its partners, and professional employees to be independent in accordance with Ethics Rule 101 of the code whenever a firm performs an attest service for a client. Attest services include the following:

- ▶ Financial statement audits
- ▶ Financial statement reviews
- ▶ Other attest services, as defined in the Statements on Standards for Attestation Engagements

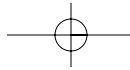
.16 Performing a compilation of a client's financial statements does not require independence; however, if a firm that is not independent issues a compilation report, the report must state, "I am (we are) not independent with respect to XYZ Company." If the firm does not include this disclosure in the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

.17 The questionnaire shown in an upcoming section addresses the following five general categories under AICPA independence rules:

- ▶ Personal financial interests and relationships
- ▶ Employment and business relationships
- ▶ Nonattest services engagements
- ▶ Fee arrangements
- ▶ Miscellaneous

.18 A citation to the applicable AICPA Ethics Rule in volume 2 of *Professional Standards* follows each question. You should refer directly to the AICPA rules if you do not understand the question or need further information (also see appendix C, "Sources of Guidance"). Words appearing in italics are defined in appendix A. It is very important that you understand the meaning of all terms used in the questions before you provide a response.

.19 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 development of this practice aid. You should be aware of and comply with current independence rules.



Part I: Questionnaire

Category 1: Personal Financial Interests and Relationships

.20 The following are important points:

- ▶ 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.
- ▶ For purposes of these questions, *covered member* includes the *covered member's immediate family*, namely, his or her spouse, *spousal equivalent*, and *dependents*.

Q1. Has a *covered member*³ had or been committed to acquire any *direct financial interest* in the *client*?

[ET sec. 101 par. .02 and .17]

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? [ET sec. 101 par. .02 and .17]

Yes No

Q3. Has a *covered member* had an insurance policy that had an investment option that provided the *covered member* a *direct financial interest* or a material *indirect financial interest* in the *client*? [ET sec. 101 par. .17]

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*? [ET sec. 101 par. .17]

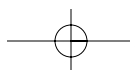
Yes No

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?

[ET sec. 101 par. .17]

Yes No

.....
3. The term *covered member* includes the firm.



Q6. If the *client* is a Section 529 savings plan, has a *covered member* been an account owner in the plan?
[ET sec. 101 par. .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*? [ET sec. 101 par. .17]

Yes No

Q8. 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) that invested in the *client*? [ET sec. 101 par. .17]

Yes No

Q9. Has a *covered member* invested as a limited partner in a partnership that invested in the *client* and was material to the *covered member*? [ET sec. 191 par. .162-.163]

Yes No

Q10. 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*? [ET sec. 101 par. .17]

Yes No

Q11. 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*? [ET sec. 101 par. .02]

Yes No

Q12. Did a *close relative* of a member of the *attest engagement team* have the ability to exercise *significant influence* over the *client*? [ET sec. 101 par. .02]

Yes No

Q13. 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*? [ET sec. 101 par. .02]

Yes No

Q14. Has a *covered member* served as a trustee of a trust or executor or administrator of an estate if such trust or estate 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 estate, (b) the trust or estate 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 or estate's holdings in the *client* exceeded 10 percent of the total assets of the trust or estate? [ET sec. 101 par. .02] Yes No

Q15. 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*? [ET sec. 101 par. .17] Yes No

Q16. If the *covered member* has been the grantor of a trust, did the *covered member* retain the right to amend or revoke the trust or otherwise have the authority to control the trust or supervise or participate in the trust's investment decisions? [ET sec. 101 par. .17] Yes No N/A

Q17. Has a *covered member* been a beneficiary of a trust that had or was committed to acquire a material *financial interest* in the *client*? [ET sec. 101 par. .17] Yes No

Q18. Has a *covered member* been the beneficiary of a trust that had or was committed to acquire a *financial interest* in the *client* and the *covered member* was able to control or participate in investment decision making for the trust? [ET sec. 101 par. .17] 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*? [ET sec. 101 par. .17] Yes No

Q20. Has a *covered member* had a *joint closely held investment* that was material to the *covered member's* net worth? [ET sec. 101 par. .02] Yes No

Q21. Has a *covered member* had a *loan* from a *client* or from the *client's* significant shareholders, officers, or directors that was neither a *grandfathered loan* nor a *permitted loan*? [ET sec. 101 par. .07] Yes No

Q22. Has a *covered member* had a *loan* with a nonclient subsidiary or parent of the *client* that was neither a *grandfathered loan* nor a *permitted loan*? [ET sec. 191 par. .196–.197] Yes No

Q23. If a *client* subsidiary is material to a nonclient parent, has a *covered member* had a *loan* with the nonclient parent that was neither a *grandfathered loan* nor a *permitted loan*? [ET sec. 191 par. .196–.197]

Yes No N/A

Q24. Has a *partner* or professional employee of the *firm*, 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 ownership interests? [ET sec. 101 par. .02]

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 a *direct financial interest* or material *indirect financial interest* in the *client* or a *loan* that was neither a *grandfathered loan* nor a *permitted loan*? [ET sec. 101 par. .02]

Yes No

Q26. Has a *covered member* had a bank account (checking, savings, money market, or certificate of deposit) with a *client* holding funds that were not fully insured by a federal or state agency (such as the Federal Deposit Insurance Corporation) or other insurer and were material to the *covered member's* net worth? [ET sec. 191 par. .140–.141]

Yes No

Q27. Has a *covered member* had a margin *loan* with a broker that was a *client*? [ET sec. 101 par. .07]

Yes No

Q28. Has a *covered member* invested in an entity that had *significant influence* over a *client* and that was material to the *client*? [ET sec. 101 par. .10]

Yes No

Q29. Has a *covered member* invested in an entity over which a *client* had *significant influence* and the entity was material to the *client*? [ET sec. 101 par. .10]

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*? [ET sec. 101 par. .10]

Yes No

Q31. Has a member of the *attest engagement team* accepted a gift from the *client* that would be considered more than clearly insignificant? [ET sec. 191 par. .228–.229]

Yes No

Category 2: Employment and Business Relationships

.21 *Note:* 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*).

Q1. Has a *partner* or professional employee served as a director, officer, or in any other managerial position (for example, general counsel or promoter) for the *client*? [ET sec. 101 par. .02]

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? [ET sec. 101 par. .02]

Yes No

Q3. Has the *close relative* of a *covered member* (excluding *covered members* who provided only nonattest services to the *client*) or the *immediate family* of such *covered member* been employed by the *client* in a *key position*? [ET sec. 101 par. .02 and ET sec. 92 par. .17]

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*? [ET sec. 101 par. .02]

Yes No

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* (for example, consulting arrangements or other associations)? [ET sec. 101 par. .04]

Yes No

Q6. Did the *firm* and the *client* participate in a cooperative arrangement (for example, joint venture, subcontracting arrangement, distribution, or marketing arrangement) that was material to the *firm* or the *client*? [ET sec. 101 par. .14]

Yes No

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*? [ET sec. 101 par. .04]

Yes No

Category 3: Nonattest Services Engagements

.22 The following are important points:

- ▶ Before answering the questions in this category, you should determine whether your *firm* provided any nonattest services during the period described in the second bullet point that follows. If only attest services have been and are being performed for the *client* during these periods, you may skip this section.
- ▶ 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*).
- ▶ For purposes of questions in this category, the *firm* includes all professionals performing services on behalf of the *firm*.
- ▶ If this *client* is a new attest *client*, see the AICPA frequently asked questions (FAQs)⁴ included in appendix F, “AICPA Professional Ethics Division Frequently Asked Questions—Performance of Nonattest Services,” of this practice aid under the heading “Period of the Professional Engagement.” See appendix C for the URL to the AICPA FAQs.

4. The answers to these frequently asked questions (FAQs) are based on guidance the AICPA Professional Ethics Division staff provided in response to members’ inquires concerning Interpretation 101-3, “Performance of Nonattest Services,” under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .05). The FAQs are not rules, regulations, or statements of the Professional Ethics Executive Committee and, therefore, are not authoritative guidance.

Q1. Did the *firm* perform any management functions or make managerial decisions for the *client* in connection with nonattest services? [ET sec. 101 par. .05] Also see the FAQ included in appendix F of this practice aid under the heading “Management Functions.”

Yes No

Q2. Were there any instances in which the *client* was unable (that is, lacked suitable skill, knowledge, and/or experience) or unwilling to perform management functions, set the scope of the *firm's* nonattest services, and evaluate and accept responsibility for the results of the nonattest services? [ET sec. 101 par. .05] Also see the FAQs included in appendix F of this practice aid under the heading “Suitable Skill, Knowledge, and/or Experience.”

Yes No

Q3. Were there any instances in which an understanding between the *firm* and the *client* (that is, 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? [ET sec. 101 par. .05] Also see the FAQs included in appendix F of this practice aid under the heading “Documentation Requirement.”

Yes No

Q4. Did the *firm* at any time have custody of the *client's* assets (for example, handle *client* cash, checks, or other financial instruments or otherwise take responsibility for the safekeeping of assets)? [ET sec. 101 par. .05]

Yes No

Q5. Did the *firm* at any time assume responsibility for making payments on behalf of the *client* (electronically or otherwise)? [ET sec. 101 par. .05]

Yes No

Q6. Did the *firm* at any time assume responsibility for signing or cosigning *client* checks? [ET sec. 101 par. .05]

Yes No

Q7. Did the *firm* at any time maintain a bank account on behalf of the *client*? [ET sec. 101 par. .05]

Yes No

Q8. Did the *firm* at any time sign payroll tax returns on behalf of the *client*? [ET sec. 101 par. .05]

Yes No

- Q9. Did the *firm* at any time authorize, execute, or consummate transactions on behalf of the *client* (for example, approve vendor invoices for payment or authorize payment of *client* funds)? [ET sec. 101 par. .05] Yes No
- Q10. Did the *firm* at any time prepare *source documents* that evidenced accounting transactions (for example, invoices, purchase orders, or payroll time cards) for the *client*? [ET sec. 101 par. .05] Yes No
- Q11. Did the *firm* at any time supervise the *client's* employees in their daily activities? [ET sec. 101 par. .05] Yes No
- Q12. Did the *firm* at any time lend its professional staff to the *client*? [ET sec. 101 par. .02 and .05] Yes No
- Q13. Did the *firm* at any time report to the board of directors (or other governing body) on behalf of management? [ET sec. 101 par. .05] Yes No
- Q14. Did the *firm* at any time design or implement policies or procedures for the *client*? [ET sec. 101 par. .05] 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? [ET sec. 101 par. .05] Yes No
- Q16. Did the *firm* at any time serve an employee benefit plan *client* as a fiduciary as defined by the Employee Retirement Income Security Act of 1974? [ET sec. 101 par. .05 and ET sec. 102 par. .03] Yes No
- Q17. Did the *firm* at any time make investment decisions for the client or have discretionary authority over *client* investments? [ET sec. 101 par. .05] Yes No
- Q18. Did the *firm* at any time execute transactions to buy or sell investments on behalf of the *client*? [ET sec. 101 par. .05] Yes No
- Q19. Did the *firm* at any time negotiate transactions on behalf of the *client*? [ET sec. 101 par. .05] 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? [ET sec. 101 par. .05] Yes No

Q21. Did the *firm* perform any ongoing compliance or quality control functions for the *client*? [ET sec. 101 par. .05]

Yes No

Q22. Did the *firm* perform bookkeeping services for the *client*? [ET sec. 101 par. .05] (If the answer is “No,” skip questions 23–25.)

Yes No

Q23. Did the *firm* determine or change journal entries without obtaining *client* approval? [ET sec. 101 par. .05] Also see the FAQs included in appendix F of this practice aid under the heading “Bookkeeping Services.”

Yes No

Q24. Did the *firm* change *source documents* or account codings on transactions without *client* approval? [ET sec. 101 par. .05] Also see the FAQs included in appendix F of this practice aid under the heading “Bookkeeping Services.”

Yes No

Q25. Did the *firm* determine the assumptions underlying journal entries (for example, useful lives or bad debt percentages) for the *client*? [ET sec. 101 par. .05] Also see the FAQs included in appendix F of this practice aid under the heading “Bookkeeping Services.”

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)? [ET sec. 101 par. .05]

Yes No

Q27. Did the *firm* modify the source code underlying the *client*'s financial information system (excluding insignificant modifications)? [ET sec. 101 par. .05] Also see the FAQs included in appendix F of this practice aid under the heading “Information Technology Services.”

Yes No

Q28. Did the *firm* manage or operate the *client*'s local area network? [ET sec. 101 par. .05] Also see the FAQs included in appendix F of this practice aid under the heading “Information Technology Services.”

Yes No

Q29. Did the *firm* provide valuation or appraisal services to the *client* that were subject to significant subjectivity and whose results were material to the financial statements? [ET sec. 101 par. .05] Also see the FAQ included in appendix F of this practice aid under the heading “Appraisal, Valuation, and Actuarial Services.”

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) that was material to the financial statements? [ET sec. 101 par. .05] Also see the FAQ included in appendix F of this practice aid under the heading “Appraisal, Valuation, and Actuarial Services.”

Yes No

Q31. Did the *firm* provide internal audit services to the *client*? [ET sec. 101 par. .05] (If the answer is “No,” skip questions 32–36.)

Yes No

Q32. Did the *firm* manage internal audit activities for the *client*? [ET sec. 101 par. .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* (for example, preparing or approving the audit work plan)? [ET sec. 101 par. .05]

Yes No

Q34. In performing internal audit services, did the *firm* evaluate the findings of internal audit activities, including those performed by the *firm*? [ET sec. 101 par. .05]

Yes No

Q35. In performing internal audit services, did the *firm* determine the adequacy of internal audit activities including those performed by the *firm*? [ET sec. 101 par. .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*? [ET sec. 101 par. .05]

Yes No

Q37. 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*? [ET sec. 101 par. .05]

Yes No

Q38. Did the *firm* represent the *client* in court (for example, tax, district, or federal court of claims and the equivalent state, local, or foreign forum)?

[ET sec. 101 par. .05]

Yes No

Q39. Did the *firm* provide or agree to provide (either conditionally or unconditionally) expert witness

services to the *client*? [ET sec. 101 par. .05]

Yes No

Category 4: Fee Arrangements

.23 Note: 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.

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? [ET sec. 191 par. .103-.104]

Yes No

Q2. Did or will the *firm* provide any of the following attest services to the *client*: (a) financial statement audit or review; (b) financial statement compilation in which the *member* expects, or might reasonably expect, third-party reliance and the *member* did not disclose a lack of independence in the report; or (c) an examination of prospective financial information? [ET sec. 302 par. .01] (If the answer is "No," skip questions 3-7.)

Yes No

Q3. Did the *firm* also provide any service, other than tax services, for a *contingent fee* that was not fixed by a court or other public authority? [ET sec. 302 par. .01]

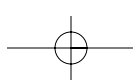
Yes No

Q4. Did the *firm* provide tax services to the *client* for a *contingent fee* when the *firm* did not expect that the fee would be determined based on the results of judicial proceedings or the findings of governmental agencies (that is, you could not demonstrate a reasonable expectation, at the time of the arrangement, that the result of your work would be substantively reviewed by an agency)? [ET sec. 302 par. .02]

Yes No

Q5. Did the *firm* sell goods or services to the *client* for a *commission*? [ET sec. 503 par. .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)? [ET sec. 503 par. .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)? [ET sec. 503 par. .01] Yes No

Category 5: Miscellaneous

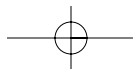
.24 *Note:* The time period you should consider for purposes of these questions is the *period of the professional engagement*.

Q1. Does the engagement letter for this audit or other attest service include a provision that indemnifies the *client* for damages, losses, or costs arising from lawsuits, claims, or settlements that relate, directly or indirectly, to *client* acts? [ET sec. 191 par. .204–.205] Yes No

Q2. Has there been any actual or threatened litigation between the *client* (or its management) that has placed the *firm* or a *covered member* and the *client* at material adverse interests? [ET sec. 101 par. .08] Yes No

Q3. Has a *covered member* accepted entertainment (for example, dinner or tickets to a show or sporting event) from key persons or significant shareholders of the *client* or offered gifts or provided entertainment to such persons that would not be considered reasonable under the circumstances? [ET sec. 191 par. .226–.227] For additional guidance, see www.aicpa.org/download/ethics/Gifts_Basis_Document.pdf. Yes No

Q4. Has a member of the *attest engagement team* or an *individual in a position to influence the attest engagement* accepted a gift from the attest *client* whose value was not clearly insignificant to the recipient? [ET sec. 191 par. .228–.229] For additional guidance, see www.aicpa.org/download/ethics/Gifts_Basis_Document.pdf. Yes No



Q5. Has a member of the *firm* identified a possible conflict of interest that could be viewed by the *client* or other appropriate parties as impairing the *member's* objectivity, but the potential conflict either was not disclosed to such parties or, if the conflict was disclosed, the parties did not provide their consent to perform the services? [ET sec. 102 par. .03]

Yes No

.25 **Note:** The code recognizes that it is impossible to identify all circumstances in which the appearance of independence might be questioned by third parties. Interpretation No. 101-1, "Interpretation of Rule 101," under Rule 101 (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .02), requires that *members* use the approach described in ET section 100.01, *Conceptual Framework for AICPA Independence Standards* (AICPA, *Professional Standards*, vol. 2), (the framework) when making decisions about matters that are not specifically addressed in the independence interpretations and rulings in the code. The framework primarily requires the *member* to analyze interests and relationships in light of "threats and safeguards" to independence. Specifically, if threats to independence are unacceptable, safeguards should be applied (for example, by removing a *member* from the engagement team or performing a second review of a *member's* work) to eliminate threat(s) or reduce them to an acceptable level. If threats to independence are eliminated or reduced by safeguards, the *member* should document the matter.

Part II: Resolution of Potential Independence Issues

.26 Please review the following categories carefully for any "Yes" response you provided and for any questions that you were unable to answer in the questionnaire. For each of the five categories, we suggest several types of information you may wish to consider in evaluating your compliance with the independence rules. These suggestions are intended to help you gather and analyze the information.

.27 **Note:** Some suggested items may be relevant for evaluating certain matters but not others. For example, materiality of a *covered member's direct financial interest* in an audit *client* would not be considered relevant in determining whether the interest was deemed to impair independence under the code. You should refer directly to the code for specific information.

.28 If, based on your evaluation, you determine that an independence matter needs to be resolved, the *member* should document the matter. An illustration of how to do this appears in appendix D, "Documenting Independence Matters."

Category 1: Personal Financial Interests and Relationships

.29 The AICPA prohibition on personal financial interests and relationships applies during the *period of the professional engagement*; hence, caught early, timely actions may avoid an independence issue.

.30 For matters involving *financial interests*, 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) (for example, the *period of the professional engagement*, how long the interest was held, or when the holder became a *covered member*)
- ▶ The nature of the attest work (for example, audit, review, or agreed-upon procedures)⁵
- ▶ Whether the interest was material to the *covered member's* net worth
- ▶ 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)
- ▶ Whether the interest is 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 Interpretation 101-15, "Financial Relationships," under Rule 101 [AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .17])

.31 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 borrower was a *covered member* 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*

5. See appendix E, "Modified AICPA Independence Requirements for Certain Statements on Standards for Attestation Engagements," for specific guidance on agreed-upon procedures engagements.

-
- ▶ Specifics surrounding *loan* renewals and revisions
 - ▶ Whether the *loan* is secured by property or other assets and to what degree

.32 The following are possible follow-up actions:

- ▶ Remove from the engagement team the individual whose interest or relationship caused the independence issue
- ▶ Dispose of the *financial interest* or relationship (for example, the *loan* or checking account) that caused the independence issue
- ▶ Discuss the matter with the *client's* governance board (for example, the board of directors, those charged with governance, or other equivalent body) to determine the board's views on 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 Discovery of Facts Existing at the Date of the Auditor's Report* (AICPA, *Professional Standards*, vol. 1)

Category 2: Employment and Business Relationships

.33 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* (that is, all *partners* and professional staff) than the restrictions on financial interests and relationships, which, with some exceptions, apply only to *covered members* and certain family members. As such, issues arising from employment and business relationships 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) positions in the *client* and their relationship to the *firm* or a member of the *firm*
- ▶ If a relative has an employment or business relationship with the *client*, the nature of the relationship with the *firm* member and the *member's* position in the *firm*

-
- ▶ The applicable time frames (for example, the period of the *professional engagement*, the period covered by financial statements, or the 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*

.34 The following are possible follow-up actions:

- ▶ Cease the employment or business relationship that caused the independence issue
- ▶ Discuss the matter with the *client's* governance board (for example, the board of directors, those charged with governance, or other equivalent body) to determine the board's views on the appearance of independence
- ▶ Review the work of the individual whose relationship caused the independence issue
- ▶ Reperform 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

Category 3: Nonattest Services Engagements

.35 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 (for example, audit, review, or agreed-upon procedures)⁶

6. See appendix E for specific guidance on agreed-upon procedures engagements.

-
- ▶ Whether the nonattest services were performed before the entity became an attest *client* (see the FAQ included in appendix F of this practice aid under the heading “Period of the Professional Engagement”)
 - ▶ The applicable time frames (for example, the *period of the professional engagement*, the period covered by the financial statements, and the period during which prohibited services or activities were performed)
 - ▶ The individuals who performed the services or activities and their relationship, if any, to the *attest engagement team*
 - ▶ The *client* designee assigned to oversee the *firm’s* work; their title; and a description of their skills, knowledge, and/or experience
 - ▶ Whether an agreement on the *firm’s* and the *client’s* respective roles was reached prior to performing the services
 - ▶ Whether an agreement on the *firm’s* and the *client’s* respective roles was documented prior to performing the services

.36 The following are possible follow-up actions:

- ▶ Cease performing the prohibited services or activities
- ▶ Discuss the matter with the *client’s* governance board (for example, the board of directors, those charged with governance, 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)
- ▶ Have an independent third party reperform the nonattest services that gave rise to an independence issue⁷
- ▶ When appropriate, consider AU section 561

Category 4: Fee Arrangements

Unpaid Fees

.37 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

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

impair independence. To address fee-related issues, consider the following facts (*Note:* These are not all-inclusive.):

- ▶ The magnitude of the fees to the *client* and the *firm*
- ▶ The length of time the fees have been outstanding
- ▶ Whether the *client* has the financial means to pay the outstanding fees in full prior to the issuance of the report
- ▶ Whether the *client* is willing to pay the fees in full prior to the issuance of the report
- ▶ Whether the *firm* can rely on the *client's* promise to pay the outstanding fees prior to the issuance of the report for the current year
- ▶ Whether the *firm* is willing to compromise on previously owed amounts, including forgiving the debt in full

.38 The following are possible follow-up actions:

- ▶ Obtain assurance from the *client* that all fees will be paid in full prior to the 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 no balance will remain by the time the attest report is issued)
- ▶ Decline to perform the current-year *attest engagement* due to the continuing existence of unpaid fees that will not be resolved by the report date

Commissions and Contingent Fees

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

- ▶ The applicable time period(s)
- ▶ The nature of the service (for example, audit or review of financial statements or other listed service)
- ▶ 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

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- ▶ If the *contingent fee* was or will be fixed by the courts or another public authority, a description of the specific details

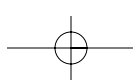
.40 The following are possible follow-up actions:

- ▶ Restructure the *contingent fee* arrangement so that it is not contingent (for example, 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)
- ▶ Cancel *commission* agreements involving an attest *client* purchase or an attest *client* supplier
- ▶ Decline to perform the services outlined in ET section 302 and ET section 503, *Commissions and Referral Fees* (AICPA, *Professional Standards*, vol. 2), covering the period of any historical financial statements during which prohibited *commissions* or *contingent fees* were received

Category 5: Miscellaneous

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

- ▶ **Indemnification or limitation of liability agreements.** Revoke the indemnification or limitation of liability provision.
- ▶ **Gifts and entertainment.** Gifts can be returned to the *client*. Alternatively, the *client* can be reimbursed for gifts or entertainment.
- ▶ **Conflicts of interests.** Depending on timing, discuss the matter with the appropriate parties as soon as possible and follow up as needed or take action(s) to resolve the matter (for example, decline to perform the service or change engagement team personnel).



Independence Compliance Tool: GAO Independence Rules

.42 **Reminder:** The following questions only address the requirements that go beyond those of the AICPA. Thus, it is necessary to also complete the AICPA independence compliance tool (pages 4–23 of this publication).

Government Auditing Standards

.43 The GAO standards apply to audits; other attest engagements; and performance audits provided to federal, state, and local governments and organizations receiving federal (and some state) funds, including profit and not-for-profit entities. Various laws require compliance with GAS in connection with the audits of federal entities and funds. Many states, local governments, and other entities also have adopted these standards.

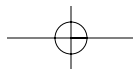
.44 Paragraph 3.02 of GAS (the second general standard) states, “In all matters relating to the audit work, the audit organization and the individual auditor, whether government or public, must be free from personal, external, and organizational impairments to independence, and must avoid the appearance of such impairments of independence.”

.45 According to footnote 22 in paragraph 3.07 of GAS, independence is required during “the period covered by the audit and the period in which the audit is being performed and reported.”

.46 In 2002, the GAO issued *Government Auditing Standards: Answers to Independence Standard Questions* (questions and answers [Q&A]), which provides guidance on how to implement the GAO’s independence rules. This guidance remains in effect. See appendix C for the URL to the GAO Q&A. In July 2007, the GAO released a revision of the Yellow Book, which supersedes the 2003 version.⁸

.47 The 2007 Yellow Book is effective for (1) financial statement audits and attest engagements for periods beginning on or after January 1, 2008, and (2) performance audits beginning on or after January 1, 2008. The distinction between (1) and (2) is that (1) applies to the period under audit, whereas (2) applies to the engagement start date. Thus, an audit of financial statements for the period ended December 31, 2007, would be subject to the 2003 Yellow Book, even though the audit is performed in 2008, whereas a performance audit would be subject to the 2007 Yellow Book regardless of the period under audit.

8. The document is available at www.gao.gov/new.items/d07731g.pdf.



.48 The following questionnaire addresses these two general categories defined in the GAO independence rules that apply to members in public practice (the third category, which will not be described in this document, applies to accountants and auditors employed by governmental entities):

- ▶ Personal impairments
- ▶ Nonaudit services (organizational impairments)

.49 A citation to the applicable GAO rule or Q&A number follows each question. You should refer directly to the GAO rules and Q&A guidance if you do not understand the question or need further information. Words appearing in italics are defined in appendix B. It is very important that you understand the meaning of all terms used in the questions before you provide a response.

.50 The GAO independence rules and other citations included in the questionnaire may have changed after the development of this practice aid. You should be aware of and comply with current GAO independence rules.

Part I: Questionnaire

Category 1: Personal Impairments

.51 Auditors participating on an audit assignment must be free from personal impairments to independence. This includes those who review the work or the report and all others within the firm who can directly influence the outcome of the audit.

Q1. Was the immediate family or close family member of a member of the *audit engagement team* in a position to exert direct and *significant* influence over the client or the program under audit? [GAS par. 3.07a] Yes No

Q2. Did a member of the *audit engagement team* perform *prohibited bookkeeping services* (other than a staff person who played only an insignificant role in providing the services)? [GAS par. 3.07d; Q&A No. 39] Yes No

Q3. Does a member of the *audit engagement team* hold preconceived ideas toward individuals, groups, organizations, or objectives of a particular program or harbor other biases or loyalties that could impair his or her objectivity in connection with the audit? [GAS par. 3.07e–f] Yes No

Q4. Did a member of the *audit engagement team* set policy for the client within the last two years, which directly and significantly affected the *subject matter of the audit*? [Q&A No. 40]

Yes No

Category 2: Nonaudit Services (Organizational Impairments)

.52 Before answering the questions in this category, you should determine whether your firm performed any *nonaudit services* for the client during the period of the professional engagement or the period covered by the financial statements (or other subject matter of the attest engagement). If *nonaudit services* were not performed for the client, this section may be skipped.

.53 For purposes of the questions in this category, the firm includes all professionals performing services on behalf of the firm. The client also includes related entities of the client (see questions 23–26 of the Q&A for further information).

Q1. In performing *nonaudit services* for the client, did you audit your own work (or the work of others in the firm) such that the amounts or services involved were *significant* or *material* to the *subject matter of the audit* (aggregating all *nonaudit services* for the period)? [GAS par. 3.16; Q&A No. 15]

Yes No

Q2. Did your firm maintain or prepare the client's basic accounting records or maintain or take responsibility for basic financial or other records that the firm will audit (including in temporary or emergency situations)? [GAS par. 3.29a; Q&A No. 46–63]

Yes No

Q3. Did your firm post transactions (whether coded or not coded) to the client's financial records or to other records that subsequently provided input to the entity's financial records? [GAS par. 3.29b]

Yes No

Q4. Did your firm determine account balances or capitalization criteria for the client? [GAS par. 3.29c]

Yes No

Q5. Did the firm reconcile cash balances to bank statements for the client? [Q&A No. 56]

Yes No

Q6. Did your firm design, develop, install, or operate the client's accounting system or other information systems that are *material* or *significant* to the *subject matter of the audit*? [GAS par. 3.29d; Q&A No. 68–74] Yes No

Q7. Did your firm provide payroll services that were *material* to the *subject matter of the audit*? [GAS par. 3.29e] Yes No

Q8. Did your firm provide appraisal or valuation services, including services related to pension expense or liabilities, that involved amounts that were *material* to the client's financial statements? [GAS par. 3.29f; Q&A No. 24–25, 55, and 79–80] Yes No

Q9. Did your firm perform any of the following human resource related services: (a) recommend a single individual for a specific position that was key to the entity or program under audit, (b) rank or otherwise influence management's selection of a candidate, or (c) conduct an executive search or manage a recruiting program for the client? [GAS par. 3.29g; Q&A No. 91–92] Yes No

Q10. Did your firm develop the client's performance measurement system when that system was *material* or *significant* to the *subject matter of the audit*? [GAS par. 3.29h] Yes No

Q11. Did your firm perform internal *audit services* for the client? [GAS par. 3.29i and l; Q&A No. 66–67] Yes No

Q12. Did your firm perform management's assessment of internal controls when those controls are *significant to the subject matter of the audit*? [GAS par. 3.29j] Yes No

Q13. Did your firm provide services that are (or were) intended to be used as management's primary basis for making decisions that are *significant* to the subject matter under audit? [GAS par. 3.29k] Yes No

Q14. Did your firm perform any services for the client that would constitute monitoring or quality control activities? [GAS par. 3.07c; Q&A No. 56] Yes No

Q15. Did your firm prepare the client's indirect cost proposal or cost allocation plan when (a) management had not taken responsibility for all *significant* assumptions and data or (b) the results of the service were *material* to the client's financial statements? [GAS par. 3.28d; Q&A No. 64–65]

Yes No

Q16. For *nonaudit services* performed for the client in accordance with paragraph 3.28 of GAS, were there any instances in which the firm did not document its consideration of the *nonaudit services*, including its conclusions about the impact on independence? [GAS par. 3.30a]

Yes No N/A

Q17. For *nonaudit services* performed for the client in accordance with paragraph 3.28 of GAS, were there instances in which the firm did not establish in writing an understanding with the client regarding the objectives, scope of work, product or deliverables of the *nonaudit service*, and management's responsibilities? [GAS par. 3.30b]

Yes No N/A

Q18. For *nonaudit services* performed for the client in accordance with paragraph 3.28 of GAS, will (or did) you allow personnel who provided the *nonaudit services* to plan, conduct, or review audit work related to the *nonaudit services*? (Exclude services having no relationship to the *subject matter of the audit* or engagements that involved only a *de minimus amount of time*.) [GAS par. 3.30c; Q&A No. 27 and 30–31]

Yes No N/A

Q19. For *nonaudit services* performed for the client in accordance with paragraph 3.28 of GAS, do you plan to reduce the scope and extent of audit work below the level that would be appropriate if the *nonaudit services* were performed by an unrelated party? [GAS par. 3.30d]

Yes No N/A

Part II: Follow-Up Considerations

.54 Please review the following categories carefully for any "Yes" response and for any questions that you were unable to answer in the questionnaire. For each category, we suggest several types of information you may wish to consider in evaluating your compliance with the GAO independence rules. These suggestions are intended to help you gather and analyze the information.

.55 **Note:** Some suggested items may be relevant for evaluating certain matters but not others. For example, it may be appropriate to consider materiality (in part) when evaluating certain types of *nonaudit services* (for example, payroll) but not others (for example, internal audit) in determining whether Yellow Book independence requirements have been met. You should refer directly to the Yellow Book and the Q&A document for specific information.

.56 An illustration of how to document independence matters appears in appendix D.

Category 1: Personal Impairments

.57 Members of *audit engagement teams* should notify the appropriate officials within their firms if they have any personal impairment to independence. Once a firm identifies a personal impairment to independence, the impairment needs to be resolved in a timely manner.

.58 In situations in which the personal impairment is applicable only to an individual auditor or a specialist⁹ (individual) on a particular assignment, the firm may be able to mitigate the personal impairment by

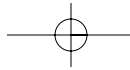
- ▶ requiring the individual to eliminate the personal impairment (for example, he or she could move a prohibited loan to a financial institution that does not cause independence issues).
- ▶ removing the individual from the audit (or other attest) engagement team.

.59 If a personal impairment cannot be mitigated through these means, the only other option is for the firm to withdraw from or decline to perform the audit or other attest engagement.

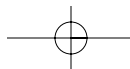
Category 2: Nonaudit Services

.60 Practitioners have the capability of performing a range of services for their clients. However, sometimes, it is not appropriate for them to perform both audit and certain *nonaudit services* for the same client. In these circumstances, the practitioner or the client will have to make a choice about which of these services will be provided.

9. This includes those who review the work or the report and all others within the firm who can directly influence the outcome of the audit



.61 Practitioners will need to apply professional judgment in making these decisions, which are likely to rest on different factors (for example, the nature of the *nonaudit service* and its significance or materiality to the audit). In other words, the specific facts and circumstances of the *nonaudit service* will drive the judgment. In addition, practitioners should consider the totality of services provided to the client in making judgments on independence.



.62

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), 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 the following:

- ▶ Entities engaged in the practice of public accounting
- ▶ Federal, state, and local governments or component units thereof, provided the member performing professional services with respect to those entities
 - is directly elected by voters of the government or component unit thereof with respect to the professional services that are performed.
 - is an individual who is (1) appointed by a legislative body and (2) subject to removal by a legislative body.
 - 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

- ▶ an individual on the attest engagement team.
- ▶ an individual in a position to influence the attest engagement.
- ▶ 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.
- ▶ a partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement.
- ▶ the firm, including the firm's employee benefit plans.
- ▶ 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 herein as a covered member 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).
- ▶ under the control¹ of an individual or entity (including those managed on a discretionary basis by others).

1. For purposes of this definition, the term *control* includes situations in which the covered member, individually or acting together with his or her firm, other partners, or professional employees, has the ability to exercise such control.

-
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- ▶ 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. 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 criteria of the Investment Company Act of 1940.

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 Interpretation 101-5, "Loans From Financial Institution Clients and Related Terminology," under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .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 that is engaged in the practice of public accounting and whose characteristics conform to resolutions of the council of the AICPA. Except for purposes of applying Ethics Rule 101, the firm includes the individual partners thereof.

grandfathered loan. Grandfathered loans are unsecured loans that are not material to the covered member's net worth. Home mortgages and other secured loans are grandfathered if

- ▶ they were obtained from a financial institution under that institution's normal lending procedures, terms, and requirements.

-
- ▶ after the borrower becomes a covered member, they are kept current concerning all terms at all times and those terms do not change in any manner not provided for in the original loan agreement.
 - ▶ they were obtained from a financial institution
 - prior to its becoming a client requiring independence.
 - for which independence was not required and were later sold to a client for which independence is required.
 - ▶ 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

- ▶ evaluates the performance or recommends the compensation of the attest engagement partner.
- ▶ directly supervises or manages the attest engagement partner, including all successively senior levels above that individual through the firm's chief executive.
- ▶ consults with the attest engagement team regarding technical or industry-related issues specific to the attest engagement.
- ▶ 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

- ▶ has primary responsibility for significant accounting functions that support material components of the financial statements.
- ▶ has primary responsibility for the preparation of the financial statements.
- ▶ 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 previously described.

loan. A loan is a financial transaction, the characteristics of which generally include, 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:

- ▶ Continuing responsibility for the overall planning and supervision of engagements for specified clients
- ▶ 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 AICPA.

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 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 the following:

- ▶ The amount of the loan in relation to the value of the collateral pledged as security and the credit standing of the covered member
- ▶ Repayment terms
- ▶ Interest rate, including "points"
- ▶ Closing costs
- ▶ 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 Securities and Exchange Commission.

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, equity or nonequity partner of the firm, or 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 when a member either signs an initial engagement letter or other agreement to perform attest services or when a member 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 concerning all terms, such as the following:

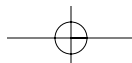
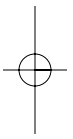
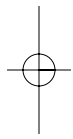
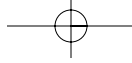
- ▶ Automobile loans and leases collateralized by the automobile
- ▶ Loans fully collateralized by the cash surrender value of an insurance policy
- ▶ Loans fully collateralized by cash deposits at the same financial institution (for example, "passbook loans")
- ▶ Aggregate outstanding balances from 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 No. 18, *The Equity Method of Accounting for Investments in Common Stock*, and its interpretations.²

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 time-cards, 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.

² At the time of this writing, the Financial Accounting Standards Board (FASB) was expected to make the FASB *Accounting Standards Codification*TM (FASB ASC) authoritative effective July 1, 2009. Accounting Principles Board Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, has been codified at FASB ASC 323, *Investments—Equity Method and Joint Ventures*, and FASB ASC 325, *Investments—Other*.



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APPENDIX B: GAO Independence Terms

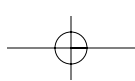
audit engagement team. The audit engagement team consists of individuals participating in the audit engagement, including those who perform concurring and second partner reviews. The audit engagement team includes all employees and contractors retained by the firm who participate in the audit engagement, irrespective of their functional classification (for example, audit, tax, or management consulting services). In addition, if the work of a specialist is used, auditors need to consider the specialist as a member of the audit team.

audit services. Audit services are financial audits, attestation engagements, and performance audits.

de minimus amount of time. Generally, if a nonaudit service involves a total of 40 or fewer hours as it relates to a specific audit engagement, the safeguard associated with precluding personnel who provided the nonaudit service from performing related audit work would not be required. The other safeguards in paragraph 3.17 of *Government Auditing Standards* (GAS, also known as the Yellow Book) would apply. Audit firms should consider related services that may have been performed under separate contracts or separate engagements in applying the de minimus criteria. Related nonaudit services should be considered together in determining the overall time involved in performing the services. In applying the safeguards, firms should be able to articulate why the nonaudit service should be considered as a separate, unrelated service to other nonaudit services being provided.

management functions. Management functions include the following activities (*Note:* These are not all-inclusive.):

- ▶ Serving as a member of an entity's management decision-making committee or on its board of directors
- ▶ Making policy decisions affecting the direction and operations of entity programs
- ▶ Supervising entity employees
- ▶ Developing entity program policies
- ▶ Authorizing entity transactions
- ▶ Maintaining custody of entity assets (unless the assets are in the custody of an investigative unit and, under its statutory authority, are being held as evidence in an investigation)



material. See GAS paragraph 4.26.

nonaudit services. Nonaudit services involve performing tasks requested by management and directly supporting the entity's operations. Nonaudit services (1) generally are performed for the sole use and benefit of the entity requesting the work or (2) provide information or data to a requesting party without providing verification, analysis, or evaluation of the information or data and, therefore, the work does not usually provide a basis for conclusions, recommendations, or opinions on the information or data. The nature and scope of a nonaudit service generally is determined by agreement between an audit firm and a client or by the requesting party. In contrast, the nature and scope of an audit is determined by an audit firm in order to satisfy the audit objectives.

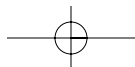
prohibited bookkeeping services. Prohibited bookkeeping services include the following:

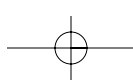
- ▶ Maintaining the official accounting records, if such services involve preparing source documents or originating data in electronic or other form
- ▶ Posting transactions (whether coded by management or not)
- ▶ Authorizing, executing, or consummating transactions (for example, approving invoices, payrolls, claims, or other payments of the entity or program being audited)
- ▶ Maintaining an entity's bank account or otherwise having custody of the audited entity's funds
- ▶ Otherwise exercising authority on behalf of the entity or having authority to do so

routine activities. Routine activities generally include routine advice to a client and its management to assist in activities, such as establishing internal controls or implementing audit recommendations, answering technical questions, or providing training. In addition, routine activities include providing tools and methodologies, such as best practice guides, benchmarking studies, and internal control assessment methodologies; collaborating with others to strengthen professional standards; developing audit methodologies; and providing legal and accounting opinions or other assistance to a legislative body.

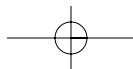
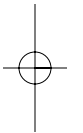
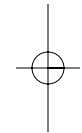
significant. See GAS paragraph 7.04.

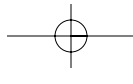
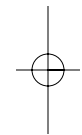
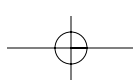
subject matter of the audit. For performance audits, the subject matter of the audit is defined by the audit objectives and it is generally limited to the program, activity, or operation under review. For financial statement audits, the subject matter of the audit is determined by the audit objectives and can vary among audits. If the financial





statement audit objective is to express an opinion on the financial statements taken as a whole, then the subject matter of the audit is the financial statements taken as a whole. If the financial statement audit objective is to express an opinion on each material unit within a state and local government, then the subject matter of the audit is each material unit.





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APPENDIX C: Sources of Guidance

Readers may refer to www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics for comprehensive and current information about the AICPA and the independence rules of other standard setters and regulators.

AICPA resources for practitioners are as follows:

- ▶ The AICPA Code of Professional Conduct is available at www.aicpa.org/about/code/index.html (see ET section 100, *Independence, Integrity, and Objectivity*; ET section 302, *Contingent Fees*; and ET section 503, *Commissions and Referral Fees* [AICPA, *Professional Standards*, vol. 2]).
- ▶ Resources related to understanding and applying the provisions of Interpretation 101-3, “Performance of Nonattest Services,” under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .05), can be found at www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/Resources+and+Tools/Frequently+Asked+Questions.htm.
- ▶ The document *Background and Basis for Conclusions: New Ethics Rulings Under Rule 102—Integrity and Objectivity and Rule 101—Independence* can be found at www.aicpa.org/download/ethics/Gifts_Basis_Document.pdf.
- ▶ For independence inquiries by phone, call (888) 777-7077, menu option #5, followed by menu option #2. Send e-mail inquiries to ethics@aicpa.org.
- ▶ The AICPA Audit Risk Alert *Independence and Ethics Developments* is published annually and is available at www.cpa2biz.com or by calling 1-888-777-7077.
- ▶ The AICPA interactive CD-ROM course on independence, titled *Independence*, provides information on the AICPA’s and the Securities and Exchange Commission’s independence rules and qualifies for eight hours of continuing professional education credits. See www.cpa2biz.com/AST/Main/CPA2BIZ_Primary/Ethics/PRDOVR-PC-739155HS/PC-739155HS.jsp.

U.S. Government Accountability Office (GAO) resources are as follows:

- ▶ GAO Yellow Book requirements are available at www.gao.gov/new.items/d07731g.pdf.

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- ▶ The document *Government Auditing Standards: Answers to Independence Standard Questions* can be obtained at www.gao.gov/govaud/d02870g.pdf.
 - ▶ Direct inquiries to Michael C. Hrapsky, Manager—GAGAS Technical Assistance at (202) 512-9535 or e-mail yellowbook@gao.gov.

Department of Labor (DOL) resources are as follows:

- ▶ Title 29 U.S. *Code of Federal Regulations* (CFR) Part 2509.75-9. This regulation can be found at www.dol.gov/dol/allcfr/EBSA/Title_29/Part_2509/29CFR2509.75-9.htm.
- ▶ Direct inquiries to the DOL at 1-866-4-USA-DOL.

Banking regulators' resources are as follows:

- ▶ The Federal Deposit Insurance Corporation regulations (12 CFR Part 363), *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 can be found at www.aicpa.org/Legislative+Activities+and+State+Licensing+Issues/State+News+and+Info/States/.

International Federation of Accountants (IFAC) resources are as follows:

- ▶ Information about the International Ethics Standards Board for Accountants (IESBA) can be found on the IFAC's Web site at www.ifac.org/Ethics/.
- ▶ The IESBA's *Code of Ethics for Professional Accountants* can be found at www.ifac.org/Members/Pubs-Details.tmp?PubID=10456070402914590&Category=Ethics.

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APPENDIX D: Documenting Independence Matters

Firms should ensure that they adequately document matters involving independence considerations, other than clearly insignificant matters, in the audit working papers.

The following is an illustration of a fictional firm's documentation of an independence matter.

Date: December 11, 20XX

Name of Engagement: Salem, Inc. Annual Audit

Responsible Partner: B. Brown

Description of the Facts:

1. T. M., a partner in the Long Island, NY, office of CPA Firm, LLP, has a daughter who has plans to accept an employment offer from Salem Company, a Long Island-based electronics firm.
2. Salem Company is a privately held company (not subject to Government Accountability Office or other independence rules).
3. CPA Firm, LLP has performed the annual audit of Salem's financial statements since 1999.
4. The lead engagement partner for this engagement is B. Brown, a Long Island office partner, and the engagement is conducted by the Long Island office.
5. The daughter would work in Salem Company's internal audit department as an internal audit director with overall responsibility for Salem Company's financial and operational internal audit function including the following:
 - a. Setting project objectives, methodology, timeline, and deliverables
 - b. Identifying areas to be examined
 - c. Documenting process flows
 - d. Performing interviews
 - e. Supervising staff

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- f. Evaluating the adequacy of internal controls associated with business processes and adherence to controls and processes
 - g. Analyzing data and forming recommendations
 - h. Communicating findings and recommendations to management

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

6. CPA Firm has determined that the position being considered is a *key position* in that it would allow the daughter to exercise influence over the contents of the financial statements.
7. The daughter meets the definition of a close relative because she is not a dependent of the partner.
8. The AICPA rules (Interpretation 101-1, "Interpretation of Rule 101," under Rule 101, *Independence* [AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .02]) say that a covered member (that is, a partner in the office of the lead partner) whose close relative has a key position with the client impairs the firm's independence.
9. The firm and the partner have agreed that T.M. should relocate to a separate office of the firm located in New York City prior to his daughter's employment with Salem Company. By doing so, T.M. will no longer be considered a covered person whose close relative's position impairs the firm's independence.

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APPENDIX E: Modified AICPA Independence Requirements for Certain Statements on Standards for Attestation Engagements

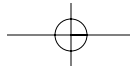
Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. 01), and its interpretations and rulings apply to all attest engagements. However, for purposes of performing engagements to issue reports under the Statements on Standards for Attestation Engagements (SSAEs) that are 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 Ethics Rule 101. These covered members are individuals

- ▶ who participate on the attest engagement team.
- ▶ who directly supervise or manage the attest engagement partner.
- ▶ who consult with the attest engagement team regarding technical or industry-related issues specific to the attest engagement.

In addition, as covered by Interpretation 101-1, “Interpretation of Rule 101,” under Rule 101 (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .02), independence would be considered to be impaired if the firm had a financial relationship with the responsible party that was material to the firm.

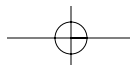
In cases in which the firm provides nonattest services to the responsible party that are proscribed under Interpretation 101-3, “Performance of Nonattest Services,” under Rule 101 (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .05), and that do not directly relate to the subject matter of 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 Interpretation 102-2, “Conflicts of Interest,” under Rule 102, *Integrity and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 102 par. .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 or Statements on Standards for Accounting and Review Services or to an examination or review engagement performed under SSAEs.

Source: Interpretation 101-11, “Modified Application of Rule 101 for Certain Engagements to Issue Restricted-Use Reports Under the Statements on Standards for Attestation Engagements,” under Rule 101 (AICPA, *Professional Standards*, vol. 2, ET sec. 101 par. .13), of the AICPA Code of Professional Conduct.



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APPENDIX F: AICPA Professional Ethics Division Frequently Asked Questions—Performance of Nonattest Services

Disclaimer: The following language is reproduced in full from www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/Resources+and+Tools/Frequently+Asked+Questions.

Answers to frequently asked questions (FAQs) regarding performance of nonattest services follow. The answers to these FAQs are based on guidance the AICPA Professional Ethics Division staff provided in response to members' inquiries concerning Interpretation No. 101-3, "Performance of Nonattest Services," under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec.101 par. .05), and have been updated through the date of this practice aid. Unless specifically noted otherwise, the Professional Ethics Division published these FAQs through various documents between May 2004 and May 2005. In an effort to make the guidance more user-friendly, the FAQs were reformatted into this document in March 2008. The FAQs are not rules, regulations, or statements of the Professional Ethics Executive Committee and, therefore, are not authoritative guidance. Further, the answers do not address the requirements of other regulatory bodies, such as the state boards of accountancy, the Securities and Exchange Commission (SEC), and the U.S. Government Accountability Office whose positions may differ from those of the AICPA.

Important note:

For the following questions, it is assumed that the member is in compliance with all applicable provisions of Interpretation No. 101-3, including, but not limited to, the general requirements¹ unless specifically identified otherwise and that the client in question is an attest client that is not required to file with the SEC.

1. The general requirements for performing nonattest services are the following:

- The member should not perform management functions or make management decisions for the attest client. However, the member may provide advice, research materials, and recommendations to assist the client's management in performing its functions and making decisions.
- The client must agree to perform the following functions in connection with the engagement to perform nonattest services:
 - Make all management decisions and perform all management functions
 - Designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services

(continued)

The FAQs in this appendix cover the following topics:

- ▶ Management Functions (1 FAQ)
- ▶ Routine Activities (2 FAQs)
- ▶ Suitable Skill, Knowledge, and/or Experience (10 FAQs)
- ▶ Documentation Requirement (8 FAQs)
- ▶ Period of the Professional Engagement (1 FAQ)
- ▶ Bookkeeping Services (10 FAQs)
- ▶ Controllorship Services (1 FAQ)
- ▶ Tax Services (3 FAQs)

(continued from previous page)

- Evaluate the adequacy and results of the services performed
- Accept responsibility for the results of the services
- Establish and maintain internal controls, including monitoring ongoing activities

The member should be satisfied that the client will be able to meet all of these criteria and make an informed judgment on the results of the member's nonattest services. In assessing whether the designated individual possesses suitable skill, knowledge, and/or experience, the member should be satisfied that such individual sufficiently understands the services to be performed to oversee them. However, the individual is not required to possess the expertise to perform or reperform the services.

In cases when the client is unable or unwilling to assume these responsibilities (for example, the client does not have an individual with suitable skill, knowledge, and/or experience to oversee the nonattest services provided or is unwilling to perform such functions due to lack of time or desire), the member's provision of these services would impair independence.

- Before performing nonattest services, the member should establish and document in writing* his or her understanding with the client (that is, board of directors, audit committee, or management, as appropriate in the circumstances) regarding the (a) objectives of the engagement, (b) services to be performed, (c) client's acceptance of its responsibilities, (d) member's responsibilities, and (e) limitations of the engagement.

The documentation requirement does not apply to the following:

- Nonattest services performed prior to January 1, 2005.
- Nonattest services performed prior to the client becoming an attest client.**

The preceding second and third general requirements do not apply to certain routine activities performed by the member, such as providing advice and responding to the client's questions as part of the normal client-member relationship.

* A failure to prepare the required documentation would not impair independence but would be considered a violation of Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, vol. 2, ET sec. 202 par. .01), provided that the member did establish the understanding with the client. [Footnote added; effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote subsequently revised January 27, 2005.]

** However, upon the acceptance of an attest engagement, the member should prepare written documentation demonstrating his or her compliance with the other general requirements during the period covered by the financial statements, including the requirement to establish an understanding with the client.

- ▶ Information Technology Services (8 FAQs)
- ▶ Appraisal, Valuation, and Actuarial Services (1 FAQ)

Management Functions

1. The first general requirement under Interpretation No. 101-3 states that the member should not perform management functions or make management decisions for the attest client. What are some examples of management functions for purposes of Interpretation No. 101-3?

A management function generally would include doing or having the authority to do the following:

- ▶ Make decisions on behalf of the client
- ▶ Authorize, execute, or consummate client transactions
- ▶ Supervise, hire, or terminate client employees
- ▶ Oversee or manage any aspect of the client's business
- ▶ Set policy for the client
- ▶ Have access to or custody of client assets
- ▶ Sign or cosign client checks
- ▶ Establish or maintain internal controls for the client

Note: The preceding list is not intended to be all-inclusive.

Providing advice, research materials, and recommendations to assist the client's management in performing its functions and making decisions would not constitute the performance of a management function.

Routine Activities

1. The second and third general requirements under Interpretation No. 101-3 do not apply to certain routine activities performed by the member. What are considered to be routine activities for purposes of the interpretation?

Whether an activity is routine should be determined by considering all of the facts and circumstances surrounding the activity. Routine activities generally involve providing advice

or assistance to the client on an informal basis as part of the normal client-member relationship. Routine activities typically are insignificant in terms of time incurred or resources expended and generally do not result in a specific project or engagement or in the member producing a formal report or other formal work product. Examples of routine activities may include the following:

- ▶ Providing advice to the client on an accounting matter as an ancillary part of the overall attest engagement
- ▶ Researching and responding to the client's technical questions on relevant tax laws as an ancillary part of providing tax services
- ▶ Providing advice to the client on routine business matters
- ▶ Educating the client on matters within the technical expertise of the member
- ▶ Providing information to the client that is readily available to the member, such as best practices and benchmarking studies

2. Is a member permitted to assist the client in understanding the nature of adjusting entries and their impact on the financial statements?

Yes. If a client needs assistance in understanding the nature of the entries and their impact on the financial statements, the member may explain the accounting principles giving rise to the adjustments, as well as the impact of the adjustments on the financial statements.

Suitable Skill, Knowledge, and/or Experience

1. What does suitable skill, knowledge, and/or experience mean in the context of Interpretation No. 101-3?

Suitable skill, knowledge, and/or experience means that the individual designated to oversee the nonattest service has the ability to understand the nature, objective, and scope of the nonattest service. Overseeing the service does not require the designated individual to supervise the member in the day-to-day rendering of the services. Rather, the individual should agree on the nature, objective, and scope of the services; receive periodic progress reports when appropriate; make all significant judgments; evaluate the adequacy and results of the service; accept responsibility for the service results; and ensure that the resulting work product meets the agreed-upon specifications. The skill, knowledge, and/or experience needed will vary depending on the nature of the nonattest service. For example, the skill, knowledge, and/or experience needed to oversee a payroll service can be expected to be different than the skill, knowledge, and/or experience needed to oversee a complex tax service. The requirement for the designated individual to possess suitable

skill, knowledge, and/or experience does not, however, require that the individual possess the technical expertise that the member possesses or the ability to perform or reperform the services.

2. Is the requirement that the client possess suitable skill, knowledge, and/or experience to oversee the nonattest services provided by the member a new provision?

No. Since the mid-1970s, Interpretation No. 101-3 has called for the attest client to undertake certain responsibilities in connection with the delivery of various nonattest services. For example, at various times the rule has called for the client to “be sufficiently knowledgeable,” “sufficiently informed,” and “have an informed judgment on the results of the nonattest service.” These requirements necessitate oversight by an individual with suitable skill, knowledge, and/or experience.

3. Why does the rule require an individual who possesses suitable skill, knowledge, and/or experience to oversee the nonattest services provided by the member?

If the individual designated by the client does not possess suitable skill, knowledge, and/or experience to oversee the nonattest service, there would be no one (other than the member) to make the significant judgments that become necessary during the delivery of the service or discharge the other client responsibilities under Interpretation No. 101-3. Performing those activities on behalf of the attest client would be inconsistent with the member’s requirement to be independent of the client.

4. What are the underlying concepts that support the conclusion that a member’s independence would be impaired if an individual designated by the client with suitable skill, knowledge, and/or experience does not perform the activities described in the interpretation?

Two threats to a member’s independence arise if the member assumes the client’s responsibilities under Interpretation No. 101-3. First a “self-review threat” arises when the member reviews, as part of an attest engagement (for example, an audit), evidence that results from his or her (or his or her firm’s) own nonattest work. That could happen, for example, when the member makes significant judgments on behalf of the client during the performance of the nonattest service, or the designated client individual lacks suitable skill, knowledge, and/or experience to evaluate the adequacy and results of the service and accept responsibility for those results. In that situation, the member has a disincentive to challenge the related financial statement amounts because doing so could call into question his or her (or his or her firm’s) own work. That disincentive is inconsistent with the need for the member to be independent and objective with respect to the client. The second threat that arises is a “management participation threat.” Making significant judgments on behalf of the attest client during the performance of the nonattest service causes

the member to function as management in connection with the service. That also is inconsistent with the need for the member to be independent and objective with respect to the client. By ensuring that an individual designated by the client with suitable skill, knowledge, and/or experience oversees the member's nonattest services and makes all management decisions, both threats are eliminated.

5. How should a member assess whether the individual designated by the client to oversee the nonattest service possesses suitable skill, knowledge, and/or experience?

In assessing whether the designated individual has suitable skills, knowledge, and/or experience to oversee a nonattest service, the member might consider the following factors that pertain to the individual:

- ▶ Understanding of the nature of the service
- ▶ Knowledge of the client's business
- ▶ Knowledge of the client's industry
- ▶ General business knowledge
- ▶ Education
- ▶ Position at the client

Some factors may be given more weight than others, depending on the nature of the service. For example, although the level of education attained by the individual can be one indicator of his or her skills and/or knowledge, it is not necessarily true that the more formal education the individual possesses, the more able he or she would be to oversee the nonattest service. If the individual understands the nature of the service and possesses a sufficient knowledge of the client's business and industry, he or she may have the skills, knowledge, and/or experience to oversee the service, regardless of the level of education he or she possesses. For example, most small business owners know their company's operations and financial position better than anyone, and they understand the services they need from the member and what those services are intended to accomplish. Because they are the owners of the business, they regularly make important decisions about all matters affecting their business. Accordingly, members might conclude that those individuals would possess the necessary skills, knowledge, and/or experience to understand the services being performed; make any management decisions; and determine whether the results of the services meet the agreed-upon specifications.

6. Interpretation No. 101-3 requires that the client designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to

oversee the nonattest services. Which individual(s) at the client can serve in this capacity (for example, the owner[s], controller, or bookkeeper)?

The individual(s) designated by the client will likely depend on the nature of the client's organization and the nature of the nonattest engagement. In an owner-managed business, it will often be the owner, but depending on the nature of the nonattest services and the qualifications (that is, skill, knowledge, and/or experience) of other client employees or individuals, it also could be the controller, bookkeeper, or another employee. In larger organizations or for more complex services, the client is more likely to designate a senior officer to oversee the services. The employee or individual responsible for overseeing the nonattest services needs to understand the services sufficiently to oversee them but does not need to possess the technical qualifications to perform or reperform the services.

For example, consider a nonattest engagement in which the member has been asked to provide investment advisory services that include recommendations on the allocation of funds that the client should invest in various asset classes based on the client's desired rate of return and risk tolerance. The owner of the company has knowledge of the company's investment objectives and therefore serves as the client designee. The owner makes all investment decisions concerning the allocation of funds and investment selections and accepts responsibility for the resulting investment plan. For purposes of this nonattest engagement, the member may conclude that the owner of the company possesses the skill, knowledge, and/or experience to oversee the service. On the other hand, consider an engagement when the member is asked to install an off-the-shelf accounting package and set up the chart of accounts and financial statement format for a small business client. The owner of the company is traveling on business and designates the office manager to oversee the installation. The office manager primarily performs routine clerical and receptionist functions for the business and has limited understanding of the company's operations. He or she has never used accounting or financial software, such as the application being installed by the practitioner. In addition, because the company hires a part-time bookkeeper to maintain its general ledger and subsidiary records, the office manager has no understanding of the company's books or records and financial statements. For purposes of this nonattest engagement, it appears unlikely that the office manager would be in a position to sufficiently understand the services being performed to oversee them and accept responsibility for the resulting accounting system.

7. May the client contract with a third party who is not an employee of the client to oversee or advise on the member's performance of the nonattest service?

The client may contract with a third party to advise management regarding the nature of the services and the evaluation of the adequacy and results of the services in order to enable

management to effectively oversee the services, perform all management functions, make all management decisions, accept responsibility for the services, and maintain internal controls over the services.

When the client outsources the nonattest services oversight functions to a third party, such third party may serve as the individual designated by the client to oversee the nonattest services provided he or she possesses the necessary skill, knowledge, and/or experience; functions in a capacity equivalent to that of a client employee; and has the authority to make decisions on behalf of the client.

8. How can a member be satisfied that the client designee understands the nonattest services performed and the resulting work product?

Members are expected to utilize their professional judgment and experience to recognize which individuals are able and willing to fulfill the client responsibilities that are set forth in the interpretation. Through interaction with the client owner(s) or client employees, experienced practitioners should be able to assess whether the designated client individual possesses the skill, knowledge, and/or experience to effectively oversee the nonattest service.

9. A client has difficulty understanding deferred tax assets and deferred tax liabilities. What must a client know about these concepts in order to be considered to possess the skill, knowledge, and/or experience necessary to fulfill the requirement(s) under Interpretation No 101-3?

The intent of Interpretation No. 101-3 is not for the client to possess a level of technical expertise commensurate with that of the member. In the case of deferred taxes, the client should understand the basis for the deferred tax assets or liabilities and the impact of the deferred taxes on the financial statements.

10. What are some examples of nonattest services and the level of understanding that the client designee should possess in order to comply with Interpretation No. 101-3?

Bookkeeping—When the member performs routine bookkeeping services for an audit, review, or compilation client, the member should be satisfied that the designated individual understands the reason why the journal entries are being proposed and the effect they have on the financial statements. For recurring or standard journal entries (for example, depreciation), the designated individual may require no explanation regarding the reason for the entry (for example, when the member has previously discussed these entries with the client), whereas for more complex journal entries (for example, deferred taxes), the

member may need to explain to the client the reason and basis for the entry and its impact on the financial statements. In any case, the individual should be in a position to approve the proposed journal entries and accept responsibility for the company's financial statements.

Tax Services—For tax return preparation engagements, the individual designated by the client need not have an understanding of the applicable tax laws; however, the member should have the designated individual review the tax return with an emphasis on the key tax positions taken. The member also should be satisfied that the individual understands the company's tax situation, has a general understanding of how the amounts on the tax return were determined, and make all decisions regarding significant tax positions taken in the return.

Valuation Services—For more complex engagements, such as permitted valuation services, the member may need to explain to the individual designated by the client the valuation methodologies used as well as all significant assumptions. The individual then should be in a position to approve all significant assumptions and accept responsibility for the resulting valuation.

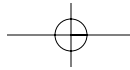
Documentation Requirement

1. The third general requirement of Interpretation No. 101-3 requires that the member should establish and document in writing his or her understanding with the client regarding the (a) objectives of the engagement, (b) services to be performed, (c) client's acceptance of its responsibilities, (d) member's responsibilities, and (e) limitations of the engagement. Would a member be in compliance with this requirement if the preceding points were documented in an engagement letter, the audit planning memo, or in a memo of understanding maintained in the member's billing files?

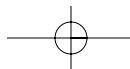
Yes. The general requirements of Interpretation No. 101-3 only require a member to document his or her understanding with the client and do not indicate any specific method of documentation. The methods indicated are not all-inclusive, and other methods may be appropriate as well. FAQ No. 2 that follows provides further details, including illustrative sample language.

2. What form of documentation is required?

Although the rule requires that the understanding with the client must be in writing, the form of documentation is left to the member's discretion. The method of documentation is not as important as the content of the documentation. For example, if the member



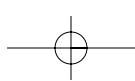
performs a consulting engagement for an audit client, the member may decide to document the required elements with respect to the consulting engagement in the audit engagement letter. The understanding also could be documented, for example, in a separate engagement letter specific to the consulting service engagement, a memo to the audit files, or a checklist that the member completes as part of the audit. If a client engages the member to perform tax services, the understanding could be documented in a tax organizer or a memo contained in the tax working papers. Other methods of documentation, such as a memo of understanding maintained in the member's billing or correspondence files (that is, separate from the client working paper files), also would satisfy this requirement. The following is illustrative sample language that can be incorporated into an audit, review, or compilation engagement letter; a "stand-alone" nonattest services engagement letter; a tax organizer letter; or other documentation method preferred by the member:



Sample Language to Document Understanding With the Client for the Provision of
Bookkeeping and Tax Services

Objectives of the Engagement and Services to be Performed

1. We provide the bookkeeping and tax services outlined as follows:
 - ▶ At the end of each month, CPA Firm agrees to perform the following functions:
 - Post coded transactions to ABC Company's general ledger
 - Propose adjusting or correcting journal entries to be reviewed and approved by ABC Company
 - Prepare a trial balance based on the adjusted general ledger
 - Prepare monthly sales and payroll tax returns [*insert applicable tax jurisdictions*]
 - ▶ At the end of the year, CPA Firm agrees to perform the following functions:
 - Propose adjusting or correcting journal entries to be reviewed and approved by ABC Company
 - Prepare federal and state income tax returns [*insert applicable tax jurisdictions*]
 - Prepare year-end sales and payroll tax returns [*insert applicable tax jurisdictions*]
 - Answer inquiries on specific tax matters
 - ▶ CPA Firm will not perform management functions or make management decisions on behalf of ABC Company. However, we will provide advice and recommendations to assist management of ABC Company in performing its functions and making decisions.
2. ABC Company's responsibilities are as follows:
 - ▶ ABC Company agrees to perform the following functions in connection with CPA Firm's provision of the bookkeeping and tax services:
 - Make all management decisions and perform all management functions, including determining account codings and approving all proposed journal entries
 - Assign [*name of competent client employee*] to oversee the bookkeeping and tax services and evaluate the adequacy and results of the services
 - Accept responsibility for the results of the bookkeeping and tax services, including the journal entries, general ledger, trial balance, and tax returns
 - Establish and maintain internal controls over the bookkeeping and tax return preparation processes
3. CPA Firm's responsibilities and limitations of the engagement are as follows:
 - ▶ CPA Firm will perform the services in accordance with applicable professional standards, including the Statements on Standards for Tax Services issued by the AICPA.
 - ▶ This engagement is limited to the bookkeeping and tax services previously outlined. CPA Firm, in its sole professional judgment, reserves the right to refuse to do any procedure or take any action that could be construed as making management decisions or performing management functions, including determining account codings and approving journal entries. CPA Firm will advise ABC Company with regard to tax positions taken in the preparation of the tax return, but ABC Company must make all decisions with regard to those matters.



3. What clients are affected by the documentation requirement?

The documentation requirement applies to any nonattest services (for example, book-keeping, tax, or consulting services) performed by the member for an *attest client*. For purposes of this rule, an attest client is any client for which the member performs any service for which independence is required. Accordingly, for purposes of this rule, a client for which a member performs a compilation would only be considered an attest client if the member's compilation report does not disclose a lack of independence.

Other regulators may have more restrictive rules regarding independence when performing nonattest services for an attest client. Accordingly, the member should be aware of and comply with all rules and regulations applicable to specific clients.

4. Are any activities excluded from the documentation requirement?

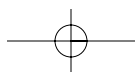
The documentation requirement does not apply to routine activities performed by the member, such as providing advice and responding to the client's technical questions as part of the normal client-member relationship. See FAQ No. 1 under the heading "Routine Activities."

5. Would independence be impaired when a member fails to document the understanding with the client?

No. A failure to prepare the required documentation would not impair the member's independence provided the understanding with the client had been established. However, the failure to document the understanding with the client would be considered a violation of Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, vol. 2, ET sec. 202 par. .01).

6. A member provides only nonattest services to a client for the year ending December 31, 2004. In 2005, the member is asked to perform an audit of the client's year-end 2004 financial statements. Would the member be in violation of the third general requirement under Interpretation No. 101-3 because the firm did not comply with the documentation requirement with respect to the nonattest services performed in 2004?

No. The documentation requirement does not apply to nonattest services performed prior to the client becoming an attest client. However, upon the acceptance of an attest engagement, the member should prepare written documentation demonstrating his or her compliance with the other general requirements of Interpretation No. 101-3 during the period covered by the financial statements, including the requirement to establish an understanding with the client.



7. Must a member document the client's review and approval of journal entries proposed by the member?

Interpretation No. 101-3 does not require that the member document the client's review and approval of the journal entries. However, the member may wish to document the name of the client representative who reviewed and approved the journal entries and the date of his or her review to provide evidence that such review and approval took place.

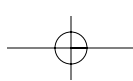
8. A member's firm does not require its clients to sign engagement letters for tax return preparation services. How does the documentation requirement under Interpretation No. 101-3 apply with respect to these clients?

Tax services are nonattest services subject to the requirements of Interpretation No. 101-3. Therefore, the documentation requirement applies when the member provides tax services to a client for which the member also provides attest services. However, the method of documentation is left to the member's discretion, and, provided it contains all of the required elements, it could be documented in a tax organizer or disclosure statement provided to the client, a memo in the tax or attest service working papers, or through other means.

Period of the Professional Engagement

1. Would a member's independence be considered impaired if a member performed services that would impair independence under Interpretation No. 101-3 during the period covered by the financial statements but prior to the period of the professional engagement?

Interpretation No. 101-3 states that in cases when the requirements of the interpretation have not been met during the period of the professional engagement or the period covered by the financial statements, the member's independence would be impaired. However, independence would not be considered impaired provided the services (a) do not constitute management functions, (b) were performed prior to the period of the professional engagement, (c) relate solely to financial statements of the prior period, and (d) those financial statements were audited by another firm (or in the case of a review engagement, reviewed or audited by another firm). See FAQ No. 1 under the previous heading "Management Functions" and ET section 100.01, *Conceptual Framework for AICPA Independence Standards* (AICPA, *Professional Standards*, vol. 2), for further guidance on what would constitute a management function (issued November 2007).



Bookkeeping Services

1. A member records journal entries while performing monthly bookkeeping services without obtaining client approval. Would independence be impaired?

Yes. In order for the member to maintain his or her independence, the client must review and approve the journal entries, and the member should be satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements.

2. During the course of providing monthly bookkeeping services, the member receives invoices from the client indicating approval for payment and identifying the appropriate general ledger accounts to record the transaction. The member prepares the client's checks for payment of those invoices, records the transactions in the client's general ledger system, and returns the checks to the client for approval and signature. The member does not have signature authority over the client's checking account. Would independence be impaired?

No. Management determined and approved the appropriate account classifications, approved the invoices for payment, and reviewed and signed the prepared checks.

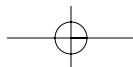
3. During the course of providing monthly bookkeeping services, the member discusses with client management the need to record recurring journal entries (for example, depreciation expense) each month in the general ledger. The client approves the recurring journal entries and makes any necessary decisions (for example, useful lives of the assets). The member then records these entries in the client's general ledger each month. Would independence be impaired?

No. The client understands the general nature of the journal entries and the impact they have on its financial statements.

4. A client records all disbursements in its checkbook and identifies the type of expense (for example, telephone, rent, and so on) on the checkbook stubs. During the course of providing monthly bookkeeping services, the member assigns the general ledger account number based on the type of expense indicated by the client and records these payments in the client's accounting system. Would independence be impaired?

No. The member would not be considered coding transactions.

5. A member is engaged to perform an audit, review, or compilation of a client's financial statements. During the course of the audit, review, or compilation, the member proposes



audit adjustments to the financial statements. Examples of these entries include the current tax accrual and deferred tax assets or liabilities and the amount of depreciation and amortization necessary for the current year. The client reviews these entries, understands the impact on its financial statements, and records the adjustments identified by the member. Would the proposal of such entries constitute a nonattest bookkeeping service subject to Interpretation No. 101-3?

No. Proposing entries as a result of the member's audit, review, or compilation services is a normal part of those engagements and would not constitute performing a nonattest bookkeeping service subject to Interpretation No. 101-3.

6. A member is engaged to perform an audit for a client who records all transactions on a cash basis in its general ledger. During the audit process, the member identifies all appropriate journal entries required to convert the client's general ledger to an accrual basis and prepares the financial statements, including footnotes, on the accrual basis in order to conform with generally accepted accounting principles. The client reviews the entries and financial statements, including all footnote disclosures, and understands the impact these entries have on the financial statements. As part of the management representation letter, the client acknowledges responsibility for the financial statements and footnotes. Would these services be considered nonattest bookkeeping services subject to Interpretation No. 101-3?

No. Providing these services as part of the member's audit of the client's financial statements would not be considered bookkeeping services subject to the requirements of Interpretation No. 101-3. In addition, a member should use judgment concerning what would be considered part of the normal audit process and what would be a separate nonattest service. A client's books and records have to be substantially complete and current in order to conduct an audit of those books and records. The client's books and records would include all subsidiary ledgers or information required by the auditor (such as accounts receivable or payable) for the necessary conversion. If a member performs a service to bring those books and records current or complete (such as compiling the subsidiary information), the service should be considered outside the scope of the normal audit process and, therefore, a nonattest service subject to Interpretation No. 101-3. However, Interpretation No. 101-3 would be applicable when the member is engaged to perform a stand-alone bookkeeping engagement for the client. An example would be when a member is engaged to perform monthly bookkeeping services, including the preparation of monthly compiled financial statements.

7. The member prepares a bank reconciliation of a client's bank account in connection with monthly bookkeeping services. The client reviews and approves the bank reconciliation. Would independence be impaired?

No. The client reviews and approves the bank reconciliation and sufficiently understands the services performed to oversee them.

8. A member performing bookkeeping services records adjusting and reclassification journal entries and compiles preliminary financial statements. The member delivers the financial statements and compilation report to the client and provides the client copies of the general ledger, journals, and journal entries, which contain a description of the nature of each entry. The member asks the client to review the journal entries and then asks whether the client has any questions about any of the entries. Would the requirements of Interpretation No. 101-3 be met?

Yes. Provided the member is satisfied that the client understands the nature and impact of the journal entries, the requirements of Interpretation No. 101-3 would be met.

9. Must the member review the proposed journal entries and explain their impact on the financial statements to the client in person or can this review take place by phone, fax, mail, or e-mail?

The review process can take place in person; by phone, fax, mail, or e-mail; or a combination thereof. Regardless of the method used, the member must be satisfied that the client understands the nature and impact of the journal entries.

10. As part of performing bookkeeping services, a member records adjusting journal and reclassification entries and prepares the client's preliminary financial statements. The member does not review each and every journal entry with the client, but, rather, the member describes the nature of the journal entries and their impact on the preliminary financial statements. The client approves the preliminary financial statements and issues them to its bank. Would the requirements of Interpretation No. 101-3 be met?

Yes. Provided all of the other requirements of Interpretation No. 101-3 are met.

Controllership Services

1. A member provides temporary controllership services and various types of other temporary accounting services for clients during client maternity leaves, illnesses, and sudden departures. Do these activities impair independence under Interpretation No. 101-3?

These services would be subject to Interpretation No. 101-3. If a member performs controller-type activities, independence would be impaired because such activities typically involve the performance of management functions or the supervision of client employees.

However, if the member performs temporary accounting and other services in compliance with the requirements of Interpretation No. 101-3, independence would not be impaired. The member also should consider whether the duration or regularity of the services might appear to impair independence. Having the title of controller would impair independence regardless of the actual services performed.

Tax Services

1. The member performs year-end tax planning and prepares the tax returns for an attest client. Would these services be considered nonattest services and therefore subject to the requirements of Interpretation No. 101-3?

Yes. Tax services are considered nonattest services and are therefore subject to the general requirements of Interpretation No. 101-3, including the member's understanding with the client with respect to the tax services that must be documented in writing.

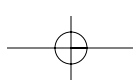
2. Does Interpretation No. 101-3 apply when the member prepares the personal tax returns of the owners and officers of an audit, review, or compilation client? Does it matter whether the owners or officers pay for the services themselves or whether the client pays for the services as an executive perk?

If the personal tax returns are prepared without having to rely on representations of the client, then Interpretation No. 101-3 would not apply. The mere fact that the client pays for the services also would not cause Interpretation No. 101-3 to apply.

3. Would assisting a client in applying Financial Accounting Standards Board Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*,² impair independence (for example, identifying potential uncertain tax positions, advising the client whether those tax positions meet the more-likely-than-not [MLTN] threshold, and calculating the related unrecognized tax benefits)?

The provision of such services would not impair independence provided the client can make an informed judgment on the results of the member's services and the other requirements of Interpretation No. 101-3 are met. In meeting the requirements of Interpretation No. 101-3, the member may assist the client in understanding why the tax positions do or do not meet the MLTN threshold and the basis for any unrecognized tax benefit so that

2. At the time of this writing, the Financial Accounting Standards Board (FASB) was expected to make the FASB *Accounting Standards Codification*TM (FASB ASC) authoritative effective July 1, 2009. FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109*, has been codified at FASB ASC 740, *Income Taxes*.



the client can accept responsibility for the amounts reported and disclosed in the financial statements (issued July 2007).

Information Technology Services

1. Why does Interpretation No. 101-3 indicate that independence would be impaired if a member is operating a client's local area network (LAN) system?

Operating a client's LAN is considered to be a management function that would violate the general requirements of Interpretation No. 101-3.

2. Would outsourcing the client's entire network operation and independently operating the client's LAN system impair independence?

Yes.

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

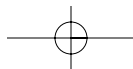
No. Performing network maintenance is not considered to be operating the client's network and, therefore, would not impair independence provided a client employee with the necessary skill, knowledge, and/or experience is making all decisions and approving all activities.

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

No. Provided the member does not make other than insignificant modifications to the source code underlying the client's financial information system.

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

Yes. In this case, the member would be performing management duties (supervising client employees in the performance of their normal recurring activities), which would impair independence.



6. Would assisting a client with procuring and securing Internet access impair independence?

No. Provided a client employee with the necessary skill, knowledge, and/or experience makes all decisions concerning the Internet provider and services to be provided.

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

Information systems that produce information that is reflected in the amounts and disclosures in the client's financial statements, used in determining such amounts and disclosures, or used in effecting internal control over financial reporting are considered to be related to the financial statements and accounting records. However, information systems that are used only in connection with controlling the efficiency and effectiveness of operations are considered to be unrelated to the financial statements and accounting records.

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

If the modifications have more than an insignificant effect on the functionality of the software, they should be considered to be other than insignificant.

Appraisal, Valuation, and Actuarial Services

1. Would assisting a client in applying FASB Statement No. 141 (revised 2007), *Business Combinations*, or FASB Statement No. 142, *Goodwill and Other Intangible Assets*,³ impair independence (for example, providing advice on the various valuation methodologies available and assumptions needed and providing valuation templates, software, or other tools so that the client can determine an appropriate value for acquired assets, goodwill, contingent consideration, and so on)?

When the client requests that the member perform valuation services or when the member is in essence performing the valuation for the client (such as when the member provides the client with a firm-developed template or software product or inserts amounts into a template or software product), the member should refer to the guidance in Interpretation

3. At the time of this writing, FASB was expected to make the FASB ASC authoritative effective July 1, 2009. FASB Statement No. 141 (revised 2007), *Business Combinations*, has been codified at FASB ASC 805, *Business Combinations*. FASB Statement No. 142, *Goodwill and Other Intangible Assets*, has been codified at FASB ASC 350, *Intangibles—Goodwill and Other*.

No. 101-3. That guidance states that independence would be impaired if a member performs an appraisal or valuation service for an attest client when the results of the service would be material to the financial statements and the appraisal or valuation involves a significant degree of subjectivity. Valuations performed in connection with business combinations or appraisals of assets or liabilities normally materially affect the financial statements and involve a significant degree of subjectivity.

Providing advice on the various valuation methodologies available and assumptions to be made in performing the valuation would not impair independence provided the requirements of Interpretation No. 101-3 are met. These requirements include the client determining or approving all significant assumptions and matters of judgment and making an informed judgment on, and accepting responsibility for, the results of the service. In meeting the requirements of Interpretation No. 101-3, the member also may assist the client in understanding the accounting standards and the nature of the necessary accounting adjustments.

In addition, the member may provide the client with generic or standardized templates or software products not developed by the firm to assist the client with performing the valuation. *Generic or standardized products* are those in which formulas are well established and subject to only minor judgments or interpretations. Accordingly, it is reasonable to expect that the result produced by such products will be similar to the result that would be produced by other vendors' products (issued August 2008).

