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AICPA Professional Standards

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2009

**AICPA professional standards as of June 1, 2009, Volume 2:  
accounting and review services, code of professional conduct,  
bylaws, valuation services, quality control, peer review, tax  
services, personal financial planning, continuing professional  
education**

American Institute of Certified Public Accountants (AICPA)

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# AICPA Professional Standards

Volume 2

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

- > Accounting and Review Services
- > Code of Professional Conduct
- > Bylaws
- > Valuation Services
- > Consulting Services
- > Quality Control
- > Peer Review
- > Tax Services
- > Personal Financial Planning
- > Continuing Professional Education

**AS OF JUNE 1, 2009**

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**AICPA Professional Standards**  
AS OF JUNE 1, 2009

Volume 2

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# AICPA Professional Standards

Volume 2

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS



1955-355

- > Accounting and Review Services
- > Code of Professional Conduct
- > Bylaws
- > Valuation Services
- > Consulting Services
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**AS OF JUNE 1, 2009**

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## WHAT'S NEW IN THIS EDITION

### STANDARDS RECENTLY ISSUED

<u>Statement</u>	<u>Title</u>	<u>Issue Date</u>	<u>Section</u>
SSARS No. 18	<i>Applicability of Statements on Standards for Accounting and Review Services</i>	Feb. 2009	Integrated into AR 100

### ADDITIONAL CHANGES

In addition to this recently issued standard, other changes to this edition of volume 2 of *AICPA Professional Standards* include the following:

<u>Section</u>	<u>Change</u>
How to Use Volume 2	Addition of the section "Special Note About Financial Accounting Standards Board <i>Accounting Standards Codification</i> <sup>TM</sup> ."
AR 50	Amendments to reflect conforming changes due to the issuance of Statement on Standards of Accounting and Review Services (SSARS) No. 17, <i>Omnibus Statement on Standards for Accounting and Review Services—2008</i> .
AR 100	Amendments to reflect conforming changes due to the issuance of Statement on Quality Control Standards (SQCS) No. 7, <i>A Firm's System of Quality Control</i> , and the contributions of the Accounting and Review Services Committee.
AR 9100.136–.137	Addition of Interpretation No. 31, "Preparation of Financial Statements for Use by an Entity's Auditor," of AR section 100.
AR 100A, 9100A, 110A, 120A, 200A, 300A, 9300A, and 400A	Deletions due to the issuance of SSARS No. 17.
Various AR sections	Revisions to various AR sections to reflect conforming changes due to the issuance of Financial Accounting Standards Board (FASB) <i>Accounting Standards Codification</i> <sup>TM</sup> (ASC).
ET 505.04	Revisions to reflect conforming changes due to the issuance of recent authoritative literature.
Various ET sections	Revisions to reflect conforming changes due to the issuance of FASB ASC.
ET Guide for Complying With Rules 102–505	Addition of <i>ET Guide for Complying With Rules 102–505</i> to help members make decisions unrelated to independence regarding relationships or circumstances that are not explicitly addressed by Ethics interpretations and rulings.
VS 100	Revision to reflect conforming changes due to the issuance of FASB ASC.

**Section**

**Change**

QC 20, 30, and 40

Deleted due to the issuance of SQCS No. 7.

PR 100 and 9100

Amendments due to various editorial changes.

PR 100A and 9100A

Deletions due to the effective date of PR sections 100 and 9100.

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## TABLE OF CONTENTS

---

### VOLUME 2

<i>Section</i>	<i>Page</i>
... How to Use Volume 2.....	1393
<b>ACCOUNTING AND REVIEW SERVICES</b>	
AR ... Statements on Standards for Accounting and Review Services.....	1399
20—Defining Professional Requirements in Statements on Standards for Accounting and Review Services	
50—Standards for Accounting and Review Services	
100—Compilation and Review of Financial Statements	
9100—Compilation and Review of Financial Statements: Accounting and Review Services Interpretations of Section 100	
110—Compilation of Specified Elements, Accounts, or Items of a Financial Statement	
120—Compilation of Pro Forma Financial Information	
200—Reporting on Comparative Financial Statements	
9200—Reporting on Comparative Financial Statements: Accounting and Review Services Interpretations of Section 200	
300—Compilation Reports on Financial Statements Included in Certain Prescribed Forms	
9300—Compilation Reports on Financial Statements Included in Certain Prescribed Forms: Accounting and Review Services Interpretations of Section 300	
400—Communications Between Predecessor and Successor Accountants	
9400—Communications Between Predecessor and Successor Accountants: Accounting and Review Services Interpretations of Section 400	
500—Reporting on Compiled Financial Statements [Deleted by the issuance of Statement on Standards for Accounting and Review Services 7, November 1992.]	
600—Reporting on Personal Financial Statements Included in Written Personal Financial Plans	
9600—Reporting on Personal Financial Statements Included in Written Personal Financial Plans: Accounting and Review Services Interpretation of Section 600	
AR ... Exhibits.....	1553

**VOLUME 2—continued**

<i>Section</i>	<i>Page</i>
AR ...	Appendixes ..... 1567
AR ...	Topical Index ..... 1581
<b>CODE OF PROFESSIONAL CONDUCT</b>	
ET ...	Code of Professional Conduct—Introduction ..... 1593
ET 50	Principles of Professional Conduct ..... 1595
	51—Preamble
	52—Article I—Responsibilities
	53—Article II—The Public Interest
	54—Article III—Integrity
	55—Article IV—Objectivity and Independence
	56—Article V—Due Care
	57—Article VI—Scope and Nature of Services
ET 90	Rules: Applicability and Definitions ..... 1611
	91—Applicability
	92—Definitions
ET 100	Independence, Integrity, and Objectivity ..... 1621
	100.01—Conceptual Framework for AICPA Independence Standards
	101—Independence
	Rule 101—Independence
	Interpretations under Rule 101—Independence
	102—Integrity and Objectivity
	Rule 102—Integrity and objectivity
	Interpretations under Rule 102—Integrity and Objectivity
	191—Ethics Rulings on Independence, Integrity, and Objectivity
ET 200	General Standards—Accounting Principles ..... 1699
	201—General Standards
	Rule 201—General standards
	Interpretations under Rule 201—General Standards
	202—Compliance With standards
	Rule 202—Compliance with standards
	Interpretation under Rule 202—Compliance With Standards

**VOLUME 2—continued**

<i>Section</i>		<i>Page</i>
ET 200	General Standards—Accounting Principles—continued	
	203—Accounting Principles	
	Rule 203—Accounting principles	
	Interpretations under Rule 203—	
	Accounting Principles	
	291—Ethics Rulings on General and Technical Standards	
ET 300	Responsibilities to Clients . . . . .	1711
	301—Confidential Client Information	
	Rule 301—Confidential client information	
	Interpretations under Rule 301—	
	Confidential Client Information	
	302—Contingent Fees	
	Rule 302—Contingent fees	
	Interpretation under Rule 302—Contingent Fees	
	391—Ethics Rulings on Responsibilities to Clients	
ET 400	Responsibilities to Colleagues . . . . .	1725
ET 500	Other Responsibilities and Practices . . . . .	1727
	501—Acts Discreditable	
	Rule 501—Acts discreditable	
	Interpretations under Rule 501—Acts Discreditable	
	502—Advertising and Other Forms of Solicitation	
	Rule 502—Advertising and other forms of	
	solicitation	
	Interpretations under Rule 502—Advertising and	
	Other Forms of Solicitation	
	503—Commissions and Referral Fees	
	Rule 503—Commissions and referral fees	
	Interpretation under Rule 503—Commissions	
	and Referral Fees	
	504—[Deleted]	
	505—Form of Organization and Name	
	Rule 505—Form of organization and name	
	Interpretations under Rule 505—Form of	
	Organization and Name	
	591—Ethics Rulings on Other Responsibilities and Practices	
ET ...	Appendixes . . . . .	1763
ET ...	Rules Compliance Guide . . . . .	1771
ET ...	Topical Index . . . . .	1779

**VOLUME 2—continued**

<i>Section</i>		<i>Page</i>
	<b>BYLAWS</b>	
BL ...	Definitions .....	1795
BL 100	Name and Purpose .....	1797
	101—Name and Purpose	
BL 200	Admission to, and Retention of, Membership and Association .....	1801
	210—Members	
	220—Requirements for Admission to Membership	
	220R—Implementing Resolution Under Section 2.2 Requirements for Admission to Membership	
	230—Requirements for Retention of Membership	
	230R—Implementing Resolutions Under Section 2.3 Requirements for Retention of Membership	
	240—Certificate of Membership	
	250—Right of Members to Describe Themselves as Such	
	260—International Associates	
	260R—Implementing Resolution Under Section 2.6 International Associates	
BL 300	Organization and Procedure .....	1821
	310—General	
	320—Membership	
	320R—Implementing Resolution Under Section 3.2 Membership	
	330—Council	
	340—Board of Directors	
	340R—Implementing Resolution Under Section 3.4 Board of Directors	
	350—Officers Elected by Council	
	350R—Implementing Resolution Under Section 3.5 Officers Elected by Council	
	360—Committees	
	360R—Implementing Resolutions Under Section 3.6 Committees	
BL 400	Financial Management and Controls .....	1845
	401—Financial Management and Controls	
	401R—Implementing Resolution Under Article 4 Financial Management and Controls	

**VOLUME 2—continued**

<i>Section</i>	<i>Page</i>
BL 400	Financial Management and Controls—continued
	410—Audit
	420—Committee on Audit
	430—Execution of Instruments on Behalf of the Institute
	440—Indemnification
	450—Dues
	460—Fiscal Year
	460R—Implementing Resolution Under Section 4.6 Fiscal Year
BL 500	Meetings of the Institute and the Council . . . . . 1865
	501—Meetings of the Institute and the Council
	510—Meetings of the Institute
	520—Meetings of Council
	530—General Provisions Governing Meetings
BL 600	Election of Council, Board of Directors, and Officers of the Institute . . . . . 1875
	601—Election of Council, Board of Directors, and Officers of the Institute
	610—Members of Council Directly Elected by Members of the Institute
	610R—Implementing Resolution Under Section 6.1 Members of Council Directly Elected by Members of the Institute
	620—Selection of Members of Council to Represent State Societies
	630—Election of Members-at-Large of Council, Board of Directors, Chairman of the Board, and Vice Chairman of the Board
	640—Forfeiture of Office for Nonattendance
	650—Vacancies
	650R—Implementing Resolution Under Section 6.5 Vacancies
	660—Election Meeting of Council
	670—Term Limit
BL 700	Termination of Membership and Disciplinary Sanctions . . . . . 1899
	701—Termination of Membership and Disciplinary Sanctions



**VOLUME 2—continued**

<i>Section</i>	<i>Page</i>
BL 700	Termination of Membership and Disciplinary Sanctions—continued
	710—Resignation of Membership
	710R—Implementing Resolution Under Section 7.1 Resignation of Membership
	720—Termination of Membership for Nonpayment of Financial Obligation or for Failure to Comply With Membership-Retention Requirements
	720R—Implementing Resolution Under Section 7.2 Termination of Membership for Nonpayment of Financial Obligation or for Failure to Comply With Membership-Retention Requirements
	730—Disciplinary Action Without a Hearing
	730R—Implementing Resolution Under Section 7.3 Disciplinary Action Without a Hearing
	740—Disciplining of Member by Trial Board
	740R—Implementing Resolution Under Section 7.4 Disciplining of Member by Trial Board
	750—Reinstatement
	750R—Implementing Resolution Under Section 7.5 Reinstatement
	760—Publication of Disciplinary Action
	760R—Implementing Resolution Under Section 7.6 Publication of Disciplinary Action
	770—Disciplinary Sections Not to Be Applied Retroactively
BL 800	Amendments ..... 1931
	801—Amendments
	810—Proposals to Amend the Bylaws
	820—Proposals to Amend the Code of Professional Conduct
	830—Submission to Council via Board of Directors
	840—Submission to Membership by Mail Ballot
BL 900	General ..... 1943
	911—AICPA Mission Statement
	921—A Description of the Professional Practice of Certified Public Accountants
BL ...	Topical Index ..... 1949

**VOLUME 2—continued**

<i>Section</i>	<i>Page</i>
U.S. AUDITING—PCAOB	
PC ... Public Company Accounting Oversight Board Standards and Audits of Public Companies.....	1959

The full text of the PCAOB's Releases can be found in the AICPA's *PCAOB Standards and Related Rules (Including Select SEC-Approved PCAOB Releases and Staff Guidance)*, which is available in the annual paperback that was sent to each subscriber of AICPA *Professional Standards* as part of your subscription. The PCAOB Releases are also available on *AICPA Resource: Online Accounting & Auditing Library* which offers online access to the PCAOB releases and is updated on a regular basis. For more information about *AICPA Resource*, please visit [www.cpa2biz.com](http://www.cpa2biz.com).

## VALUATION SERVICES

VS ... Statements on Standards for Valuation Services.....	1961
100—Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset	
9100—Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset: Valuation Services Interpretations of Section 100	

## CONSULTING SERVICES

CS ... Statement on Standards for Consulting Services.....	2013
100—Consulting Services: Definition and Standards	
CS ... Topical Index .....	2019

## QUALITY CONTROL

QC ... Quality Control .....	2021
10—A Firm's System of Quality Control	

## PEER REVIEW

PR ... Standards for Performing and Reporting on Peer Reviews....	2049
100—Standards for Performing and Reporting on Peer Reviews	
9100—Standards for Performing and Reporting on Peer Reviews: Interpretations of Section 100	

**VOLUME 2—continued**

<i>Section</i>		<i>Page</i>
	<b>TAX SERVICES</b>	
TS ...	Tax Services .....	2201
	100—Tax Return Positions	
	9100—Tax Return Positions: Tax Services Interpretations of Section 100	
	200—Answers to Questions on Returns	
	300—Certain Procedural Aspects of Preparing Returns	
	400—Use of Estimates	
	500—Departure From a Position Previously Concluded in an Administrative Proceeding or Court Decision	
	600—Knowledge of Error: Return Preparation	
	700—Knowledge of Error: Administrative Proceedings	
	800—Form and Content of Advice to Taxpayers	
	900—Appendix: Cross-Reference of Previous and Revised Statements	
TS ...	Topical Index	2237
	<b>PERSONAL FINANCIAL PLANNING</b>	
PFP ...	Personal Financial Planning	2241
	100—Basic Personal Financial Planning Engagement Functions and Responsibilities	
	200—Working With Other Advisers	
	300—Implementation Engagement Functions and Responsibilities	
	400—Monitoring and Updating Engagements—Functions and Responsibilities	
	500—Developing a Basis for Recommendations	
PFP ...	Topical Index .....	2271
	<b>CONTINUING PROFESSIONAL EDUCATION</b>	
CPE ...	Continuing Professional Education .....	2275
	10—Policies for the CPE Membership Requirement ... CPE—Form for CPE Information	
	100—Preamble	
	200—Standards for CPAs	
	300—Standards for CPE Program Sponsors	
	400—Glossary	
CPE ...	Topical Index .....	2301

## HOW TO USE VOLUME 2

### Scope of Volume 2

This volume, which is a reprint of volume 2 of the looseleaf edition of *AICPA Professional Standards*, includes the currently effective pronouncements on professional standards issued by the the American Institute of Certified Public Accountants (AICPA).

### Special Note About Financial Accounting Standards Board *Accounting Standards Codification*<sup>TM</sup>

The accounting guidance in this publication has been conformed to reflect reference to Financial Accounting Standards Board (FASB) *Accounting Standards Codification*<sup>TM</sup> (ASC) as it existed on June 1, 2009 (through FASB ASC Update 2009-179). Although FASB ASC is not effective at this writing, it will be released as authoritative on July 1, 2009; therefore, this publication has been conformed to FASB ASC to assist you during this transition.

On June 3, 2009, FASB voted to approve FASB ASC as the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance issued by the Securities and Exchange Commission (SEC). FASB ASC becomes authoritative upon its release on July 1, 2009, significantly changing the way financial statement preparers, auditors, and academics perform accounting research.

Upon release, FASB ASC will supersede all existing, non-SEC accounting and reporting standards for nongovernmental entities. When FASB ASC becomes effective, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC will become nonauthoritative.

FASB ASC will be effective for interim and annual periods ending after September 15, 2009, which means that preparers must begin to use FASB ASC for periods that begin on or about July 1, 2009.

FASB ASC is a major restructuring of accounting and reporting standards designed to simplify user access to all authoritative U.S. generally accepted accounting principles (GAAP) by providing the authoritative literature in a topically organized structure. FASB ASC disassembled thousands of nongovernmental accounting pronouncements (including those of FASB, the Emerging Issues Task Force, and the AICPA) and reassembled them under approximately 90 topics.

FASB ASC also includes relevant portions of authoritative content issued by the SEC, select SEC staff interpretations, and administrative guidance issued by the SEC; however, FASB ASC is not the official source of SEC guidance and does not contain the entire population of SEC rules, regulations, interpretive releases, and staff guidance.

FASB ASC is not intended to change U.S. GAAP or any requirements of the SEC; rather, it is part of FASB's efforts to reduce the complexity of accounting standards and also to facilitate international convergence. Moreover,

FASB ASC does not include governmental accounting standards. The purposes behind the codification project include the following:

- Reduce the amount of time and effort required to solve an accounting research issue
- Mitigate the risk of noncompliance with standards through improved usability of the literature
- Provide accurate information with real-time updates as new standards are released
- Assist FASB with the research and convergence efforts required during the standard-setting process
- Become the authoritative source of literature for the completed eXtensible Business Reporting Language (XBRL) taxonomy
- Clarify that guidance not contained in FASB ASC is not considered authoritative

FASB ASC uses a topical structure in which guidance is organized into areas, topics, subtopics, sections, and subsections. These terms are defined as follows:

**Areas.** The broadest category in FASB ASC and represent a grouping of topics.

**Topics.** The broadest categorization of related content and correlate with the International Accounting Standards (IASs) and International Financial Reporting Standards (IFRSs).

**Subtopics.** Represent subsets of a topic and are generally distinguished by type or scope.

**Sections.** Indicate the nature of the content such as recognition, measurement, or disclosure. The sections' structure correlates with the IASs and IFRSs.

**Subsections.** Allow further segregation and navigation of content.

Topics, subtopics, and sections are numerically referenced. This effectively organizes the content without regard to the original standard setter or standard from which the content was derived. An example of the numerical referencing is FASB ASC 305-10-05, in which 305 is the *Cash and Cash Equivalents* topic, 10 represents the "Overall" subtopic, and 05 represents the "Overview and Background" section.

FASB ASC features a notice to constituents, which explains the scope, structure, and usage of consistent terminology of FASB ASC. Users are encouraged to read this notice.

By July 1, 2009, FASB is expected to issue a final standard to flatten the GAAP hierarchy and replace FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*. The standard's effective date is expected to be July 1, 2009 to coincide with the release of FASB ASC as authoritative. The new standard will essentially reduce the GAAP hierarchy to two levels, one that is authoritative (in FASB ASC) and one that is not (not in FASB ASC).

Exceptions include all rules and interpretive releases of the SEC under authority of federal securities laws—which are sources of authoritative GAAP for SEC registrants—and certain grandfathered guidance having an effective date before March 15, 1992. The proposed standard is expected to create a new topic, *Generally Accepted Accounting Principles*, in FASB ASC. One piece of the grandfathered guidance relates to AICPA software revenue recognition Technical

Practice Aid Questions and Answers (TIS) sections 5100.38–76, which were elevated into the authoritative literature during development of FASB ASC. Nonpublic entities would be required to apply this guidance prospectively for revenue agreements entered into or materially modified in annual periods beginning on or after December 15, 2009, and interim periods within those years. This transition provision would only be applicable for nonpublic entities that had not previously applied this guidance. Public entities should have already been applying guidance in TIS sections 5100.38–76. Readers can monitor the status of the proposed statement at [www.fasb.org/draft/index.shtml](http://www.fasb.org/draft/index.shtml).

FASB ASC represents a major shift in the organization and presentation of U.S. GAAP. For more information refer to the FASB ASC Web site at <http://asc.fasb.org/home> and the FASB ASC project status page at [www.fasb.org/project/codification&retrieval\\_project.shtml](http://www.fasb.org/project/codification&retrieval_project.shtml). To read more about it, including recent developments and updates, please also see the AICPA's dedicated FASB ASC Web site at [www.aicpa.org/Professional+Resources/Accounting+and+Auditing/FASB+Accounting+Standards+Codification/](http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/FASB+Accounting+Standards+Codification/).

## How This Volume Is Arranged

The contents of this volume are arranged as follows:

### **Statements on Standards for Accounting and Review Services and Related Accounting and Review Services Interpretations**

Defining Professional Requirements in Statements on Standards for Accounting and Review Services

Standards for Accounting and Review Services

Compilation and Review of Financial Statements

Compilation of Specified Elements, Accounts, or Items of a Financial Statement

Compilation of Pro Forma Financial Information

Reporting on Comparative Financial Statements

Compilation Reports on Financial Statements Included in Certain Prescribed Forms

Communications Between Predecessor and Successor Accountants

Reporting on Personal Financial Statements Included in Written Personal Financial Plans

### **Code of Professional Conduct**

Introduction

Principles of Professional Conduct

Rules: Applicability and Definitions

Independence, Integrity, and Objectivity

General Standards/Accounting Principles

Responsibilities to Clients

Responsibilities to Colleagues

Other Responsibilities and Practices

**Bylaws**

- Definitions
- Name and Purpose
- Admission to, and Retention of, Membership and Association
- Organization and Procedure
- Financial Management and Controls
- Meetings of the Institute and the Council
- Election of Council, Board of Directors, and Officers of the Institute
- Termination of Membership and Disciplinary Sanctions
- Amendments
- General

**Valuation Services**

- Statements on Standards for Valuation Services
- Interpretations of Statements on Standards for Valuation Services

**Consulting Services**

- Statement on Standards for Consulting Services

**Quality Control**

- Statements on Quality Control Standards

**Peer Review**

- Standards for Performing and Reporting on Peer Reviews
- Interpretations of Standards for Performing and Reporting on Peer Reviews

**Tax Services**

- Statements on Standards for Tax Services
- Interpretations of Statements on Standards for Tax Services

**Personal Financial Planning**

- Statements on Responsibilities in Personal Financial Planning Practice

**Continuing Professional Education**

- Policies for the CPE Membership Requirement
- Preamble
- Standards for CPAs
- Standards for CPE Program Sponsors
- Glossary

**How to Use Volume 2**

The arrangement of material is indicated in the general table of contents at the front of the volume. There is a detailed table of contents covering the material within each major division.

**ACCOUNTING AND REVIEW SERVICES**

Statements on Standards for Accounting and Review Services and Accounting and Review Services Interpretations appear with the prefix AR in their



section numbers. Accounting and Review Services Interpretations are numbered in the 9000 series with the last three digits indicating the section to which the interpretation relates. Interpretations immediately follow their corresponding section. For example, interpretations related to section 100 are numbered 9100, which directly follows section 100.

There are two appendixes related to Accounting and Review Services Standards as follows:

Appendix A indicates sections of the text cross-referenced to Statements on Standards for Accounting and Review Services.

Appendix B is reserved.

Appendix C provides a schedule of changes in Statements on Standards for Accounting and Review Services beginning with the issuance of Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements*.

A topical index is provided for this division and is identified as AR Topical Index.

#### CODE OF PROFESSIONAL CONDUCT

The Rules of Conduct, Interpretations of Rules of Conduct, and Ethics Rulings related to the same subjects have been assembled within the major divisions of the Code of Professional Conduct part of the volume. For example, Rule 101—*Independence*, ET section 101, is followed by the first Ethics Interpretation under Rule 101, ET section 101-1, *Interpretation of Rule 101*. Ethics Rulings for this section appear in ET section 191.

A topical index is provided for this division and is identified as ET Topical Index.

#### BYLAWS

The Bylaws of the AICPA and the related Implementing Resolutions of Council are assembled within the major divisions by section numbers. For example, BL section 230, *Requirements for Retention of Membership*, is followed by BL section 230R, *Implementing Resolutions Under Section 2.3 Requirements for Retention of Membership*.

In BL section 900, *General*, the following sections are included:

AICPA Mission Statement

A Description of the Professional Practice of Certified Public Accountants

A topical index is provided for this division and is identified as BL Topical Index.

#### VALUATION SERVICES

Statements on Standards for Valuation Services and Valuation Services Interpretations appear with the prefix VS in their section numbers.

#### CONSULTING SERVICES

Statement on Standards for Consulting Services appears with the prefix CS in its section number.

A topical index is provided for this division and is identified as CS Topical Index.

## QUALITY CONTROL

Statements on Quality Control Standards appear with the prefix QC in their section numbers.

## PEER REVIEW

Standards for Performing and Reporting on Peer Reviews and Peer Review Interpretations appear with the prefix PR in their section numbers.

## TAX SERVICES

Statements on Standards for Tax Services and Tax Services Interpretations appear with the prefix TS in their section numbers.

A topical index is provided for this division and is identified as TS Topical Index.

## PERSONAL FINANCIAL PLANNING

Statements on Responsibilities in Personal Financial Planning Practice appear with the prefix PFP in their section numbers.

A topical index is provided for this division and is identified as PFP Topical Index.

## CONTINUING PROFESSIONAL EDUCATION

Policies for the CPE Membership Requirement and Statement on Standards for Continuing Professional Education (CPE) Programs appear with the prefix CPE in their section numbers.

A topical index is provided for this division and is identified as CPE Topical Index.

## Topical Index

The topical indexes use the key word method to facilitate reference to the pronouncements. The indexes are arranged alphabetically by topic and refer the reader to major divisions, sections, and paragraph numbers.

Indexes are cited in this volume as follows:

	<u>Citation</u>
Accounting and Review Services	AR
Code of Professional Conduct	ET
Bylaws	BL
Valuation Services	VS
Consulting Services	CS
Tax Services	TS
Personal Financial Planning	PFP
Continuing Professional Education	CPE

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## AR Section

# STATEMENTS ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES

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Statements on Standards for Accounting and Review Services (SSARS) are issued by the AICPA Accounting and Review Services Committee (ARSC), the senior technical committee of the Institute designated to issue pronouncements in connection with the unaudited financial statements or other unaudited financial information of a non-public entity. Council has designated ARSC as a body to establish technical standards under *Rule 202* of the Institute's Code of Professional Conduct.

Interpretations are issued to provide guidance on the application of SSARS. Interpretations are issued after all members of ARSC have been provided an opportunity to consider and comment on whether the proposed Interpretation is consistent with SSARS. An Interpretation is not as authoritative as a SSARS, but members should be aware that they may have to justify a departure from an Interpretation if the quality of their work is questioned.

### TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
20	Defining Professional Requirements in Statements on Standards for Accounting and Review Services	.01-.08
	Introduction .....	.01
	Professional Requirements .....	.02-.04
	Explanatory Material .....	.05-.07
	Application .....	.08
50	Standards for Accounting and Review Services	.01-.10
	Interpretative Publications .....	.05-.06
	Other Compilation and Review Publications .....	.07-.08
	Predecessor's Compilation or Review Report .....	.09
	Effective Date .....	.10
100	Compilation and Review of Financial Statements	.01-.106
	Definitions .....	.04
	Understanding With the Entity .....	.05
	Compilation of Financial Statements .....	.06-.27
	Objective of a Compilation Engagement .....	.06-.07

<i>Section</i>	<i>Paragraph</i>
100	Compilation and Review of Financial Statements—continued
	Compilation Performance Requirements ..... .08-.11
	Limitations of a Compilation Engagement ..... .12
	Reporting on the Financial Statements ..... .13-.18
	Reporting on Financial Statements That Omit Substantially All Disclosures ..... .19-.22
	Reporting When the Accountant Is Not Independent ..... .23
	Accountant’s Communications With the Client When the Compiled Financial Statements Are Not Expected to Be Used by a Third Party ..... .24-.27
	Review of Financial Statements ..... .28-.53
	Objective of a Review Engagement ..... .28
	Review Performance Requirements ..... .29-.31
	Limitations of a Review Engagement ..... .32
	Knowledge of Accounting Principles and Practices of the Industry ..... .33-.35
	Analytical Procedures ..... .36-.37
	Inquiries and Other Review Procedures ..... .38
	Management Representations ..... .39-.42
	Documentation in a Review Engagement ..... .43-.45
	Reporting on the Financial Statements ..... .46-.53
	Emphasis of a Matter ..... .54-.55
	Departures From Generally Accepted Accounting Principles ..... .56-.58
	Restricting the Use of an Accountant’s Compilation or Review Report ..... .59-.68
	General-Use and Restricted-Use Reports ..... .59-.61
	Reporting on Subject Matter or Presentations Based on Measurement or Disclosure Criteria Contained in Contractual Agreements or Regulatory Provisions ..... .62
	Combined Reports Covering Both Restricted-Use and General-Use Subject Matter or Presentations ..... .63
	Inclusion of a Separate Restricted-Use Report in the Same Document With a General-Use Report ..... .64
	Adding Other Specified Parties ..... .65-.66
	Limiting the Distribution of Reports ..... .67
	Report Language—Restricted Use ..... .68
	An Entity’s Ability to Continue as a Going Concern ..... .69-.72
	Subsequent Events ..... .73-.76
	Subsequent Discovery of Facts Existing at Date of Report .... .77-.82
	Supplementary Information ..... .83
	Communicating to Management and Others ..... .84-.85
	Change in Engagement From Audit to Review or Compilation (or From Review to Compilation) ..... .86-.91
	Comparative Financial Statements ..... [.92]

<i>Section</i>	<i>Paragraph</i>
100	Compilation and Review of Financial Statements—continued
	Relationship of Statements on Standards for Accounting and Review Services to Quality Control Standards ..... 93-95
	Effective Date ..... 96
	Appendix A — Compilation of Financial Statements ..... 97
	Appendix B — Review of Financial Statements— Illustrative Inquiries ..... 98
	Appendix C — Compilation of Financial Statements— Illustrative Engagement Letter ..... 99
	Appendix D — Compilation of Financial Statements Not Intended for Third Party Use — Illustrative Engagement Letter ..... 100
	Appendix E — Review of Financial Statements—Illustrative Engagement Letter ..... 101
	Appendix F — Review of Financial Statements—Illustrative Representation Letter ..... 102
	Appendix G — Review of Financial Statements—Illustrative Updating Management Representation Letter ..... 103
	Appendix H — Rule 201 of the AICPA Code of Professional Conduct [ET section 201.01] ..... [104]
	Appendix I — Analytical Procedures the Accountant May Consider Performing When Conducting a Review of Financial Statements ..... 105
	Appendix J — Sources of Generally Accepted Accounting Principles ..... 106
9100	Compilation and Review of Financial Statements: Accounting and Review Services Interpretations of Section 100
	1. Omission of Disclosures in Reviewed Financial Statements (12/79) ..... 01-02
	[2.] Financial Statements Included in SEC Filings (12/79) [Withdrawn, December 2008] ..... [03-05]
	3. Reporting on the Highest Level of Service (12/79) ..... 06-12
	[4.] Discovery of Information After the Date of the Accountant's Report (11/81) [Rescinded, July 2007] ..... [13-15]
	5. Planning and Supervision (8/81) ..... 16-17
	6. Withdrawal From Compilation or Review Engagement (8/81) ..... 18-22
	7. Reporting When There Are Significant Departures From GAAP (8/81) ..... 23-26
	[8.] Reports on Specified Elements, Accounts, or Items of a Financial Statement (11/81) [Rescinded, July 2005] ..... [27-28]
	9. Reporting When Management Has Elected to Omit Substantially All Disclosures (5/82) ..... 29-30
	10. Reporting on Tax Returns (11/82) ..... 31-32
	[11.] Reporting on Uncertainties (12/82) [Rescinded, February 2007] ..... [33-40]
	[12.] Reporting on a Comprehensive Basis of Accounting Other Than GAAP (12/82) [Rescinded, July 2007] ..... [41-45]
	13. Additional Procedures (3/83) ..... 46-49

<i>Section</i>	<i>Paragraph</i>
9100	Compilation and Review of Financial Statements: Accounting and Review Services Interpretations of Section 100—continued
	[14.] Reporting on Financial Statements When the Scope of the Accountant's Procedures Has Been Restricted (4/84) [Withdrawn, April 1990] ..... [50-53]
	15. Differentiating a Financial Statement Presentation From a Trial Balance (9/90) ..... 54-57
	[16.] Determining if the Accountant Has "Submitted" Financial Statements Even When Not Engaged to Compile or Review Financial Statements (9/90) [Withdrawn, November 1992] ..... [58-60]
	17. Submitting Draft Financial Statements (9/90) ..... 61-62
	[18.] Special-Purpose Financial Presentations to Comply With Contractual Agreements or Regulatory Provisions (9/90) [Rescinded, September 2005] ..... [63-72]
	19. Reporting When Financial Statements Contain a Departure From Promulgated Accounting Principles That Prevents the Financial Statements From Being Misleading (2/91) ..... 73-75
	20. Applicability of Statements on Standards for Accounting and Review Services to Litigation Services (5/91) ..... 76-79
	21. Applicability of SSARS No. 1 When Performing Controllorship or Other Management Services (7/02) .... 80-84
	22. Use of "Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included" (12/02) ..... 85-88
	23. Applicability of Statements on Standards for Accounting and Review Services When an Accountant Engaged to Perform a Business Valuation Derives Information From an Entity's Tax Return (8/03) ..... 89-92
	24. Reference to the Country of Origin in a Review or Compilation Report (9/03) ..... 93-94
	25. Omission of the Display of Comprehensive Income in a Compilation (9/03) ..... 95-99
	[26.] Communicating Possible Fraud and Illegal Acts to Management and Others (5/04) [Rescinded, July 2005] ..... [100-103]
	27. Applicability of Statements on Standards for Accounting and Review Services to Reviews of Nonissuers Who Are Owned by or Controlled by an Issuer (8/05) ..... 104-108
	28. Special-Purpose Financial Statements to Comply With Contractual Agreements or Regulatory Provisions (12/06) ..... 109-119
	29. Reporting on an Uncertainty, Including an Uncertainty About an Entity's Ability to Continue as a Going Concern (2/07) ..... 120-129

<i>Section</i>		<i>Paragraph</i>
9100	Compilation and Review of Financial Statements: Accounting and Review Services Interpretations of Section 100—continued	
	30. Considerations Related to Financial Statements Prepared in Accordance With International Financial Reporting Standards and Compilations and Reviews Performed in Accordance With International Standards (5/08) .....	.130-.135
	31. Preparation of Financial Statements for Use by an Entity’s Auditors (12/08) .....	.136-.137
110	Compilation of Specified Elements, Accounts, or Items of a Financial Statement .....	.01-.15
	Conditions for Compiling Specified Elements, Accounts, or Items of a Financial Statement .....	.04-.05
	Understanding With the Entity .....	.06-.07
	Performance Requirements .....	.08-.09
	Reporting Requirements .....	.10-.14
	Appendix: Compilation of Specified Elements, Accounts, or Items of a Financial Statement—Illustrative Engagement Letter .....	.15
120	Compilation of Pro Forma Financial Information .....	.01-.18
	Conditions for Compiling Pro Forma Financial Information ...	.06-.08
	Understanding With the Entity .....	.09-.10
	Performance Requirements .....	.11-.12
	Reporting Requirements .....	.13-.17
	Appendix: Compilation of Pro Forma Financial Information—Illustrative Engagement Letter .....	.18
200	Reporting on Comparative Financial Statements .....	.01-.37
	Definitions .....	.07
	Continuing Accountant’s Standard Report .....	.08-.12
	Continuing Accountant’s Changed Reference to a Departure From Generally Accepted Accounting Principles .....	.13-.15
	Predecessor’s Compilation or Review Report .....	.16-.27
	Predecessor’s Compilation or Review Report Not Presented .....	.17-.19
	Predecessor’s Compilation or Review Report Reissued .....	.20-.24
	Restated Prior-Period Financial Statements .....	.25-.27
	Reporting When One Period Is Audited .....	.28-.29
	Reporting on Financial Statements That Previously Did Not Omit Substantially All Disclosures .....	.30-.31
	Change of Status—Issuer/Nonissuer .....	.32-.33
	Transition .....	[.34-.36]
	Effective Date .....	.37



9200	Reporting on Comparative Financial Statements: Accounting and Review Services Interpretations of Section 200	
	1. Reporting on Financial Statements That Previously Did Not Omit Substantially All Disclosures (11/80) .....	.01-.04
300	Compilation Reports on Financial Statements Included in Certain Prescribed Forms	.01-.05
9300	Compilation Reports on Financial Statements Included in Certain Prescribed Forms: Accounting and Review Services Interpretations of Section 300	
	1. Omission of Disclosures in Financial Statements Included in Certain Prescribed Forms (5/82) .....	.01-.03
400	Communications Between Predecessor and Successor Accountants	.01-.12
	Inquiries Regarding Acceptance of an Engagement .....	.03-.06
	Other Inquiries .....	[.07]-.08
	Successor Accountant’s Use of Communications .....	.09
	Financial Statements Reported on by Predecessor Accountant .....	.10-.11
	Appendix: Illustrative Successor Accountant Acknowledgment Letter .....	.12
9400	Communications Between Predecessor and Successor Accountants: Accounting and Review Services Interpretations of Section 400	
	1. Reports on the Application of Accounting Principles (8/87) .....	.01-.05
500	Reporting on Compiled Financial Statements [Deleted by the issuance of Statement on Standards for Accounting and Review Services 7, November 1992.]	
600	Reporting on Personal Financial Statements Included in Written Personal Financial Plans	.01-.07
	Effective Date .....	.07
9600	Reporting on Personal Financial Statements Included in Written Personal Financial Plans: Accounting and Review Services Interpretation of Section 600	
	1. Submitting a Personal Financial Plan to a Client’s Advisers (5/91) .....	.01-.03



## AR Section 20

# Defining Professional Requirements in Statements on Standards for Accounting and Review Services

Issue date, unless  
otherwise indicated:  
December, 2007

Source: SSARS No. 16

### Introduction

.01 This section sets forth the meaning of certain terms used in Statements on Standards for Accounting and Review Services (SSARSs) issued by the Accounting and Review Services Committee (ARSC) in describing the professional requirements imposed on accountants performing a compilation or review.

### Professional Requirements

.02 SSARSs contain professional requirements, together with related guidance, in the form of explanatory material. Accountants performing a compilation or review have a responsibility to consider the entire text of a SSARS in carrying out their work on an engagement and in understanding and applying the professional requirements of the relevant SSARSs.

.03 Not every paragraph of a SSARS carries a professional requirement that the accountant is expected to fulfill. Rather, the professional requirements are communicated by the language and the meaning of the words used in the SSARSs.

.04 SSARSs use two categories of professional requirements identified by specific terms to describe the degree of responsibility they impose on accountants. They are as follows:

- *Unconditional requirements.* The accountant is required to comply with an unconditional requirement in all cases in which the circumstances exist to which the unconditional requirement applies. SSARSs use the words *must* or *is required* to indicate an unconditional requirement.
- *Presumptively mandatory requirements.* The accountant is also required to comply with a presumptively mandatory requirement in all cases in which the circumstances exist to which the presumptively mandatory requirement applies; however, in rare circumstances, the accountant may depart from a presumptively mandatory requirement provided that the accountant documents his or her justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. SSARSs use the word *should* to indicate a presumptively mandatory requirement.

If a SSARS provides that a procedure or action is one that the accountant "should consider," the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not. The professional

requirements of a SSARS are to be understood and applied in the context of the explanatory material that provides guidance for their application.

## **Explanatory Material**

**.05** Explanatory material is defined as the text within a SSARS (excluding any related appendixes or interpretations<sup>1</sup>) that may do the following:

- Provide further explanation and guidance on the professional requirements
- Identify and describe other procedures or actions relating to the activities of the accountant

**.06** Explanatory material that provides further explanation and guidance on the professional requirements is intended to be descriptive rather than imperative. That is, it explains the objective of the professional requirements (where not otherwise self-evident); it explains why the accountant might consider or employ particular procedures, depending on the circumstances; and it provides additional information for the accountant to consider in exercising professional judgment in performing the engagement.

**.07** Explanatory material that identifies and describes other procedures or actions relating to the activities of the accountant is not intended to impose a professional requirement for the accountant to perform the suggested procedures or actions. Rather, these procedures or actions require the accountant's attention and understanding; how and whether the accountant carries out such procedures or actions in the engagement depends on the exercise of professional judgment in the circumstances consistent with the objective of the standard. The words *may*, *might*, and *could* are used to describe these actions and procedures.

## **Application**

**.08** The provisions of this section are effective upon issuance.<sup>2</sup>

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<sup>1</sup> Compilation and review interpretations of the Statements on Standards for Accounting and Review Services (SSARSs) and appendixes represent interpretive publications, which differ from explanatory material. Explanatory material is always contained within the standards sections of the SSARS and is meant to be descriptive in nature. Interpretive publications, as defined in paragraphs .05–.06 of AR section 50 reside outside of the standards section of a SSARS and are recommendations on the application of the SSARS in specific circumstances, including engagements for entities in specialized industries. Interpretive publications are issued after all members of the Accounting and Review Services Committee (ARSC) have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with the SSARSs. Interpretive publications consist of compilation and review interpretations of the SSARSs, appendixes to the SSARSs, compilation and review guidance included in *AICPA Audit and Accounting Guides*, and AICPA Statements of Position to the extent that those statements are applicable to compilation and review engagements.

<sup>2</sup> The specific terms used to define professional requirements in this section are not intended to apply to interpretive publications issued under the authority of the ARSC, since interpretive publications are not SSARSs. (See footnote 1.) It is the ARSC's intention to make conforming changes to the interpretive publications to remove any language that would imply a professional requirement where none exists. It is the ARSC's intention that such language would only be used in the standards sections of the SSARSs.

## AR Section 50

# *Standards for Accounting and Review Services*

Issue date, unless  
otherwise indicated:  
May, 2004

Source: SSARS No. 11

**.01** An accountant must perform a compilation or review of a nonissuer in accordance with Statements on Standards for Accounting and Review Services (SSARS) issued by the American Institute of Certified Public Accountants. SSARS provide a measure of quality and the objectives to be achieved in both a compilation and review. [Paragraph amended by the issuance of SSARS No. 17, December 2008.]

**.02** The SSARS are issued by the AICPA Accounting and Review Services Committee (ARSC) and provide performance and reporting standards for compilations and reviews.

**.03** Rule 202, *Compliance With Standards*, of the AICPA Code of Professional Conduct [ET section 202.01], requires an AICPA member who performs compilations or reviews to comply with standards promulgated by the ARSC. The ARSC develops and issues standards in the form of Statements on Standards for Accounting and Review Services through a due process that includes deliberations in meetings open to the public, public exposure of proposed SSARS, and a formal vote. The SSARS are codified.

**.04** The accountant should have sufficient knowledge of the SSARS to identify those that are applicable to his or her engagement. The nature of the SSARS requires an accountant to exercise professional judgment in applying them. The accountant should be prepared to justify departures from the SSARS.

## Interpretative Publications

**.05** *Interpretative publications* consist of compilation and review Interpretations of the SSARS, appendixes to the SSARS, compilation and review guidance included in *AICPA Audit and Accounting Guides*, and AICPA Statements of Position to the extent that those Statements are applicable to compilation and review engagements. Interpretative publications are not standards for accounting and review services. Interpretative publications are recommendations on the application of the SSARS in specific circumstances, including engagements for entities in specialized industries. An interpretative publication is issued after all ARSC members have been provided an opportunity to consider and comment on whether the proposed interpretative publication is consistent with the SSARS.

**.06** The accountant should be aware of and consider interpretative publications applicable to his or her compilation or review. If the accountant does not apply the guidance included in an applicable interpretative publication, the accountant should be prepared to explain how he or she complied with the SSARS provisions addressed by such guidance.

## Other Compilation and Review Publications

.07 *Other compilation and review publications* include AICPA accounting and review publications not referred to above; AICPA's annual *Compilation and Review Alert*; compilation and review articles in the *Journal of Accountancy* and other professional journals; compilation and review articles in the AICPA *The CPA Letter*; continuing professional education programs and other instruction materials, textbooks, guide books, compilation and review programs, and checklists; and other compilation and review publications from state CPA societies, other organizations, and individuals.<sup>1</sup> Other compilation and review publications have no authoritative status; however, they may help the accountant understand and apply the SSARS.

.08 If an accountant applies the guidance included in an other compilation and review publication, he or she should be satisfied that, in his or her judgment, it is both relevant to the circumstances of the engagement, and appropriate. In determining whether an other compilation and review publication is appropriate, the accountant may wish to consider the degree to which the publication is recognized as being helpful in understanding and applying the SSARS and the degree to which the issuer or author is recognized as an authority in compilation and review matters. Other compilation and review publications published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff are presumed to be appropriate.

## Predecessor's Compilation or Review Report

.09 SSARS currently provide guidance to be followed when the financial statements of a prior period have been compiled or reviewed by a predecessor accountant whose report is not presented and the successor accountant has not compiled or reviewed those financial statements. This Statement amends footnote 9 in SSARS No. 2, *Reporting on Comparative Financial Statements* [section 200.17], to state that a successor accountant may name the predecessor accountant if the predecessor accountant's practice was acquired by, or merged with, that of the successor accountant. New language is shown in boldface italics.

<sup>9</sup> The successor ***accountant*** should not name the predecessor ***accountant*** in his ***or her*** report; ***however, the successor accountant may name the predecessor accountant if the predecessor accountant's practice was acquired by, or merged with, that of the successor accountant.***

## Effective Date

.10 This section is effective upon issuance.

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<sup>1</sup> The accountant is not expected to be aware of the full body of other compilation and review publications.

**AR Section 100*****Compilation and Review of  
Financial Statements***\*

Issue date, unless  
otherwise indicated:  
December, 1978

Source: SSARS No. 1; SSARS No. 2; SSARS No. 3;  
SSARS No. 5; SSARS No. 7; SSARS No. 8; SSARS No. 9;  
SSARS No. 10; SSARS No. 12; SSARS No. 15; SSARS No. 17; SSARS No. 18

.01 This section sets forth the performance and communication requirements when an accountant submits unaudited financial statements of a non-issuer to his or her client or third parties. The accountant should not submit unaudited financial statements of a nonissuer to his or her client or a third party unless, as a minimum, he or she complies with the provisions of this section applicable to a compilation engagement.

- a. *Compilation of financial statements.*<sup>1</sup> If the accountant performs a compilation, a communication to management is required. The type of communication depends on the following.
1. If the accountant is engaged to report on compiled financial statements or submits financial statements to a client that are or reasonably might be expected to be used by a third party, see paragraphs .13–.23 for reporting requirements.
  2. If the accountant submits financial statements to a client that are not reasonably expected to be used by a third party, see paragraphs .24–.27 for required communications to management.

In deciding whether the financial statements are or reasonably might be expected to be used by a third party, the accountant may rely on management's representation without further inquiry, unless information comes to his or her attention that contradicts management's representation.

In each of the previous circumstances, the performance requirements in paragraphs .05 and .09–.12 apply.

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\* This section has been revised to reflect the amendments and conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 8, effective for financial statements submitted after December 31, 2000. The amendments provide communication and performance requirements for unaudited financial statements submitted to a client that are not expected to be used by a third party. Specifically, the amendments are to the replacement of paragraphs .01–.22 with new paragraphs .01–.27 (subsequent paragraphs and footnotes have been renumbered accordingly), the addition of a new Appendix A [paragraph .97] and D [paragraph .100], and the deletion of former Appendix E [paragraph .101]. In addition, conforming changes to terminology and cross references have been made throughout this section.

<sup>1</sup> See Appendix A [paragraph .97], "Compilation of Financial Statements," for a flowchart regarding the requirements of Statements on Standards for Accounting and Review Services (SSARSs) for a compilation engagement. [As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

## 1410 Statements on Standards for Accounting and Review Services

- b. *Review of financial statements.*<sup>[2]</sup> If the accountant performs a review, see paragraphs .05 and .28–.53 for performance and reporting requirements.

[As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008, by SSARS No. 17.]

### Note

Statements on Standards for Accounting and Review Services (SSARS) No. 18 amends paragraph .01 so that SSARSs do not apply when the provisions of AU section 722, *Interim Financial Information* (AICPA, *Professional Standards*, vol. 1), apply. The following reflects the changes that will be made to paragraph .01, effective for compilations and reviews of financial statements (which includes condensed interim financial statements) for periods beginning after December 15, 2009. Early application is permitted.

**.01** This section establishes standards and provides guidance on compilations and reviews of financial statements. The accountant should not submit unaudited financial statements of a nonissuer to his or her client or a third party unless, as a minimum, he or she complies with the provisions of this section applicable to a compilation engagement.

- a. *Compilation of financial statements.*<sup>1</sup> If the accountant performs a compilation, a communication to management is required. The type of communication depends on the following.

- i. If the accountant is engaged to report on compiled financial statements or submits financial statements to a client that are or reasonably might be expected to be used by a third party, see paragraphs .13–.23 and .54–.76 for reporting requirements.
- ii. If the accountant submits financial statements to a client that are not reasonably expected to be used by a third party, see paragraphs .24–.27 for required communications to management.

In deciding whether the financial statements are or reasonably might be expected to be used by a third party, the accountant may rely on management's representation without further inquiry, unless information comes to his or her attention that contradicts management's representation.

In each of the previous circumstances, the performance requirements in paragraphs .05 and .08–.11 apply.

- b. *Review of financial statements.*<sup>[2]</sup> If the accountant performs a review, see paragraphs .05 and .28–.76 for performance and reporting requirements. Statements on Standards for Accounting and Review Services are not applicable to reviews of interim financial information if

- i. the entity's latest annual financial statements have been audited by the accountant or a predecessor;
- ii. the accountant has been engaged to audit the entity's current year financial statements, or the accountant audited the entity's latest annual financial statements and expects to be engaged to audit the current year financial statements; and

<sup>[2]</sup> [Footnote deleted by the issuance of SSARS No. 15, July 2007.]

- iii. the client prepares its interim financial information in accordance with the same financial reporting framework as that used to prepare the annual financial statements.

Accountants engaged to perform reviews of interim financial information when the previously mentioned conditions in i–iii are met should perform such reviews in accordance with AU section 722, *Interim Financial Information* (AICPA, *Professional Standards*, vol. 1).

[As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008, by SSARS No. 17. As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2009, by SSARS No. 18.]

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[<sup>1</sup> See appendix A [paragraph .97], "Compilation of Financial Statements," for a flowchart regarding the requirements of Statements on Standards for Accounting and Review Services (SSARSs) for a compilation engagement. [As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

[<sup>2</sup> [Footnote deleted by the issuance of SSARS No. 15, July 2007.]

**.02** If the accountant performs more than one service (for example, a compilation and an audit), the accountant should issue the report that is appropriate for the highest level of service rendered.<sup>3</sup>

**.03** An accountant should not consent to the use of his or her name in a document or written communication containing unaudited financial statements of a nonissuer unless (a) the accountant has compiled or reviewed the financial statements in compliance with the provisions of this section or (b) the financial statements are accompanied by an indication that the accountant has not compiled or reviewed the financial statements and that the accountant assumes no responsibility for them. For example, the indication may be worded as follows:

The accompanying balance sheet of X Company as of December 31, 20X1, the related statements of income, and cash flows for the year then ended were not audited, reviewed, or compiled by us and, accordingly, we do not express an opinion or any other form of assurance on them.

If an accountant becomes aware that his or her name has been used improperly in any client-prepared document containing unaudited financial statements, the accountant should advise the client that the use of his or her name is inappropriate and should consider what other actions might be appropriate, including consultation with his or her attorney. [As amended, effective November 2002, by SSARS No. 9. As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008, by SSARS No. 17.]

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<sup>3</sup> AR section 300, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms*, permits an accountant who has reviewed the financial statements of a nonissuer to issue a compilation report on financial statements for the same period that are included in a prescribed form that calls for departure from generally accepted accounting principles (GAAP). [Footnote amended by the issuance of SSARS No. 17, December 2008.]



## Definitions

**.04** Certain terms are defined for purposes of this section as follows.

*Submission of financial statements.* Presenting to a client or third parties financial statements that the accountant has prepared either manually or through the use of computer software.

*Those charged with governance.* The person(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. In some cases, those charged with governance are responsible for approving the entity's financial statements (in other cases, management has this responsibility). In some entities, governance is a collective responsibility that may be carried out by a board of directors, a committee of the board of directors, a committee of management, partners, equivalent persons, or some combination thereof. Those charged with governance are specifically excluded from management, unless they perform management functions as defined in the following.

*Management.* The person(s) responsible for achieving the objectives of the entity and who have the authority to establish policies and make decisions by which those objectives are to be pursued. Management is responsible for the financial statements, including designing, implementing, and maintaining effective internal control over financial reporting.

*Third party.* All persons, including those charged with governance, except for those members of management as defined previously.<sup>4</sup>

*Generally accepted accounting principles (GAAP).* See Appendix J, [paragraph .106], "Sources of Generally Accepted Accounting Principles," for the hierarchy of GAAP.

*Other comprehensive basis of accounting (OCBOA).* A definite set of criteria, other than GAAP, having substantial support underlying the preparation of financial statements prepared pursuant to that basis. Examples of an OCBOA are:

- (a) A basis of accounting that the reporting entity uses to comply with the requirements or financial reporting provisions of a governmental regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting insurance companies use pursuant to the rules of a state insurance commission).
- (b) A basis of accounting that the reporting entity uses or expects to use to file its income tax return for the period covered by the financial statements.
- (c) The cash basis of accounting and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets). Ordinarily a modification would have substantial support if the method is equivalent to the accrual basis of accounting for that item and if the method is not illogical. If modifications to the cash basis of accounting do not have substantial support, the accountant should appropriately modify his or her report in accordance with the guidance in paragraphs .56–.58. If the modifications are so extensive that the modified "cash basis" statements are, in the accountant's judgment, equivalent to financial statements on the accrual basis, the statements

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<sup>4</sup> The accountant may wish to specify those members of management. See Appendix D [paragraph .100], "Compilation of Financial Statements Not Intended for Third-Party Use—Illustrative Engagement Letter." [As amended, effective November 2002, by SSARS No. 9.]

should be considered GAAP basis. The accountant may use the standard form of report modified as appropriate because of the departures from generally accepted accounting principles.

*Financial statement.* A presentation of financial data, including accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time, or the changes therein for a period of time, in accordance with generally accepted accounting principles (GAAP)<sup>[5]</sup> or an OCBOA.<sup>[6]</sup> Reference in the SSARSs to GAAP include, where applicable, an OCBOA. Financial forecasts, projections and similar presentations,<sup>7</sup> and financial presentations included in tax returns are not financial statements for purposes of this section. The following financial presentations are examples of financial statements and are not meant to be all-inclusive.<sup>[8]</sup>

Appropriate GAAP financial statement titles:

- Balance sheet
- Statement of income
- Statement of comprehensive income
- Statement of retained earnings
- Statement of cash flows
- Statement of changes in owners' equity
- Statement of assets and liabilities (with or without owners' equity accounts)
- Statement of revenue and expenses
- Statement of financial position (condition)
- Statement of activities
- Summary of operations
- Statement of operations by product lines

Appropriate OCBOA financial statement titles:

- Balance sheet—cash basis
- Statement of assets and liabilities arising from cash transactions
- Statement of assets, liabilities, and stockholders' equity—income tax basis
- Statement of revenue collected and expenses paid
- Statement of revenue and expenses—income tax basis
- Statement of income—statutory basis
- Statement of operations—income tax basis

A financial statement may be, for example, that of a corporation, a consolidated group of corporations, a combined group of affiliated entities, a not-for-profit organization, a governmental entity, an estate or trust, a partnership, a proprietorship, a limited liability partnership (LLP), a limited liability company (LLC), a segment of any of these, or an individual. The method of preparation (for example, manual or computer preparation) is not relevant to the definition of a financial statement.

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<sup>[5]</sup> [Footnote deleted by the issuance of SSARS No. 15, July 2007.]

<sup>[6]</sup> [Footnote deleted by the issuance of SSARS No. 17, February 2008.]

<sup>7</sup> Statement on Standards for Attestation Engagements No. 10, Chapter 3, *Financial Forecasts and Projections* [AT section 301], as well as the AICPA *Guide for Prospective Financial Information*, provide guidance on preparing and reporting on financial forecasts, projections, and similar presentations. [Footnote revised, January 2001, to reflect conforming changes necessary due to the issuance of Statement on Standards for Attestation Engagements No. 10.]

<sup>[8]</sup> [Footnote deleted by the issuance of SSARS No. 15, July 2007.]

## 1414 Statements on Standards for Accounting and Review Services

*Issuer.* An issuer is defined in section 3 of the Securities Exchange Act of 1934 [15 U.S.C. 78c], the securities of which are registered under section 12 of that Act (15 U.S.C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a et seq.), and that it has not withdrawn.

*Nonissuer.* All entities except for those defined as issuers.

*Compilation of financial statements.* A service, the objective of which is to present in the form of financial statements, information that is the representation of management (owners) without undertaking to express any assurance on the financial statements.<sup>[9]</sup>

*Review of financial statements.* A service, the objective of which is to express limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with GAAP.

[As amended, effective November 2002, by SSARS No. 9. As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008, by SSARS No. 17.]

### Understanding With the Entity

**.05** The accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. However, if the engagement is to compile financial statements not expected to be used by a third party, a written communication is required. (See paragraphs .24 and .25.) The understanding should include a description of the nature and limitations of the services to be performed and a description of the report, if a report is to be issued. The understanding should also provide:

- a. That the engagement cannot be relied upon to disclose errors, fraud,<sup>10</sup> or illegal acts<sup>11</sup> and
- b. That the accountant will inform the appropriate level of management<sup>[12]</sup> of any material errors and of any evidence or information that comes to the accountant's attention during the performance of compilation or review procedures<sup>13</sup> that fraud or an illegal act may have occurred.<sup>14</sup> The accountant need not report any matters regarding

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<sup>[9]</sup> [Footnote deleted by the issuance of SSARS No. 17, February 2008.]

<sup>10</sup> For purposes of this section, *fraud* is an intentional act that results in a misstatement in compiled or reviewed financial statements. [Footnote added, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12.]

<sup>11</sup> For purposes of this section, *illegal acts* are violations of laws or government regulations, excluding fraud. [Footnote added, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12.]

<sup>[12]</sup> [Footnote renumbered and deleted by the issuance of SSARS No. 12, July 2005.]

<sup>13</sup> Compilation performance requirements are contained in paragraphs .08–.12. Review performance requirements are contained in paragraphs .29–.45. [Footnote added, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12.]

<sup>14</sup> Whether an act is, in fact, fraudulent or illegal is a determination that is normally beyond the accountant's professional competence. An accountant, in reporting on financial statements, presents himself or herself as one who is proficient in accounting and compilation or review services. The accountant's training, experience, and understanding of the client and its industry may provide a basis for recognition that some client acts coming to his or her attention may be fraudulent or illegal.

(continued)

illegal acts that may have occurred that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such matters to be communicated.

Examples of engagement letters are presented in Appendixes C [paragraph .99], D [paragraph .100], and E [paragraph .101]. [As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12.]

## Compilation of Financial Statements

### Objective of a Compilation Engagement

**.06** The objective of a compilation engagement is to present in the form of financial statements, information that is the representation of management (owners) without undertaking to express any assurance on the financial statements. [Paragraph and preceding section header added, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

**.07** Paragraphs .08–.11 are applicable to a compilation of financial statements, whenever the accountant—

- Is engaged to report on compiled financial statements.
- Submits financial statements to a client that are or reasonably might be expected to be used by a third party.
- Submits financial statements to a client that are not expected to be used by a third party.

[Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

### Compilation Performance Requirements

**.08** The accountant should possess a level of knowledge of the accounting principles and practices of the industry in which the entity operates that will enable him or her to compile financial statements that are appropriate in form for an entity operating in that industry.<sup>15</sup> This standard does not prevent an accountant from accepting a compilation engagement for an entity in an industry with which the accountant has no previous experience. It does, however, place upon the accountant a responsibility to obtain the required level of knowledge. The accountant may do so, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, or individuals knowledgeable about the industry. [Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.09** To compile financial statements, the accountant should possess a general understanding of the nature of the entity's business transactions, the form of its accounting records, the stated qualifications of its accounting personnel, the accounting basis on which the financial statements are to be presented, and the form and content of the financial statements. The accountant ordinarily

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*(footnote continued)*

However, the determination as to whether a particular act is fraudulent or illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law. [Footnote added, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12.]

<sup>15</sup> For purposes of this section, the term *industry* includes governmental and not-for-profit activities. [Footnote renumbered by the issuance of SSARS No. 12, July 2005.]

obtains knowledge of these matters through experience with the entity or inquiry of the entity's personnel. On the basis of that understanding, the accountant should consider whether it will be necessary to perform other accounting services, such as assist in adjusting the books of account or consult on accounting matters, when he or she compiles financial statements. [Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.10** The accountant is not required to make inquiries or perform other procedures to verify, corroborate, or review information supplied by the entity. However, the accountant may have made inquiries or performed other procedures. The results of such inquiries or procedures, knowledge gained from prior engagements, or the financial statements on their face may cause the accountant to become aware that information supplied by the entity is incorrect, incomplete, or otherwise unsatisfactory. If any evidence or information comes to the accountant's attention regarding fraud or an illegal act that may have occurred, the accountant should request that management consider the effect of the matter on the financial statements. Additionally, the accountant should consider the effect of the matter on his or her compilation report. In circumstances where the accountant believes that the financial statements are materially misstated, the accountant should obtain additional or revised information. If the entity refuses to provide additional or revised information, the accountant should withdraw from the engagement. (However, see paragraphs .19–.22 for guidance when management elects to omit substantially all the disclosures required by GAAP and see paragraphs .56–.58 for the accountant's reporting responsibilities when he or she is aware of other departures from GAAP.) [As amended, effective November 2002, by SSARS No. 9. As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.11** Before submission, the accountant should read the financial statements and consider whether such financial statements appear to be appropriate in form and free from obvious material errors. In this context, the term *error* refers to mistakes in the compilation of financial statements, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosure. [Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## **Limitations of a Compilation Engagement**

**.12** A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; tests of accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Therefore, a compilation does not provide a basis for expressing any level of assurance on the financial statements being compiled. [Paragraph and preceding section header added, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

## **Reporting on the Financial Statements**

**.13** When the accountant is engaged to report on compiled financial statements or submits financial statements that are reasonably expected to be used

by a third party, the financial statements should be accompanied by a report. The basic elements of the report are as follows:

- a. A statement that a compilation has been performed in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants
- b. A statement that a compilation is limited to presenting in the form of financial statements information that is the representation of management (owners)
- c. A statement that the financial statements have not been audited or reviewed and, accordingly, the accountant does not express an opinion or any other form of assurance on them
- d. A signature of the accounting firm or the accountant as appropriate (For example, the signature could be manual, stamped, electronic, or typed.)
- e. The date of the compilation report (The date of completion of the compilation should be used as the date of the accountant's report.)

Any other procedures that the accountant might have performed before or during the compilation engagement should not be described in the report. [As amended, effective November 2002, by SSARS No. 9. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.14** [Paragraph deleted by the issuance of SSARS No. 9, November 2002. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.15** Each page of the financial statements compiled by the accountant should include a reference, such as "See Accountant's Compilation Report." [Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.16** The following form of standard report is appropriate for a compilation of financial statements prepared in accordance with generally accepted accounting principles:<sup>16</sup>

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X1, and the related statements of income, retained earnings,<sup>17</sup> and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

[As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

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<sup>16</sup> If the statement of comprehensive income is included, the first paragraph of the report should also refer to this statement. [Footnote added, effective November 2002, by SSARS No. 9. Footnote renumbered by the issuance of SSARS No. 12, July 2005.]

<sup>17</sup> Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 505-10-50 requires the disclosure of a change in capital. This can be accomplished by the preparation of a separate statement, in the notes to the financial statements, or as part of another basic statement. If the accountant does not include a statement of retained earnings as a separate statement, reference in the compilation report is not needed. [Footnote added, effective November 2002, by SSARS No. 9. Footnote renumbered by the issuance of SSARS No. 12, July 2005. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

## 1418 Statements on Standards for Accounting and Review Services

**.17** The following form of standard report is appropriate for a compilation of financial statements prepared in accordance with an other comprehensive basis of accounting. For illustrative purposes, the example is of a compilation of full disclosure cash basis financial statements:

I (we) have compiled the accompanying statement of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 20X1, and the related statement of revenue collected and expenses paid for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

[Paragraph added, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.18** An accountant may be asked to issue a compilation report on one financial statement, such as a balance sheet, and not on other related financial statements, such as the statements of income, retained earnings, and cash flows. This section does not preclude the accountant from doing so. Also, an accountant may be asked to compile financial statements included in a prescribed form that calls for departure from GAAP. AR section 300, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms*, provides additional guidance, including an alternative form of standard report, applicable to such compilation engagements. [Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

### Reporting on Financial Statements That Omit Substantially All Disclosures

**.19** An entity may request an accountant to compile financial statements that omit substantially all the disclosures required by GAAP, including disclosures that might appear in the body of the financial statements.<sup>18</sup> (As previously noted, reference to GAAP in this section includes, where applicable, OCBOA.) The accountant may compile such financial statements provided the omission of substantially all disclosures is clearly indicated in the report and is not, to his or her knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such financial statements. When the entity wishes to include disclosures about only a few matters in the form of notes to such financial statements, such disclosures should be labeled "Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included." [Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.20** Notwithstanding the preceding, if financial statements compiled in conformity with a comprehensive basis of accounting other than GAAP do not include disclosure of the basis of accounting used, the basis should be disclosed

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<sup>18</sup> See paragraphs .56–.58 for the accountant's responsibilities when he or she is aware of other departures from GAAP. However, see AR section 300 for guidance when such financial statements are included in a prescribed form and the prescribed form or related instructions do not request the disclosures required by GAAP. [Footnote renumbered and amended, effective November 2002, by SSARS No. 9. Footnote subsequently renumbered by the issuance of SSARS No. 12, July 2005.]

in the accountant's report. [Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.21** When financial statements that the accountant has compiled omit substantially all disclosures but are otherwise in conformity with generally accepted accounting principles,<sup>19</sup> the following form of standard report is appropriate:

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all the disclosures (and the statement of cash flows) required by generally accepted accounting principles. If the omitted disclosures and statement were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

[Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.22** When financial statements that the accountant has compiled omit substantially all disclosures with no reference to basis but are otherwise in conformity with an other comprehensive basis of accounting, the following form of standard report is appropriate. For illustrative purposes, the example is of a compilation of income tax basis financial statements.

I (we) have compiled the accompanying statement of assets, liabilities, and equity – income tax basis of XYZ Company as of December 31, 20XX, and the related statements of revenue and expense – income tax basis for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The financial statements have been prepared on the accounting basis used by the company for Federal income tax purposes, which is a comprehensive basis of accounting other than generally accepted accounting principles.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all the disclosures ordinarily included in financial statements prepared on the income tax basis of accounting. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's assets, liabilities, equity, revenue, and expenses. Accordingly, these financial statements are not designed for those who are not informed about such matters.

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<sup>19</sup> If the statement of cash flows is omitted, the first and third paragraphs of the report should be modified accordingly. [Footnote renumbered by the issuance of SSARS No. 9, November 2002. Footnote subsequently renumbered by the issuance of SSARS No. 12, July 2005.]



[Paragraph added, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## **Reporting When the Accountant Is Not Independent**

**.23** An accountant is not precluded from issuing a report with respect to a compilation of financial statements for an entity with respect to which the accountant is not independent.<sup>20</sup> If the accountant is not independent, he or she should specifically disclose the lack of independence. However, the reason for the lack of independence should not be described. When the accountant is not independent, the following should be included as the last paragraph of the report:

I am (we are) not independent with respect to XYZ Company.

[Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## **Accountant's Communications With the Client When the Compiled Financial Statements Are Not Expected to Be Used by a Third Party**

**.24** When an accountant submits unaudited financial statements to his or her client that are not expected to be used by a third party, he or she should either

- issue a compilation report in accordance with the reporting requirements discussed in paragraphs .13–.23 or
- document an understanding with the entity through the use of an engagement letter, preferably signed by management, regarding the services to be performed and the limitations on the use of those financial statements. (Appendix D [paragraph .100] contains "Compilation of Financial Statements Not Intended for Third-Party Use—Illustrative Engagement Letter.")

[Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.25** The documentation of the understanding should include the following descriptions or statements:

- The nature and limitations of the services to be performed.
- A compilation is limited to presenting in the form of financial statements information that is the representation of management.
- The financial statements will not be audited or reviewed.
- No opinion or any other form of assurance on the financial statements will be provided.
- Management has knowledge about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements.

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<sup>20</sup> In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA *Code of Professional Conduct*. [Footnote renumbered by the issuance of SSARS No. 9, November 2002. Footnote subsequently renumbered by the issuance of SSARS No. 12, July 2005.]

- Acknowledgment of management's representation and agreement that the financial statements are not to be used by third parties.
- The engagement cannot be relied upon to disclose errors, fraud, or illegal acts.

The documentation of the understanding should also address the following additional matters if applicable:

- Material departures from GAAP or OCBOA may exist and the effects of those departures, if any, on the financial statements may not be disclosed.
- Substantially all disclosures (and statement of cash flows, if applicable) required by GAAP or OCBOA may be omitted.
- Lack of independence.
- Refer to supplementary information.

Such an understanding reduces the risk that the accountant or the client may misinterpret the needs or expectations of the other party. If the accountant believes an understanding with the client has not been established, he or she should decline to accept or perform the engagement. [Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.26** The accountant should include a reference on each page of the financial statements restricting their use such as "Restricted for Management's Use Only," or "Solely for the information and use by the management of [*name of entity*] and not intended to be and should not be used by any other party." [Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.27** If the accountant becomes aware that the financial statements have been distributed to third parties, the accountant should discuss the situation with the client and request that the client have the statements returned. If the client does not comply with this request within a reasonable period of time, the accountant should notify known third parties that the financial statements are not intended for third-party use, preferably in consultation with his or her attorney. [Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## Review of Financial Statements

### Objective of a Review Engagement

**.28** The objective of a review engagement is to express limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with GAAP. [Paragraph and preceding section header added, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

### Review Performance Requirements

**.29** In order to obtain a reasonable basis for the expression of limited assurance, the accountant must

- apply analytical procedures to the financial statements, as discussed in paragraphs .36–.37.

## 1422 Statements on Standards for Accounting and Review Services

- make inquiries of management and, when deemed appropriate, other company personnel, as discussed in paragraph .38.
- obtain representations from management for all financial statements and periods covered by the accountant's review report, as discussed in paragraphs .39–.42.

[As amended, effective November 2002, by SSARS No. 9. As amended, effective for reviews of financial statements for periods ending on or after December 15, 2004, by SSARS No. 10. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

**.30** The analytical and other procedures performed and the specific inquiries made should be tailored to the engagement based on the accountant's knowledge of the entity's business. For example, if the accountant becomes aware of a significant change in the entity's operations, the accountant may consider making additional inquiries, employing additional analytical procedures, or both. [Paragraph added, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

**.31** During the performance of the review procedures, the accountant may become aware that information coming to his or her attention is incorrect, incomplete, or otherwise unsatisfactory or that fraud or an illegal act may have occurred. The accountant should request that management consider the effect of these matters on the financial statements. Additionally, the accountant should consider the effect of these matters on his or her review report. In circumstances where the accountant believes the financial statements are materially misstated, the accountant should perform additional procedures deemed necessary to achieve limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles. (See paragraph .51 for guidance when an accountant is unable to complete a review and paragraphs .56–.58 for the accountant's responsibilities when he or she is aware of departures from generally accepted accounting principles.) [Paragraph renumbered and amended, effective November 2002, by SSARS No. 9. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2004, by SSARS No. 10. As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

### Limitations of a Review Engagement

**.32** A review differs significantly from an audit of financial statements in which the auditor provides reasonable assurance that the financial statements, taken as a whole, are free of material misstatement. A review does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; tests of accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, a review does not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit. Therefore, a review provides only limited assurance that there are no material modifications that should be made to the

financial statements in order for the statements to be in conformity with GAAP. [Paragraph and preceding section header added, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

## Knowledge of Accounting Principles and Practices of the Industry

**.33** The accountant should possess a level of knowledge of the accounting principles and practices of the industry in which the entity operates and an understanding of the entity's business<sup>21</sup> that will provide, through the performance of inquiry and analytical procedures, a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles. (As previously noted, reference to generally accepted accounting principles in this section includes, where applicable, an other comprehensive basis of accounting.) [Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2004, by SSARS No. 10. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.34** The requirement that the accountant possess a level of knowledge of the accounting principles and practices of the industry in which the entity operates does not prevent an accountant from accepting a review engagement for an entity in an industry with which the accountant has no previous experience. It does, however, place upon the accountant a responsibility to obtain the required level of knowledge. He may do so, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, or individuals knowledgeable about the industry. [Paragraph renumbered by the issuance of SSARS No. 10, May 2004. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.35** The accountant's understanding of the entity's business should include a general understanding of the entity's organization, its operating characteristics, and the nature of its assets, liabilities, revenues, and expenses. This would ordinarily involve a general knowledge of the entity's production, distribution, and compensation methods, types of products and services, operating locations, and material transactions with related parties. An accountant's understanding of an entity's business is ordinarily obtained through experience with the entity or its industry and inquiry of the entity's personnel. [Paragraph renumbered by SSARS No. 10, May 2004. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## Analytical Procedures

**.36** In a review engagement, the accountant must apply analytical procedures to the financial statements. The purpose of analytical procedures is to identify and provide a basis for inquiry about the relationships and individual

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<sup>21</sup> For purposes of this section, the term *business* includes not-for-profit entities. [Footnote renumbered by the issuance of SSARS No. 9, November 2002. Footnote subsequently renumbered by the issuance of SSARS No. 12, July 2005.]

items that appear to be unusual and that may indicate a material misstatement. Analytical procedures include:

- Developing expectations by identifying and using plausible relationships that are reasonably expected to exist based on the accountant's understanding of the entity and the industry in which the entity operates.
- Comparing recorded amounts, or ratios developed from recorded amounts, to expectations developed by the accountant.

See Appendix I [paragraph .105] for examples of analytical procedures an accountant may consider performing when conducting a review of financial statements. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2004, by SSARS No. 10. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

**.37** Expectations developed by the accountant in performing analytical procedures in connection with a review of financial statements ordinarily are less encompassing than those developed in an audit. Also, in a review the accountant ordinarily is not required to corroborate management's responses with other evidence. However, the accountant should consider the reasonableness and consistency of management's responses in light of the results of other review procedures and the accountant's knowledge of the entity's business and the industry in which it operates. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2004, by SSARS No. 10. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## **Inquiries and Other Review Procedures**

**.38** The following are inquiries the accountant should consider making and other review procedures the accountant should consider performing when conducting a review of financial statements:

- a. Inquiries to members of management who have responsibility for financial and accounting matters concerning (see Appendix B [paragraph .98]):
  1. Whether the financial statements have been prepared in conformity with generally accepted accounting principles consistently applied.
  2. The entity's accounting principles and practices and the methods followed in applying them and procedures for recording, classifying, and summarizing transactions, and accumulating information for disclosure in the financial statements.
  3. Unusual or complex situations that may have an effect on the financial statements.
  4. Significant transactions occurring or recognized near the end of the reporting period.
  5. The status of uncorrected misstatements identified during the previous engagement.
  6. Questions that have arisen in the course of applying the review procedures.
  7. Events subsequent to the date of the financial statements that could have a material effect on the financial statements.

8. Their knowledge of any fraud or suspected fraud affecting the entity involving management or others where the fraud could have a material effect on the financial statements, for example, communications received from employees, former employees, or others.
  9. Significant journal entries and other adjustments.
  10. Communications from regulatory agencies.
- b. Inquiries concerning actions taken at meetings of stockholders, board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements.
  - c. Reading the financial statements to consider, on the basis of information coming to the accountant's attention, whether the financial statements appear to conform with generally accepted accounting principles.
  - d. Obtaining reports from other accountants, if any, who have been engaged to audit or review the financial statements of significant components of the reporting entity, its subsidiaries, and other investees.<sup>22</sup>

[Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2004, by SSARS No. 10. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## Management Representations

**.39** Written representations are required from management for all financial statements and periods covered by the accountant's review report. For example, if comparative financial statements are reported on, the representations obtained at the completion of the most recent review should address all periods being reported on. The specific written representations obtained by the accountant will depend on the circumstances of the engagement and the nature and basis of presentation of the financial statements. In connection with a review of financial statements presented in accordance with generally accepted accounting principles, specific representations should relate to the following matters:<sup>23</sup>

- a. Management's acknowledgment of its responsibility for the fair presentation in the financial statements of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles
- b. Management's belief that the financial statements are fairly presented in conformity with generally accepted accounting principles
- c. Management's acknowledgement of its responsibility to prevent and detect fraud

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<sup>22</sup> The financial statements of the reporting entity ordinarily include an accounting for all significant components, such as unconsolidated subsidiaries and investees. If other accountants are engaged to audit or review the financial statements of such components, the accountant will require reports from the other accountants as a basis, in part, for the accountant's review report with respect to the review of the financial statements of the reporting entity. The accountant may decide to make reference to the work of other accountants in the accountant's review report on the financial statements. If such reference is made, the report should indicate the magnitude of the portion of the financial statements audited or reviewed by the other accountants. [Footnote renumbered by the issuance of SSARS No. 9, November 2002. As amended, effective for reviews of financial statements for periods ending on or after December 15, 2004, by SSARS No. 10. Footnote subsequently renumbered by the issuance of SSARS No. 12, July 2005.]

<sup>23</sup> Specific representations also are applicable to financial statements presented in conformity with a comprehensive basis of accounting other than generally accepted accounting principles. The specific representations to be obtained should be based on the nature and basis of presentation of the financial statements being reviewed. [Footnote added, effective for review reports dated January 1, 2003, or after, by SSARS No. 9. Footnote renumbered by the issuance of SSARS No. 12, July 2005.]

- d. Knowledge of any fraud or suspected fraud affecting the entity involving management or others where the fraud could have a material effect on the financial statements, including any communications received from employees, former employees, or others
- e. Management's full and truthful response to all inquiries
- f. Completeness of information
- g. Information concerning subsequent events

The representation letter ordinarily should be tailored to include additional appropriate representation from management relating to matters specific to the entity's business or industry. An illustrative representation letter is presented in Appendix F [paragraph .102]. [Paragraph added, effective for review reports dated January 1, 2003, or after, by SSARS No. 9. Paragraph renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2004, by SSARS No. 10. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Preceding section header amended and paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.40** There are circumstances in which an accountant should consider obtaining an updating representation letter from management (for example, the accountant obtains a management representation letter after completion of inquiry and analytical review procedures but does not issue his or her review report for a significant period of time thereafter, or a material subsequent event occurs after the completion of inquiry and analytical review procedures, including obtaining the original management representation letter, but before the issuance of the report on the reviewed financial statements). In addition, if a predecessor accountant is requested by a former client to reissue his or her report on the financial statements of a prior period, and those financial statements are to be presented on a comparative basis with reviewed financial statements of a subsequent period, the predecessor accountant should obtain an updating representation letter from the management of the former client.<sup>24</sup> The updating management representation letter should state (a) whether any information has come to management's attention that would cause management to believe that any of the previous representations should be modified and (b) whether any events have occurred subsequent to the balance-sheet date of the latest financial statements reported on by the accountant that would require adjustment to or disclosure in those financial statements.<sup>25</sup> [Paragraph added, effective for reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.41** In a review engagement, the accountant must obtain representations from management for all financial statements and periods covered by the accountant's review report. Because the accountant is concerned with events occurring through the date of the report that may require adjustment to or disclosure in the financial statements, management's representations set forth in the management representation letter should be made as of the date of the accountant's review report. The accountant need not be in physical receipt of

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<sup>24</sup> See AR section 200, *Reporting on Comparative Financial Statements* [AR section 200.20–.24]. [Footnote added, effective for reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12.]

<sup>25</sup> An illustrative updating management representation letter is contained in Appendix G, "Review of Financial Statements—Illustrative Updating Management Representation Letter" [paragraph .103]. [Footnote added, effective for reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12.]

the management representation letter as of the date of the accountant's review report provided that management has acknowledged that they will sign the representation letter without modification, and it is received prior to the date the report is released. The management representation letter should be addressed to the accountant. The letter should be signed by those members of management whom the accountant believes are responsible for and knowledgeable, directly or through others in the organization, about the matters covered in the representation letter. Normally, the chief executive officer and chief financial officer or others with equivalent positions in the entity should sign the representation letter. If the current management was not present during all periods covered by the accountant's report, the accountant should nevertheless obtain written representations from current management on all such periods. [Paragraph renumbered and amended, effective for review reports dated January 1, 2003, or after, by SSARS No. 9. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

**.42** Knowledge acquired in the performance of audits of the entity's financial statements, compilation of the financial statements, or other accounting services may result in modification of the review procedures described in paragraphs .36-.38. However, such modification would not reduce the degree of responsibility the accountant assumes with respect to the reviewed financial statements. [Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2004, by SSARS No. 10. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## Documentation in a Review Engagement

**.43** The accountant should prepare documentation in connection with a review of financial statements, the form and content of which should be designed to meet the circumstances of the particular engagement. Documentation is the principal record of the review procedures performed and the conclusions reached by the accountant in performing the review. However, an accountant would not be precluded from supporting his or her review report by other means in addition to the review documentation. Such other means might include written documentation contained in other engagement (for example compilation) files or quality control files (for example consultation files) and in limited situations, oral explanations. Oral explanations should be limited to those situations where the accountant finds it necessary to supplement or clarify information contained in the documentation. Oral explanations should not be the principal support for the work performed or the conclusions reached. [Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2004, by SSARS No. 10. Paragraph renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.44** Because of the different circumstances in individual engagements, it is not possible to specify the form or content of the documentation the accountant should prepare. However, the documentation should include any findings



## 1428 Statements on Standards for Accounting and Review Services

or issues that in the accountant's judgment are significant, for example, the results of review procedures that indicate the financial statements could be materially misstated, including actions taken to address such findings, and the basis for the final conclusions reached. [Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2004, by SSARS No. 10. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.45** The documentation of the inquiry and analytical procedures should include the following:

- a. The matters covered in the accountant's inquiry procedures.
- b. The analytical procedures performed.
- c. The expectations as discussed in paragraph .36, where significant expectations are not otherwise readily determinable from the documentation of the work performed, and factors considered in the development of those expectations.
- d. Results of the comparison of the expectations to the recorded amounts or ratios developed from recorded amounts.
- e. Any additional procedures performed in response to significant unexpected differences arising from the analytical procedure and the results of such additional procedures.
- f. Unusual matters that the accountant considered during the performance of the review procedures, including their disposition.
- g. Communications, whether oral or written, to the appropriate level of management regarding fraud or illegal acts that come to the accountant's attention.
- h. The representation letter.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2004, by SSARS No. 10. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

### Reporting on the Financial Statements

**.46** Financial statements reviewed by an accountant should be accompanied by a report. The basic elements of the report are as follows:

- a. A statement that a review has been performed in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants
- b. A statement that all information included in the financial statements is the representation of the management (owners) of the entity
- c. A statement that a review consists principally of inquiries of company personnel and analytical procedures applied to financial data
- d. A statement that a review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements taken as a whole and, accordingly, no such opinion is expressed

- e. A statement that the accountant is not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles, other than those modifications, if any, indicated in the report
- f. A signature of the accounting firm or the accountant as appropriate (For example, the signature could be manual, stamped, electronic, or typed.)
- g. The date of the review report (The date of the completion of the accountant's review procedures should be used as the date of the accountant's report.)

Any other procedures that the accountant might have performed before or during the review engagement, including those performed in connection with a compilation of the financial statements, should not be described in the report. [Paragraph renumbered and amended, effective November 2002, by SSARS No. 9. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**[.47]** [Paragraph renumbered and deleted by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.48** Each page of the financial statements reviewed by the accountant should include a reference such as "See Accountant's Review Report." [Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.49** The following form of standard report is appropriate for a review of financial statements prepared in accordance with generally accepted accounting principles.<sup>26</sup>

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X1, and the related statements of income, retained earnings,<sup>27</sup> and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an

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<sup>26</sup> See paragraphs .56–.58 for the accountant's responsibilities with respect to departures from generally accepted accounting principles.

If the statement of comprehensive income is included, the first paragraph of the report should also refer to this statement. [Footnote renumbered and amended, effective November 2002, by the issuance of SSARS No. 9. Footnote subsequently renumbered by the issuance of SSARS No. 12, July 2005.]

<sup>27</sup> FASB ASC 505-10-50 requires the disclosure of a change in capital. This can be accomplished by the preparation of a separate statement, in the notes to the financial statements, or as part of another basic statement. If the accountant does not include a statement of retained earnings as a separate statement, reference in the review report is not needed. [Footnote added, effective November 2002, by the issuance of SSARS No. 9. Footnote renumbered by the issuance of SSARS No. 12, July 2005. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

## 1430 Statements on Standards for Accounting and Review Services

audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

[Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by the issuance of SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.50** The following form of standard report is appropriate for a review of financial statements prepared in accordance with an other comprehensive basis of accounting. For illustrative purposes, the example is of a review of financial statements prepared in accordance with the income tax basis of accounting:

I (we) have reviewed the accompanying statement of assets, liabilities, and equity – income tax basis of XYZ Company as of December 31, 20X1, and the related statement of revenue and expenses – income tax basis for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the income tax basis of accounting, as described in Note X.

[Paragraph added, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.51** When an accountant is unable to perform the inquiry and analytical procedures he or she considers necessary to achieve the limited assurance contemplated by a review, or the client does not provide the accountant with a representation letter, the review will be incomplete. A review that is incomplete is not an adequate basis for issuing a review report. In such a situation, the accountant should consider the matters discussed in paragraphs .86–.91 in deciding whether it is appropriate to issue a compilation report on the financial statements. [Paragraph renumbered and amended, effective November 2002, by SSARS No. 9. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.52** An accountant may be asked to issue a review report on one financial statement, such as a balance sheet, and not on other related financial statements, such as the statements of income, retained earnings, and cash flows.

He may do so if the scope of his inquiry and analytical procedures has not been restricted. [Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.53** An accountant is precluded from issuing a review report on the financial statements of an entity with respect to which he is not independent.<sup>28</sup> If the accountant is not independent, he may issue a compilation report provided he complies with the compilation standards. [Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## Emphasis of a Matter

**.54** An accountant may emphasize, in any report on financial statements, a matter disclosed in the financial statements. Such explanatory information should be presented in a separate paragraph of the accountant's report. Emphasis paragraphs are never required; they may be added solely at the accountant's discretion.

Examples of matters the accountant may wish to emphasize are:

- Uncertainties.
- That the entity is a component of a larger business enterprise.
- That the entity has had significant transactions with related parties.
- Unusually important subsequent events.
- Accounting matters, other than those involving a change or changes in accounting principles, affecting the comparability of the financial statements with those of the preceding period.

[Paragraph and preceding section head added, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.55** Because an emphasis of matter paragraph should not be used in lieu of management disclosures, an accountant should not include an emphasis paragraph in a compilation report on financial statements that omit substantially all disclosures unless the matter is disclosed in the financial statements.<sup>29</sup> The accountant should refer to paragraph .19 if he or she believes that a disclosure is necessary to keep the financial statements from being misleading. [Paragraph added, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

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<sup>28</sup> See footnote 20. [Footnote renumbered by the issuance of SSARS No. 9, November 2002. Footnote subsequently renumbered by the issuance of SSARS No. 12, July 2005.]

<sup>29</sup> For example, the accountant may include an emphasis paragraph on a matter when management has presented selected information, even though substantially all disclosures have been omitted, as long as the matter discussed in the emphasis paragraph is disclosed in the selected information. [Footnote added, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15.]

## Departures From Generally Accepted Accounting Principles

**.56** An accountant who is engaged to compile or review financial statements may become aware of a departure from generally accepted accounting principles (which include adequate disclosure) that is material to the financial statements. (As noted previously, reference in this section to generally accepted accounting principles includes, where applicable, an OCFBOA.) Paragraphs .19–.22 provide guidance to the accountant when the departure relates to the omission of substantially all disclosures in the financial statements he or she has compiled. AR section 300 provides guidance when the departure is called for by a prescribed form or related instructions. In all other circumstances, if the financial statements are not revised, the accountant should consider whether modification of the standard report is adequate to disclose the departure. [Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.57** If the accountant concludes that modification of the standard report is appropriate,<sup>30</sup> the departure should be disclosed in a separate paragraph of the report, including disclosure of the effects of the departure on the financial statements if such effects have been determined by management or are known as the result of the accountant's procedures. The accountant is not required to determine the effects of a departure if management has not done so, provided the accountant states in the report that such determination has not been made. Examples of compilation and review reports that disclose departures from generally accepted accounting principles follow.

### Compilation Report

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them. However, I (we) did become aware of a departure (certain departures) from generally accepted accounting principles that is (are) described in the following paragraph(s).

*(Separate paragraph)*

As disclosed in note X to the financial statements, generally accepted accounting principles require that land be stated at cost. Management has informed me (us) that the company has stated its land at appraised value and that, if

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<sup>30</sup> Normally, neither an uncertainty, including an uncertainty about an entity's ability to continue as a going concern, nor an inconsistency in the application of accounting principles would cause the accountant to modify the standard report provided the financial statements appropriately disclose such matters. [Footnote renumbered by the issuance of SSARS No. 9, November 2002. Footnote subsequently renumbered by the issuance of SSARS No. 12, July 2005. Footnote renumbered and amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15.]

generally accepted accounting principles had been followed, the land account and stockholders' equity would have been decreased by \$500,000.

*or*

A statement of cash flows for the year ended December 31, 20XX, has not been presented. Generally accepted accounting principles require that such a statement be presented when financial statements purport to present financial position and results of operations.<sup>31</sup>

### Review Report

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, with the exception of the matter(s) described in the following paragraph(s), I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

*(Separate paragraph)*

As disclosed in note X to the financial statements, generally accepted accounting principles require that inventory cost consist of material, labor, and overhead. Management has informed me (us) that the inventory of finished goods and work in process is stated in the accompanying financial statements at material and labor cost only, and that the effects of this departure from generally accepted accounting principles on financial position, results of operations, and cash flows have not been determined.

*or*

As disclosed in note X to the financial statements, the company has adopted (description of newly adopted method), whereas it previously used (description of previous method). Although the (description of newly adopted method) is in conformity with generally accepted accounting principles, the company does not appear to have reasonable justification for making a change as required by Financial Accounting Standards Board *Accounting Standards Codification 250, Accounting Changes and Error Corrections*.

[Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Revised, December 2006, to reflect conforming changes necessary due to the issuance of FASB Statement No. 154. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by the issuance of SSARS No. 15. Paragraph

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<sup>31</sup> If a statement of cash flows is not presented, the first paragraph of the compilation or review report should be modified accordingly. [Footnote renumbered by the issuance of SSARS No. 9, November 2002. Footnote subsequently renumbered by the issuance of SSARS No. 12, July 2005. Footnote renumbered by the issuance of SSARS No. 15, July 2007.]

renumbered by the issuance of SSARS No. 17, February 2008. Paragraph revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

**.58** If the accountant believes that modification of the standard report is not adequate to indicate the deficiencies in the financial statements taken as a whole, the accountant should withdraw from the compilation or review engagement and provide no further services with respect to those financial statements. The accountant may wish to consult with his legal counsel in those circumstances. [Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by the issuance of SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## **Restricting the Use of an Accountant's Compilation or Review Report**

### **General-Use and Restricted-Use Reports**

**.59** The term general use applies to accountant's reports that are not restricted to specified parties. Accountant's reports on financial statements prepared in conformity with generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles ordinarily are not restricted regarding use.<sup>32</sup> [Paragraph added, effective July 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.60** The term restricted use applies to accountant's reports intended only for one or more specified third parties. The need for restriction on the use of a report may result from a number of circumstances, including, but not limited to, the purpose of the report and the potential for the report to be misunderstood when taken out of the context in which it was intended to be used. [Paragraph added, effective July 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.61** An accountant should restrict the use of a report when the subject matter of the accountant's report or the presentation being reported on is based on measurement or disclosure criteria contained in contractual agreements<sup>33</sup> or regulatory provisions that are not in conformity with generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles.<sup>34</sup> [Paragraph added, effective July 2005,

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<sup>32</sup> Nothing in this section precludes an accountant from restricting the use of any report. [Footnote added, effective July 2005, by SSARS No. 12. Footnote renumbered by the issuance of SSARS No. 15, July 2007.]

<sup>33</sup> A contractual agreement as discussed in this section is an agreement between the client and one or more third parties other than the accountant. [Footnote added, effective July 2005, by SSARS No. 12. Footnote renumbered by the issuance of SSARS No. 15, July 2007.]

<sup>34</sup> When the contractual agreement or regulatory provision specifies the use of a prescribed form for which the accountant has been engaged to compile the financial statements, the accountant should reference AR section 300 for an alternative form of standard compilation report when the prescribed form calls for a departure from generally accepted accounting principles or a comprehensive basis of

*(continued)*

by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## **Reporting on Subject Matter or Presentations Based on Measurement or Disclosure Criteria Contained in Contractual Agreements or Regulatory Provisions**

**.62** When reports are issued on subject matter or presentations based on measurement or disclosure criteria contained in contractual agreements or regulatory provisions that are not in conformity with generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles, the accountant should restrict the report because the basis, assumptions, or purpose of such presentations (contained in such agreements or regulatory provisions) are developed for and directed only to the parties to the agreement or regulatory agency responsible for the provisions and because the report, the subject matter, or the presentation may be misunderstood by those who are not adequately informed of the basis, assumptions, or purpose of the presentation. [Paragraph added, effective July 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## **Combined Reports Covering Both Restricted-Use and General-Use Subject Matter or Presentations**

**.63** If an accountant issues a single combined report covering both (a) subject matter or presentations that require a restriction on use to specified parties and (b) subject matter or presentations that ordinarily do not require such a restriction, the use of such a single combined report should be restricted to the specified parties. [Paragraph added, effective July 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## **Inclusion of a Separate Restricted-Use Report in the Same Document With a General-Use Report**

**.64** Where required by law or regulation, a separate restricted-use report may be included in a document that also contains a general-use report. The inclusion of a separate restricted-use report in a document that contains a general-use report does not affect the intended use of either report. The restricted-use report remains restricted as to use, and the general-use report continues for general use. [Paragraph added, effective July 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## **Adding Other Specified Parties**

**.65** Subsequent to the completion of an engagement resulting in a restricted-use report, or in the course of such an engagement, an accountant may be asked to consider adding other parties as specified parties. [Paragraph

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*(footnote continued)*

accounting other than generally accepted accounting principles. [Footnote added, effective July 2005, by SSARS No. 12. Footnote renumbered by the issuance of SSARS No. 15, July 2007.]



added, effective July 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.66** If an accountant is reporting on subject matter or a presentation based on measurement or disclosure criteria contained in contractual agreements or regulatory provisions, as described in paragraph .62, the accountant may agree to add other parties as specified parties based on the accountant's consideration of factors such as the identity of the other parties, their knowledge of the basis of the measurement or disclosure criteria, and the intended use of the report. If the accountant agrees to add other parties as specified parties, the accountant should obtain affirmative acknowledgment, preferably in writing, from the other parties of their understanding of the nature of the engagement, the measurement or disclosure criteria used in the engagement, and the related report. If the other parties are added after the accountant has issued his or her report, the report may be reissued or the accountant may provide other written acknowledgment that the other parties have been added as specified parties. If the report is reissued, the report date should not be changed. If the accountant provides written acknowledgment that the other parties have been added as specified parties, such written acknowledgment ordinarily should state that no procedures have been performed subsequent to the date of the report. [Paragraph added, effective July 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

### **Limiting the Distribution of Reports**

**.67** Because of the reasons presented in paragraph .60, an accountant should consider informing his or her client that restricted-use reports are not intended for distribution to nonspecified parties, regardless of whether they are included in a document containing a separate general-use report.<sup>35</sup> This section does not preclude an accountant, in connection with establishing the terms of the engagement, from reaching an understanding with the client that the intended use of the report will be restricted, and from obtaining the client's agreement that the client and the specified parties will not distribute the report to parties other than those identified in the report. However, an accountant is not responsible for controlling a client's distribution of restricted-use reports. Accordingly, a restricted-use report should alert readers to the restriction on the use of the report by indicating that the report is not intended to be and should not be used by anyone other than the specified parties. [Paragraph added, effective July 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

### **Report Language—Restricted Use**

**.68** An accountant's report that is restricted as to use should contain a separate paragraph at the end of the report that includes the following elements:

- a.* A statement indicating that the report is intended solely for the information and use of the specified parties

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<sup>35</sup> In some cases, restricted-use reports filed with regulatory agencies are required by law or regulation to be made available to the public as a matter of public record. Also, a regulatory agency as part of its oversight responsibility for an entity may require access to restricted-use reports in which they are not named as a specified party. [Footnote added, effective July 2005, by SSARS No. 12. Footnote renumbered by the issuance of SSARS No. 15, July 2007.]

- b. An identification of the specified parties to whom use is restricted
- c. A statement that the report is not intended to be and should not be used by anyone other than the specified parties

An example of such a paragraph is the following:

This report is intended solely for the information and use of [*the specified parties*]<sup>36</sup> and is not intended to be and should not be used by anyone other than these specified parties.

[Paragraph added, effective July 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## An Entity's Ability to Continue as a Going Concern

**.69** During the performance of compilation or review procedures, evidence or information may come to the accountant's attention indicating that there may be an uncertainty about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being compiled or reviewed (hereinafter referred to as a *reasonable period of time*). In those circumstances, the accountant should request that management consider the possible effects of the going concern uncertainty on the financial statements, including the need for related disclosure. [Paragraph and preceding header added, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

**.70** After management communicates to the accountant the results of its consideration of the possible effects on the financial statements, the accountant should consider the reasonableness of management's conclusions including the adequacy of the related disclosures, if applicable. [Paragraph added, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

**.71** If the accountant determines that management's conclusions are unreasonable or the disclosure of the uncertainty regarding the entity's ability to continue as a going concern is not adequate, he or she should follow the guidance in paragraphs .56–.58 with respect to departures from generally accepted accounting principles. [Paragraph added, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

**.72** The accountant may emphasize an uncertainty about an entity's ability to continue as a going concern provided the uncertainty is disclosed in the financial statements. In such circumstances, the accountant should follow the guidance in paragraphs .54–.55. [Paragraph added, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

## Subsequent Events

**.73** Events or transactions sometimes occur subsequent to the balance sheet date, but prior to management's issuance of financial statements that have a material effect on the financial statements, and therefore require adjustment to or disclosure in the statements. These occurrences hereinafter are

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<sup>36</sup> The report may list the specified parties or refer the reader to the specified parties listed elsewhere in the report. [Footnote added, effective July 2005, by SSARS No. 12. Footnote renumbered by the issuance of SSARS No. 15, July 2007.]

referred to as "subsequent events." [Paragraph and preceding header added, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

**.74** Evidence or information that a subsequent event that has a material effect on the compiled or reviewed financial statements has occurred may come to the accountant's attention in the following ways:

- (a) During the performance of compilation or review procedures
- (b) Subsequent to the date of the accountant's compilation or review report but prior to the release of the report<sup>37</sup>

In either case, the accountant should request that management consider the possible effects on the financial statements including the adequacy of any related disclosure, if applicable. [Paragraph added, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

**.75** If the accountant determines that the subsequent event is not adequately accounted for in the financial statements or disclosed in the notes, he or she should follow the guidance in paragraphs .56–.58, *Departures From Generally Accepted Accounting Principles*. [Paragraph added, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

**.76** Occasionally, a subsequent event has such a material impact on the entity that the accountant may wish to include in his or her compilation or review report an explanatory paragraph directing the reader's attention to the event and its effects. Such an emphasis of matter paragraph may be added, at the accountant's discretion, provided that the matter is disclosed in the financial statements. See paragraphs .54–.55 for additional guidance with respect to emphasis of matter paragraphs. [Paragraph added, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

## **Subsequent Discovery of Facts Existing at Date of Report**

**.77** Subsequent to the date of the report on the financial statements that the accountant has compiled or reviewed, he or she may become aware that facts may have existed at that date which might have caused him or her to believe that information supplied by the entity was incorrect, incomplete, or otherwise unsatisfactory had the accountant then been aware of such facts.<sup>38</sup> Because of the variety of conditions that might be encountered, some of the procedures contained in this section are necessarily set out only in general terms; the specific actions to be taken in a particular case may vary with the circumstances. The accountant would be well advised to consult with his or her legal counsel and insurance provider when he or she encounters the circumstances to which this section may apply because of legal implications that may be involved in

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<sup>37</sup> For purposes of this section, with respect to compiled financial statements in which the accountant does not report, the submission of the compiled financial statements is the equivalent of the accountant's compilation or review report date. [Footnote added, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

<sup>38</sup> For purposes of this section, with respect to compiled financial statements in which the accountant does not report, the submission of the compiled financial statements is the equivalent of the accountant's compilation or review report date. [Footnote added, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Footnote renumbered by the issuance of SSARS No. 17, February 2008.]

actions contemplated herein. [Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.78** After the date of the accountant's compilation or review report, the accountant has no obligation to perform other compilation or review procedures with respect to the financial statements, unless new information comes to his or her attention. However, when the accountant becomes aware of information that relates to financial statements previously reported on by him or her, but that was not known to the accountant at the date of the report, and that is of such a nature and from such a source that the accountant would have investigated it had it come to his or her attention during the course of the compilation or review, the accountant should, as soon as practicable, undertake to determine whether the information is reliable and whether the facts existed at the date of the report. In this connection, the accountant should discuss the matter with his or her client at whatever management levels the accountant deems appropriate, including the board of directors, and request cooperation in whatever investigation may be necessary. If the nature and effect of the matter are such that (a) the accountant's report or the financial statements would have been affected if the information had been known to the accountant at the accountant's compilation or review report date and had not been reflected in the financial statements and (b) the accountant believes that there are persons currently using or likely to use the financial statements who would attach importance to the information, the accountant should:

- In a compilation engagement, obtain additional or revised information.
- In a review engagement, perform the additional procedures deemed necessary to achieve limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles.

With respect to (b), consideration should be given, among other things, to the time elapsed since the financial statements were issued. [Paragraph added, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.79** When the accountant has concluded, after considering (a) and (b) in paragraph .78 as appropriate, that action should be taken to prevent further use of the accountant's report or the financial statements, the accountant should advise his or her client to make appropriate disclosure of the newly discovered facts and their impact on the financial statements to persons who are known to be currently using or who are likely to use the financial statements. When the client undertakes to make appropriate disclosure, the method used and the disclosure made will depend on the circumstances.

- a. If the effect on the accountant's report or the financial statements of the subsequently discovered information can promptly be determined, disclosure should consist of issuing, as soon as practicable, revised financial statements and, where applicable, the accountant's report. The reasons for the revision usually should be described in a note to the financial statements and, where applicable, referred to in the accountant's report.

Generally, only the most recently-issued compiled or reviewed financial statements would need to be revised, even though the revision resulted from events that had occurred in prior years.<sup>39</sup>

- b. When issuance of financial statements for a subsequent period is imminent, so that disclosure is not delayed, appropriate disclosure of the revision can be made in such statements instead of reissuing the earlier statements pursuant to subparagraph (a).<sup>40</sup>
- c. When the effect on the financial statements of the subsequently discovered information cannot be promptly determined, the issuance of revised financial statements would necessarily be delayed. In this circumstance, when it appears that the information will require a revision of the statements, appropriate disclosure would consist of notification by the client to persons who are known to be using or who are likely to use the financial statements that they should not be used, and that revised financial statements will be issued and, where applicable, the accountant's report will be issued as soon as practicable.

[Paragraph added, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.80** The accountant should take whatever steps he or she deems necessary to satisfy himself or herself that the client has made the disclosures specified in paragraph .79. [Paragraph added, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.81** If the client refuses to make the disclosures specified in paragraph .79, the accountant should notify the appropriate personnel at the highest levels within the entity, such as the manager (owner) or the board of directors, of such refusal and of the fact that, in the absence of disclosure by the client, the accountant will take steps as outlined in the following to prevent further use of the financial statements and, if applicable, the accountant's report. The steps that can appropriately be taken will depend upon the degree of certainty of the accountant's knowledge that there are persons who are currently using or who will use the financial statements and, if applicable, the accountant's report, and who would attach importance to the information, and the accountant's ability as a practical matter to communicate with them. Unless the accountant's attorney recommends a different course of action, the accountant should take the following steps to the extent applicable:

- a. Notification to the client that the accountant's report must no longer be associated with the financial statements.
- b. Notification to the regulatory agencies having jurisdiction over the client that the accountant's report should no longer be used.

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<sup>39</sup> See FASB ASC 250-10-45 and FASB ASC 250-10-50 regarding disclosure of adjustments applicable to prior periods. [Footnote added, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Footnote renumbered by the issuance of SSARS No. 17, February 2008. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

<sup>40</sup> See FASB ASC 250-10-45 and FASB ASC 250-10-50 regarding disclosure of adjustments applicable to prior periods. [Footnote added, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Footnote renumbered by the issuance of SSARS No. 17, February 2008. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

- c. Notification to each person known to the accountant to be using the financial statements that the financial statements and the accountant's report should no longer be used. In many instances, it will not be practicable for the accountant to give appropriate individual notification to stakeholders whose identities ordinarily are unknown to him or her; notification to a regulatory agency having jurisdiction over the client will usually be the only practicable way for the accountant to provide appropriate disclosure. Such notification should be accompanied by a request that the agency take whatever steps it may deem appropriate to accomplish the necessary disclosure.

Although a compilation report does not express any form of assurance on the financial statements, it would seldom be appropriate for an accountant to conclude, simply because his or her responsibilities were limited to a compilation service, that notification of third party users in the absence of notification by the client is not required when the accountant knows that the financial statements should be revised. [Paragraph added, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.82** The following guidelines should govern the content of any disclosure made by the accountant in accordance with paragraph .81 to persons other than his or her client:

- a. The disclosure should include a description of the nature of the subsequently acquired information and its effect on the financial statements.
- b. The information disclosed should be as precise and factual as possible and should not go beyond that which is reasonably necessary to accomplish the purpose mentioned in the preceding subparagraph (a). Comments concerning the conduct or motives of any person should be avoided.

If the client has not cooperated, the accountant's disclosure need not detail the specific information but can merely indicate that information has come to his or her attention which the client has not cooperated in attempting to substantiate and that, if the information is true, the accountant believes that the compilation or review report must no longer be used or associated with the financial statements. No such disclosure should be made unless the accountant believes that the financial statements are likely to be misleading and that the accountant's compilation or review report should not be used. [Paragraph added, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## Supplementary Information

**.83** When the basic financial statements are accompanied by information presented for supplementary analysis purposes, the accountant should clearly indicate the degree of responsibility, if any, he or she is taking with respect to such information.

- When the accountant has reviewed the basic financial statements, an explanation should be included in the review report, or in a separate report on the other data. The report should state that the review has been made for the purpose of expressing limited assurance that there are no material modifications that should be made to the financial

statements in order for them to be in conformity with generally accepted accounting principles, and either

- a. The other data accompanying the financial statements are presented only for supplementary analysis purposes and have been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements, and the accountant did not become aware of any material modifications that should be made to such data, or
- b. The other data accompanying the financial statements are presented only for supplementary analysis purposes and have not been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements, but were compiled from information that is the representation of management, without audit or review, and the accountant does not express an opinion or any other form of assurance on such data.

When the accountant has compiled both the basic financial statements and other data presented only for supplementary analysis purposes, the compilation report should refer to the other data or the accountant can issue a separate report on the other data. If a separate report is issued, the report should state that the other data accompanying the financial statements are presented only for supplementary analysis purposes and that the information has been compiled from information that is the representation of management, without audit or review, and the accountant does not express an opinion or any other form of assurance on such data.

[Paragraph renumbered and amended, effective November 2002, by SSARS No. 9. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

## **Communicating to Management and Others**

**.84** When evidence or information comes to the accountant's attention during the performance of compilation or review procedures that fraud or an illegal act may have occurred,<sup>41</sup> that matter should be brought to the attention of the appropriate level of management. The accountant need not report matters regarding illegal acts that are clearly inconsequential and may reach agreement in advance with the entity on the nature of such items to be communicated. When matters regarding fraud or an illegal act involve senior management, the accountant should report the matter to an individual or group at a higher level within the entity, such as the manager (owner) or the board of directors. The communication may be oral or written. If the communication is oral, the accountant should document it. When matters regarding fraud or an illegal act involve an owner of the business, the accountant should consider resigning

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<sup>41</sup> See Interpretation No. 6, "Withdrawal From Compilation or Review Engagement," of AR section 100 [AR section 9100.20–.24] for guidance on the circumstances under which the accountant would ordinarily conclude that it is necessary to withdraw from a compilation or review engagement. [Footnote added, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12. Footnote renumbered by the issuance of SSARS No. 15, July 2007. Footnote renumbered by the issuance of SSARS No. 17, February 2008.]

from the engagement.<sup>[42]</sup> Additionally, the accountant should consider consulting with his or her legal counsel and insurance provider whenever any evidence or information comes to his or her attention during the performance of compilation or review procedures that fraud or an illegal act may have occurred, unless such illegal act is clearly inconsequential. [Paragraph added, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.85** The disclosure of any evidence or information that comes to the accountant's attention during the performance of compilation or review procedures that fraud or an illegal act may have occurred to parties other than the client's senior management (or the client's board of directors, if applicable) ordinarily is not part of the accountant's responsibility and ordinarily would be precluded by the accountant's ethical or legal obligations of confidentiality. The accountant should recognize, however, that in the following circumstances a duty to disclose to parties outside of the entity may exist:

- a. To comply with certain legal and regulatory requirements
- b. To a successor accountant when the successor decides to communicate with the predecessor accountant in accordance with AR section 400, *Communications Between Predecessor and Successor Accountants*, regarding acceptance of an engagement to compile or review the financial statements of a nonissuer
- c. In response to a subpoena

Because potential conflicts between the accountant's ethical and legal obligations for confidentiality of client matters may be complex, the accountant may wish to consult with legal counsel before discussing matters covered by paragraph .84 with parties outside the client. [Paragraph added, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008, by SSARS No. 17.]

## Change in Engagement From Audit to Review or Compilation (or From Review to Compilation)

**.86** An accountant who has been engaged to audit the financial statements of a nonissuer in accordance with generally accepted auditing standards (or an accountant who has been engaged to review the financial statements of a nonissuer in accordance with SSARSs) may, before the completion of the audit (review), be requested to change the engagement to a review or compilation (compilation) of financial statements. A request to change the engagement may result from a change in circumstances affecting the entity's requirement for an audit (review), a misunderstanding as to the nature of an audit, review, or compilation, or a restriction on the scope of the audit (review), whether imposed by the client or caused by circumstances. [Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the

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<sup>[42]</sup> [Footnote renumbered and deleted by the issuance of SSARS No. 15, July 2007. Footnote renumbered by the issuance of SSARS No. 17, February 2008.]



## **1444**      **Statements on Standards for Accounting and Review Services**

issuance of SSARS No. 15, July 2007. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008, by SSARS No. 17.]

**.87** Before an accountant who was engaged to perform an audit in accordance with generally accepted auditing standards (or a review in accordance with SSARSs) agrees to change the engagement to a review or compilation (compilation), at least the following should be considered:

- a. The reason given for the client's request, particularly the implications of a restriction on the scope of the audit (review), whether imposed by the client or by circumstances.
- b. The additional audit (review) effort required to complete the audit (review).
- c. The estimated additional cost to complete the audit (review).

[Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.88** A change in circumstances that affects the entity's requirement for an audit (review), or a misunderstanding concerning the nature of an audit, review or compilation would ordinarily be considered a reasonable basis for requesting a change in the engagement. [Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.89** In considering the implications of a restriction on the scope of the audit (review), the accountant should evaluate the possibility that information affected by the scope restriction may be incorrect, incomplete, or otherwise unsatisfactory. Nevertheless, when the accountant has been engaged to audit an entity's financial statements and has been prohibited by the client from corresponding with the entity's legal counsel, the accountant ordinarily would be precluded from issuing a review or compilation report on the financial statements. If in an audit or a review engagement a client does not provide the accountant with a signed representation letter, the accountant would be precluded from issuing a review report on the financial statements and would ordinarily be precluded from issuing a compilation report on the financial statements. [Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.90** In all circumstances, if the auditing (review) procedures are substantially complete or the cost to complete such procedures is relatively insignificant, the accountant should consider the propriety of accepting a change in the engagement. [Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.91** If the accountant concludes, based upon his or her professional judgment, that there is reasonable justification to change the engagement and if he or she complies with the standards applicable to the changed engagement, the accountant should issue an appropriate review or compilation report. The report should not include reference to (a) the original engagement, (b) any auditing or review procedures that may have been performed, or (c) scope limitations that resulted in the changed engagement. [Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## Comparative Financial Statements

**[.92]**<sup>[43]</sup> [Paragraph deleted by the issuance of SSARS No. 2, November 1979. Paragraph renumbered by the issuance of SSARS No. 8, October 2000. Paragraph subsequently renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## Relationship of Statements on Standards for Accounting and Review Services to Quality Control Standards

**.93** An accountant is responsible for compliance with Statements on Standards for Accounting and Review Services (SSARSs) in a review or compilation engagement. Rule 202 [ET section 202.01] of the Code of Professional Conduct of the American Institute of Certified Public Accountants requires members to comply with such standards when associated with reviewed or compiled financial statements. [Paragraph added, effective for review reports dated January 1, 2003, or after, by SSARS No. 9. Paragraph renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

**.94** An accountant has the responsibility to adopt a system of quality control in conducting an accounting practice.<sup>44</sup> Thus, a firm should establish quality control policies and procedures to provide it with reasonable assurance that its personnel comply with SSARS in its review and compilation engagements.

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<sup>[43]</sup> [Footnote deleted. Footnote renumbered by the issuance of SSARS No. 9, November 2002. Footnote subsequently renumbered by the issuance of SSARS No. 12, July 2005. Footnote renumbered by the issuance of SSARS No. 15, July 2007. Footnote renumbered by the issuance of SSARS No. 17, February 2008.]

<sup>44</sup> The elements of a system of quality control are identified in Statement on Quality Control Standards (SQCS) No. 7, *A Firm's System of Quality Control* [QC section 10]. A system of quality control consists of policies designed to provide the firm with reasonable assurance that the firm and its personnel comply with professional standards and applicable legal and regulatory requirements and that reports issued by the firm are appropriate in the circumstances, and the procedures necessary to implement and monitor compliance with those policies. [Footnote added, effective November 2002, by SSARS No. 9. Footnote renumbered by the issuance of SSARS No. 12, July 2005. Footnote renumbered by the issuance of SSARS No. 15, July 2007. Footnote renumbered by the issuance of SSARS No. 17, February 2008. Footnote amended due to the issuance of SQCS No. 7, December 2008.]

The nature and extent of a firm's quality control policies and procedures depend on factors such as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations. [Paragraph added, effective for review reports dated January 1, 2003, or after, by SSARS No. 9. Paragraph renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

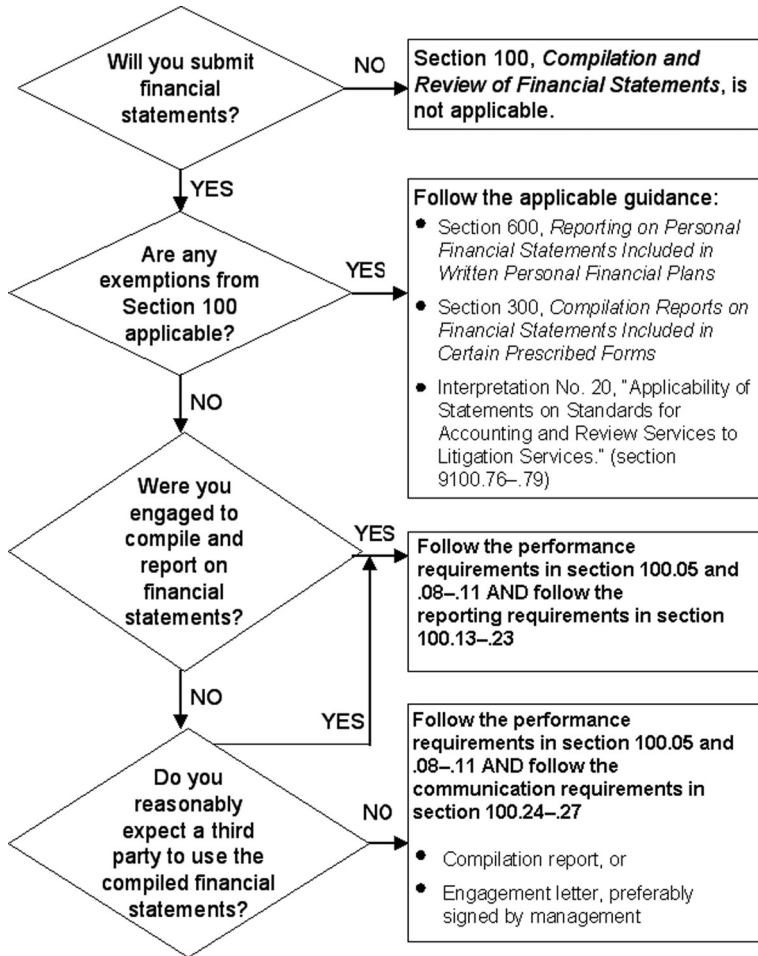
**.95** SSARSs relate to the conduct on individual review and compilation engagements; Statements on Quality Control Standards (SQCSs) relate to the conduct of a firm's accounting practice. Thus, SSARSs and SQCSs are related, and the quality control policies and procedures that a firm adopts may affect both the conduct of an individual engagement and the firm's accounting practice as a whole. However, deficiencies in or instances of noncompliance with a firm's quality control policies and procedures do not, in and of themselves, indicate that a particular review or compilation engagement was not performed in accordance with SSARSs. [Paragraph added, effective for review reports dated January 1, 2003, or after, by SSARS No. 9. Paragraph renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## **Effective Date**

**.96** This section is effective for compilations and reviews of financial statements for periods ending on or after July 1, 1979. Paragraphs .01–.27 and Appendix A [paragraph .97] and Appendix D [paragraph .100] are effective for financial statements submitted after December 31, 2000. [Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## Appendix A

### Compilation of Financial Statements



[Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## Appendix B

### Review of Financial Statements—Illustrative Inquiries

The inquiries to be made in a review of financial statements are a matter of the accountant's professional judgment. In determining the appropriate inquiries, an accountant may consider (a) the nature and materiality of the items reflected in the financial statements, (b) the likelihood of a misstatement in the financial statements, (c) knowledge obtained during current and previous engagements, (d) the stated qualifications of the entity's accounting personnel, (e) the extent to which a particular item is affected by management's judgment, and (f) inadequacies in the entity's underlying financial data. The inquiries should generally be made of members of management with financial reporting and accounting responsibilities.

The following list of inquiries is for illustrative purposes only. These inquiries will not necessarily be applicable in every review engagement, nor are these inquiries meant to be all-inclusive. These illustrative inquiries are not intended to serve as a program or checklist to be utilized in performing a review engagement; rather, they address general areas where inquiries might be made in a review engagement. Also, the accountant may feel it necessary to make several inquiries in an effort to answer questions related to the issues addressed in these illustrative inquiries.

#### 1. General

- a. Have there been any changes in the entity's business activities?
- b. Are there any unusual or complex situations that may have an effect on the financial statements (for example, business combinations, restructuring plans, or litigation)?
- c. What procedures are in place related to recording, classifying, and summarizing transactions and accumulating information related to financial statement disclosures?
- d. Have the financial statements been prepared in conformity with generally accepted accounting principles or, if appropriate, a comprehensive basis of accounting other than generally accepted accounting principles? Have there been any changes in accounting principles and methods of applying those principles? Have voluntary changes in accounting principles been reflected in the financial statements through retrospective application of the new principle in comparative financial statements?
- e. Have there been any instances of fraud or illegal acts within the entity?
- f. Have there been any allegations or suspicions that fraud or illegal acts might have occurred or might be occurring within the entity? If so, where and how?
- g. Are any entities, other than the reporting entity, commonly controlled by the owners? If so, has an evaluation been performed to determine whether those other entities should be consolidated into the financial statements of the reporting entity?



- c.* Has interest earned on receivables been properly reflected in the financial statements?
  - d.* Has there been a proper cutoff of sales transactions?
  - e.* Have there been any changes in major contracts with customers that may impact the classification or valuation of receivables?
  - f.* Are there receivables from employees or other related parties? Have receivables from owners been evaluated to determine if they should be reflected in the equity section (rather than the asset section) of the balance sheet?
  - g.* Are any receivables pledged, discounted, or factored? Are recourse provisions properly reflected in the financial statements?
  - h.* Have receivables been properly classified between current and non-current?
  - i.* Have there been significant numbers of sales returns or credit memoranda issued subsequent to the balance sheet date?
  - j.* Is the accounts receivable subsidiary ledger reconciled to the general ledger account balance on a regular basis?
4. Inventory
- a.* Are physical inventory counts performed on a regular basis, including at the end of the reporting period? Are the count procedures adequate to ensure an appropriate count? If not, how have amounts related to inventories been determined for purposes of financial statement presentation? If so, what procedures were used to take the latest physical inventory and what date was that inventory taken?
  - b.* Have general ledger control accounts been adjusted to agree with the physical inventory count? If so, were the adjustments significant?
  - c.* If the physical inventory counts were taken at a date other than the balance sheet date, what procedures were used to determine changes in inventory between the date of the physical inventory counts and the balance sheet date?
  - d.* Were consignments in or out considered in taking physical inventories?
  - e.* What is the basis of valuing inventory for purposes of financial statement presentation?
  - f.* Does inventory cost include material, labor, and overhead where applicable?
  - g.* Has inventory been reviewed for obsolescence or cost in excess of net realizable value? If so, how are these costs reflected in the financial statements?
  - h.* Have proper cutoffs of purchases, goods in transit, and returned goods been made?
  - i.* Are there any inventory encumbrances?
  - j.* Is scrap inventoried and controlled?
  - k.* Have abnormal costs related to inventory been expensed as incurred?
5. Prepaid Expenses
- a.* What is the nature of the amounts included in prepaid expenses?
  - b.* How are these amounts being amortized?

## 6. Investments

- a. What is the basis of accounting for investments reported in the financial statements (for example, securities, joint ventures, or closely-held businesses)?
- b. Are derivative instruments properly measured and disclosed in the financial statements? If those derivatives are utilized in hedge transactions, have the documentation or assessment requirements related to hedge accounting been met?
- c. Are investments in marketable debt and equity securities properly classified as trading, available-for-sale, and held-to-maturity?
- d. How were fair values of the reported investments determined? Have unrealized gains and losses been properly reported in the financial statements?
- e. If the fair values of marketable debt and equity securities are less than cost, have the declines in value been evaluated to determine whether the declines are other-than-temporary?
- f. For any debt securities classified as held-to-maturity, does management have the positive ability and intent to hold the securities until they mature? If so, have those debt securities been properly measured?
- g. Have gains and losses related to disposal of investments been properly reflected in the financial statements?
- h. How was investment income determined? Is investment income properly reflected in the financial statements?
- i. Has appropriate consideration been given to the classification of investments between current and noncurrent?
- j. For investments made by the reporting entity, have consolidation, equity, or cost method accounting requirements been considered?
- k. Are any investments encumbered?

## 7. Property and Equipment

- a. Are property and equipment items properly stated at depreciated cost or other proper value?
- b. When was the last time a physical inventory of property and equipment was taken?
- c. Are all items reflected in property and equipment held for use? If not, have items that are held for sale been properly reclassified from property and equipment?
- d. Have gains or losses on disposal of property and equipment been properly reflected in the financial statements?
- e. What are the criteria for capitalization of property and equipment? Have the criteria been consistently and appropriately applied?
- f. Are repairs and maintenance costs properly reflected as an expense in the income statement?
- g. What depreciation methods and rates are utilized in the financial statements? Are these methods and rates appropriate and applied on a consistent basis?
- h. Are there any unrecorded additions, retirements, abandonments, sales, or trade-ins?



- i.* Does the entity have any material lease agreements? If so, have those agreements been properly evaluated for financial statement presentation purposes?
  - j.* Are there any asset retirement obligations associated with tangible long-lived assets? If so, has the recorded amount of the related asset been increased because of the obligation and is the liability properly reflected in the liability section of the balance sheet?
  - k.* Has the entity constructed any of its property and equipment items? If so, have all components of cost been reflected in measuring these items for purposes of financial statement presentation, including, but not limited to, capitalized interest?
  - l.* Has there been any significant impairment in value of property and equipment items? If so, has any impairment loss been properly reflected in the financial statements?
  - m.* Are any property and equipment items mortgaged or otherwise encumbered? If so, are these mortgages and encumbrances properly reflected in the financial statements?
8. Intangibles and Other Assets
- a.* What is the nature of the amounts included in other assets?
  - b.* Do these assets represent costs that will benefit future periods? What is the amortization policy related to these assets? Is this policy appropriate?
  - c.* Have other assets been properly classified between current and non-current?
  - d.* Are intangible assets with finite lives being appropriately amortized?
  - e.* Are the costs associated with computer software properly reflected as intangible assets (rather than property and equipment) in the financial statements?
  - f.* Are the costs associated with goodwill (and other intangible assets with indefinite lives) properly reflected as intangible assets in the financial statements? Has amortization ceased related to these assets?
  - g.* Has there been any significant impairment in value of these assets? If so, has any impairment loss been properly reflected in the financial statements?
  - h.* Are any of these assets mortgaged or otherwise encumbered?
9. Accounts and Short-Term Notes Payable and Accrued Liabilities
- a.* Have significant payables been reflected in the financial statements?
  - b.* Are loans from financial institutions and other short-term liabilities properly classified in the financial statements?
  - c.* Have there been any changes in major contracts with suppliers that may impact the classification or valuation of payables?
  - d.* Have significant accruals (for example, payroll, interest, provisions for pension and profit-sharing plans, or other postretirement benefit obligations) been properly reflected in the financial statements?
  - e.* Has a liability for employees' compensation for future absences been properly accrued and disclosed in the financial statements?



## 1454 Statements on Standards for Accounting and Review Services

- f.* Is the entity responsible for any environmental remediation liability? If so, is this liability properly measured and disclosed in the financial statements?
- g.* Does the entity have any agreement to repurchase items that previously were sold? If so, have the repurchase agreements been taken into account in determining the appropriate measurements and disclosures in the financial statements?
- h.* Does the entity have any sales commitments at prices expected to result in a loss at the consummation of the sale? If so, are these commitments properly reflected in the financial statements?
- i.* Are there any violations, or possible violations, of laws or regulations the effects of which should be considered for financial statement accrual or disclosure?

### 13. Equity

- a.* What is the nature of any changes in equity accounts during each reporting period?
- b.* What classes of stock (other ownership interests) have been authorized?
- c.* What is the par or stated value of the various classes of stock (other ownership interests)?
- d.* Do amounts of outstanding shares of stock (other ownership interests) agree with subsidiary records?
- e.* Have pertinent rights and privileges of ownership interests been properly disclosed in the financial statements?
- f.* Does the entity have any mandatorily redeemable ownership interests? If so, have these ownership interests been evaluated so that a proper determination has been made related to whether these ownership interests should be measured and reclassified to the liability section of the balance sheet? Are redemption features associated with ownership interests clearly disclosed in the financial statements?
- g.* Have dividend (distribution) and liquidation preferences related to ownership interests been properly disclosed in the financial statements?
- h.* Do disclosures related to ownership interests include any applicable call provisions (prices and dates), conversion provisions (prices and rates), unusual voting rights, significant terms of contracts to issue additional ownership interests, or any other unusual features associated with the ownership interests?
- i.* Are syndication fees properly reflected in the financial statements as a reduction of equity (rather than an asset)?
- j.* Have any stock options or other stock compensation awards been granted to employees or others? If so, are these options or awards properly measured and disclosed in the financial statements?
- k.* Has the entity made any acquisitions of its own stock? If so, are the amounts associated with these reacquired shares properly reflected in the financial statements as a reduction in equity? Is the presentation in accordance with applicable state laws?
- l.* Are there any restrictions or appropriations on retained earnings or other capital accounts? If so, are these restrictions or appropriations properly reflected in the financial statements?

14. Revenue and Expenses
  - a. What is the entity's revenue recognition policy? Is the policy appropriate? Has the policy been consistently applied and appropriately disclosed?
  - b. Are revenues from sales of products and rendering of services recognized in the appropriate reporting period (that is, when the products have been delivered and when the services have been performed)?
  - c. Were any sales recorded under a "bill and hold" arrangement? If yes, have the criteria been met to record the transaction as a sale?
  - d. Are purchases and expenses recognized in the appropriate reporting period (that is, matched against revenue) and properly classified in the financial statements?
  - e. Do the financial statements include discontinued operations, items that might be considered extraordinary, or both? If so, are amounts associated with discontinued operations, extraordinary items, or both properly displayed in the income statement?
  - f. Does the entity have any gains or losses that would necessitate the display of comprehensive income (for example, gains/losses on available-for-sale securities or cash flow hedge derivatives)? If so, have these items been properly displayed within comprehensive income (rather than included in the determination of net income)?
15. Other
  - a. Have events occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial statements?
  - b. Has the entity considered whether declines in market values subsequent to the balance sheet date may be permanent and/or caused the entity to no longer be in compliance with its loan covenants?
  - c. Have actions taken at stockholders, directors, committees of directors, or comparable meetings that affect the financial statements been reflected in the financial statements?
  - d. Are significant estimates and material concentrations (for example, customers or suppliers) properly disclosed in the financial statements?
  - e. Are there plans or intentions that may materially affect the carrying amounts or classification of assets and liabilities reflected in the financial statements?
  - f. Have there been any material transactions between or among related parties (for example, sales, purchases, loans, or leasing arrangements)? If so, are these transactions properly disclosed in the financial statements?
  - g. Are there uncertainties that could have a material impact on the financial statements? Is there any change in the status of previously disclosed material uncertainties? Are all uncertainties, including going concern matters, that could have a material impact on the financial statements properly disclosed in the financial statements?
  - h. Are barter or other nonmonetary transactions properly recorded and disclosed? Have nonmonetary asset exchanges involving commercial substance been reflected in the financial statements at fair value? Have nonmonetary asset exchanges not involving commercial substance been reflected in the financial statements at carrying value?

**1456**      **Statements on Standards for Accounting and Review Services**

[Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2004, by SSARS No. 10. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Revised, September 2005, to reflect conforming changes necessary due to the issuance of recent authoritative literature. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008. Paragraph revised, December 2008. Paragraph revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

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## Appendix C

### Compilation of Financial Statements—Illustrative Engagement Letter

*[Appropriate Salutation]*

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, the annual [*and interim, if applicable*] balance sheet and related statements of income, retained earnings, and cash flows of XYZ Company for the year 20XX.

We will compile the financial statements and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to present in the form of financial statements, information that is the representation of management (owners) without undertaking to express any assurance on the financial statements.

A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; tests of accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Therefore, a compilation does not provide a basis for expressing any level of assurance on the financial statements being compiled.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts that may exist. However, we will inform the appropriate level of management of any material errors, and of any evidence or information that comes to our attention during the performance of our compilation procedures, that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

As part of our engagement, we will also (list any nonattest services to be performed, if applicable, such as income tax preparation and bookkeeping services).

You are responsible for:

- a. Making all management decisions and performing all management functions;
- b. Designating an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;
- c. Evaluating the adequacy and results of the services performed;

**1458**      **Statements on Standards for Accounting and Review Services**

- d. Accepting responsibility for the results of the services; and
- e. Establishing and maintaining internal control, including monitoring ongoing activities.

If, for any reason, we are unable to complete the compilation of your financial statements, we will not issue a report on such statements as a result of this engagement.

Our fees for these services . . . .

We will be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.\*

Sincerely yours,

\_\_\_\_\_  
[Signature of accountant]

Acknowledged:  
XYZ Company

\_\_\_\_\_  
President

\_\_\_\_\_  
Date

[Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Revised, September 2005, to reflect conforming changes necessary due to the issuance of SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008, by SSARS No. 17.]

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\* Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning, "If the foregoing..." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement..."

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## Appendix D

### Compilation of Financial Statements Not Intended for Third Party Use—Illustrative Engagement Letter

*[Appropriate Salutation]*

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, the [*monthly, quarterly, or other frequency*] financial statements of XYZ Company for the year 20XX.

We will compile the financial statements in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation engagement is to present in the form of financial statements, information that is the representation of management (owners) without undertaking to express any assurance on the financial statements.

A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; tests of accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Therefore, a compilation does not provide a basis for expressing any level of assurance on the financial statements being compiled.

The financial statements will not be accompanied by a report. Based upon our discussions with you, these statements are for management's use only and are not intended for third-party use.

Material departures from generally accepted accounting principles (GAAP) may exist and the effects of those departures, if any, on the financial statements may not be disclosed. In addition substantially all disclosures required by GAAP may be omitted. (The accountant may wish to identify known departures.) Notwithstanding these limitations, you represent that you have knowledge about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements that allows you to place the financial information in the proper context. Further, you represent and agree that the use of the financial statements will be limited to members of management with similar knowledge.

The financial statements are intended solely for the information and use of [*include list of specified members of management*] and are not intended to be and should not be used by any other party—[*optional*].

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts that may exist. However, we will inform the appropriate level of management of any material errors and of any evidence or information that comes to our attention during the performance of our compilation procedures, that fraud may have occurred. In addition, we will report to you any evidence or



## 1460 Statements on Standards for Accounting and Review Services

information that comes to our attention during the performance of our compilation procedures, regarding illegal acts that may have occurred unless they are clearly inconsequential.

We are not independent with respect to [*name of entity*] [*if applicable*].

As part of our engagement, we will also (list any nonattest services to be provided, if applicable, such as income tax preparation and bookkeeping services).

You are responsible for:

- a. Making all management decisions and performing all management functions;
- b. Designating an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;
- c. Evaluating the adequacy and results of the services performed;
- d. Accepting responsibility for the results of the services; and
- e. Establishing and maintaining internal control, including monitoring ongoing activities.

The other data accompanying the financial statements are presented only for supplementary analysis purposes and will be compiled from information that is the representation of management, without audit or review, and we do not express an opinion or any other form of assurance on such data—[*if applicable*].

Our fees for these services . . .

Should you require financial statements for third-party use, we would be pleased to discuss with you the requested level of service. Such engagement would be considered separate and not deemed to be part of the services described in this engagement letter.

We will be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.\*

Sincerely yours,

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[*Signature of accountant*]

Accepted and agreed to:

XYZ Company

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Title

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Date

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[Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July

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\* Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning, "If the foregoing . . ." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement . . ."

2005. Revised, September 2005, to reflect conforming changes necessary due to the issuance of SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008, by SSARS No. 17.]

## Appendix E

### Review of Financial Statements—Illustrative Engagement Letter

*[Appropriate Salutation]*

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will review the financial statements of XYZ Company as of December 31, 20XX, and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a review engagement is to express limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in accordance with generally accepted accounting principles.

A review differs significantly from an audit of financial statements, in which the auditor provides reasonable assurance that the financial statements, taken as a whole, are free of material misstatement. A review does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; tests of accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); and other procedures ordinarily performed in an audit. Accordingly, a review does not provide assurance that we will become aware of all significant matters that would be disclosed in an audit. Therefore, a review provides only limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts that may exist. However, we will inform the appropriate level of management of any material errors, and of any evidence or information that comes to our attention during the performance of our review procedures, that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our review procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

As part of our engagement, we will also (list any nonattest services to be provided, if applicable, such as income tax preparation and bookkeeping services).

You are responsible for:

- a. Making all management decisions and performing all management functions;
- b. Designating an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;
- c. Evaluating the adequacy and results of the services performed;

- d. Accepting responsibility for the results of the services; and
- e. Establishing and maintaining internal control, including monitoring ongoing activities.

As part of our review procedures, we will require certain written representations from management about the financial statements and matters related thereto.

If, for any reason, we are unable to complete our review of your financial statements, we will not issue a report on such statements as a result of this engagement.

Our fees for these services. . . .

We will be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

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[*Signature of accountant*]

Acknowledged:  
XYZ Company

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President

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Date

[Paragraph renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Revised, September 2005, to reflect conforming changes necessary due to the issuance of SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008, by SSARS No. 17.]

## Appendix F

### Review of Financial Statements—Illustrative Representation Letter

A review of financial statements consists principally of inquiries of company personnel and analytical procedures applied to financial data. As part of a review of financial statements, the accountant is required to obtain a written representation from his or her client to confirm the oral representations made to the accountant. The introductory paragraph should specify the financial statements and periods covered by the accountant's review report.

If matters exist that should be disclosed to the accountant, they should be indicated by listing them following the representation. For example, if an event subsequent to the date of the balance sheet has been disclosed in the financial statements, the subsequent events paragraph could be modified as follows: "To the best of our knowledge and belief, except as discussed in Note X to the financial statements, no events have occurred. . . ." Similarly, in appropriate circumstances, item 4 could be modified as follows: "The company has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities, except for our plans to dispose of Segment A, as disclosed in Note X to the financial statements, which are discussed in the minutes of the December 7, 20X1, meeting of the board of directors."

The following representation letter is included for illustrative purposes only. The accountant may decide, based on the circumstances of the review engagement or the industry in which the entity operates, that other matters should be specifically included in the letter or that some of the representations included in the illustrative letter are not necessary.

(Date<sup>1</sup>)

(To the Accountant)

We are providing this letter in connection with your review of the (identification of financial statements) of (name of entity) as of (dates, for example, December 31, 20X1 and December 31, 20X2) and for the (periods of review, for example, for the years then ended) for the purpose of expressing limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles. We confirm that we are responsible for the fair presentation in the financial statements of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the

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<sup>1</sup> This date should be the date that the client presents and signs the letter. In no event should the letter be presented and signed prior to the date of the accountant's review report. [Footnote added, August 2004, to reflect conforming changes necessary due to the issuance of SSARS No. 10. As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

light of surrounding circumstances, makes it probable that the judgment of a reasonable person using the information would be changed or influenced by the omission or misstatement.<sup>2</sup>

We confirm, to the best of our knowledge and belief, [as of (*the date of the accountant's review report*)] the following representations made to you during your review.

1. The financial statements referred to previously are fairly presented in conformity with generally accepted accounting principles.
2. We have made available to you all:
  - a. Financial records and related data.
  - b. Minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared.
3. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.
4. We acknowledge our responsibility to prevent and detect fraud.
5. We have no knowledge of any fraud or suspected fraud affecting the entity involving management or others where the fraud could have a material effect on the financial statements, including any communications received from employees, former employees or others.
6. We have no plans or intentions that may materially affect the carrying amounts or classification of assets and liabilities.
7. There are no material losses (such as from obsolete inventory or purchase or sales commitments) that have not been properly accrued or disclosed in the financial statements.
8. There are no:
  - a. Violations or possible violations of laws or regulations, whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency
  - b. Unasserted claims or assessments that our lawyer has advised us are probable of assertion that must be disclosed in accordance with Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 450, *Contingencies*.<sup>3</sup>
  - c. Other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB ASC 450

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<sup>2</sup> The qualitative discussion of materiality used in this letter is adapted from Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information*. [Footnote renumbered, August 2004, to reflect conforming changes necessary due to the issuance of SSARS No. 10.]

<sup>3</sup> If management has not consulted a lawyer regarding litigation, claims, and assessments, the representation might be worded as follows:

We are not aware of any pending or threatened litigation, claims, or assessments or unasserted claims or assessments that are required to be accrued or disclosed in the financial statements in accordance with Financial Accounting Standards Board *Accounting Standards Codification* 450, *Contingencies*, and we have not consulted a lawyer concerning litigation, claims, or assessments.

[Footnote renumbered, August 2004, to reflect conforming changes necessary due to the issuance of SSARS No. 10. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

## 1466 Statements on Standards for Accounting and Review Services

9. The company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets, nor has any asset been pledged as collateral, except as disclosed to you and reported in the financial statements.
10. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
11. The following have been properly recorded or disclosed in the financial statements:
  - a. Related party transactions, including sales, purchases, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.
  - b. Guarantees, whether written or oral, under which the company is contingently liable.
  - c. Significant estimates and material concentrations known to management that are required to be disclosed in accordance with FASB ASC 275, *Risks and Uncertainties*. [Significant estimates are estimates at the balance sheet date that could change materially with the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year.]

*[Add additional representations that are unique to the entity's business or industry. See the following for additional illustrative representations.]*

12. We are in agreement with the adjusting journal entries you have recommended, and they have been posted to the company's accounts. (if applicable)
13. To the best of our knowledge and belief, no events have occurred subsequent to the balance-sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.<sup>4</sup>
14. We have responded fully and truthfully to all inquiries made to us by you during your review.

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(Name of Owner or Chief Executive Officer and Title)

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(Name of Chief Financial Officer and Title, where applicable)

Representation letters ordinarily should be tailored to include additional appropriate representations from management relating to matters specific to the entity's business or industry. The following is a list of additional representations that may be appropriate in certain situations. This list is not intended to be all-inclusive. The accountant should consider the effects of pronouncements issued subsequent to the issuance of this section.

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<sup>4</sup> If the accountant "dual dates" his or her report, the accountant should consider whether obtaining additional representations relating to the subsequent event is appropriate. [Footnote added, August 2004, to reflect conforming changes necessary due to the issuance of SSARS No. 10.]

<i>General</i>	
<i>Condition</i>	<i>Illustrative Examples</i>
The impact of a new accounting principle is not known.	We have not completed the process of evaluating the impact that will result from adopting the guidance in Financial Accounting Standards Board (FASB) <i>Accounting Standards Codification</i> <sup>TM</sup> (ASC) Update 20YY-XX, as discussed in note [X]. The company is therefore unable to disclose the impact that adopting the guidance in FASB ASC Update 20YY-XX will have on its financial position and the results of operations when such statement is adopted.
There is justification for a change in accounting principles.	We believe that [ <i>describe the newly adopted accounting principle</i> ] is preferable to [ <i>describe the former accounting principle</i> ] because [ <i>describe management's justification for the change in accounting principles</i> ].
Financial circumstances are strained, with disclosure of management's intentions and the entity's ability to continue as a going concern.	Note [X] to the financial statements discloses all of the matters of which we are aware that are relevant to the company's ability to continue as a going concern, including significant conditions and events, and management's plans.
The possibility exists that the value of specific significant long-lived assets or certain identifiable intangibles may be impaired.	We have reviewed long-lived assets and certain identifiable intangibles to be held and used for impairment whenever events or changes in circumstances have indicated that the carrying amount of its assets might not be recoverable and have appropriately recorded the adjustment.
The entity has a variable interest in another entity.	<p>Variable interest entities (VIEs) and potential VIEs and transactions with VIEs and potential VIEs have been properly recorded and disclosed in the financial statements in accordance with GAAP.</p> <p>We have considered both implicit and explicit variable interests in (a) determining whether potential VIEs should be considered VIEs, (b) calculating expected losses and residual returns, and (c) determining which party, if any, is the primary beneficiary.</p> <p>We have provided you with lists of all identified variable interests in (a) VIEs, (b) potential VIEs that we considered but judged not to be VIEs, and (c) entities that were afforded the scope exceptions of FASB ASC 810, <i>Consolidation</i>.</p>

(continued)



<i>General</i>	
<i>Condition</i>	<i>Illustrative Examples</i>
	<p>We have advised you of all transactions with identified VIEs, potential VIEs, or entities afforded the scope exceptions of FASB ASC 810.</p> <p>We have made available all relevant information about financial interests and contractual arrangements with related parties, de facto agents, and other entities, including but not limited to their governing documents, equity and debt instruments, contracts, leases, guarantee arrangements, and other financial contracts and arrangements.</p> <p>The information we provided about financial interests and contractual arrangements with related parties, de facto agents, and other entities includes information about all transactions, unwritten understandings, agreement modifications, and written and oral side agreements.</p> <p>Our computations of expected losses and expected residual returns of entities that are VIEs and potential VIEs are based on the best information available and include all reasonably possible outcomes.</p> <p>Regarding entities in which the Company has variable interests (implicit and explicit), we have provided all information about events and changes in circumstances that could potentially cause reconsideration about whether the entities are VIEs or whether the Company is the primary beneficiary or has a significant variable interest in the entity.</p> <p>We have made and continue to make exhaustive efforts to obtain information about entities in which the Company has an implicit or explicit interest but that were excluded from complete analysis under FASB ASC 810 due to lack of essential information to determine one or more of the following: whether the entity is a VIE, whether the Company is the primary beneficiary, or what accounting is required to consolidate the entity.</p>
The work of a specialist has been used by the entity.	We agree with the findings of specialists in evaluating the [ <i>describe assertion</i> ] and have adequately considered the qualifications of the specialist in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give or cause any instructions to be given to specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an impact on the independence or objectivity of the specialists.

<i>Assets</i>	
<i>Condition</i>	<i>Illustrative Examples</i>
Cash Disclosure is required of compensating balances or other arrangements involving restrictions on cash balances, line of credit, or similar arrangements.	Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances, lines of credit, or similar arrangements have been properly disclosed.
Financial Instruments Management intends to and has the ability to hold to maturity debt securities classified as held-to-maturity.	Debt securities that have been classified as held-to-maturity have been so classified due to the company's intent to hold such securities to maturity and the company's ability to do so. All other debt securities have been classified as available-for-sale or trading.
Management considers the decline in value of debt or equity securities to be temporary.	We consider the decline in value of debt or equity securities classified as either available-for-sale or held-to-maturity to be temporary.
Management has determined the fair value of significant financial instruments that do not have readily determinable market values.	The methods and significant assumptions used to determine fair values of financial instruments are as follows: [ <i>describe methods and significant assumptions used to determine fair values of financial instruments</i> ]. The methods and significant assumptions used result in a measure of fair value appropriate for financial statement measurement and disclosure purposes.
There are financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk.	The following information about financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk has been properly disclosed in the financial statements: <ol style="list-style-type: none"> <li>1. The extent, nature, and terms of financial instruments with off-balance-sheet risk.</li> <li>2. The amount of credit risk of financial instruments with off-balance-sheet risk and information about the collateral supporting such financial instruments.</li> <li>3. Significant concentrations of credit risk arising from all financial instruments and information about the collateral supporting such financial instruments.</li> </ol>

(continued)

<i>Assets</i>	
<i>Condition</i>	<i>Illustrative Examples</i>
<p>Receivables Receivables have been recorded in the financial statements.</p>	<p>Receivables recorded in the financial statements represent valid claims against debtors for sales or other charges arising on or before the balance-sheet date and have been appropriately reduced to their estimated net realizable value.</p>
<p>Inventories Excess or obsolete inventories exist.</p>	<p>Provision has been made to reduce excess or obsolete inventories to their estimated net realizable value.</p>
<p>Investments There are unusual considerations involved in determining the application of equity accounting.</p>	<p>[For investments in common stock that are either nonmarketable or of which the entity has a 20 percent or greater ownership interest, select the appropriate representation from the following:]</p> <ul style="list-style-type: none"> <li>• The equity method is used to account for the company's investment in the common stock of [investee] because the company has the ability to exercise significant influence over the investee's operating and financial policies.</li> <li>• The cost method is used to account for the company's investment in the common stock of [investee] because the company does not have the ability to exercise significant influence over the investee's operating and financial policies.</li> </ul>
<p>Deferred Charges Material expenditures have been deferred.</p>	<p>We believe that all material expenditures that have been deferred to future periods will be recoverable.</p>
<p>Deferred Tax Assets A deferred tax asset exists at the balance-sheet date.</p>	<p>The valuation allowance has been determined pursuant to the provisions of FASB ASC 740, <i>Income Taxes</i>, including the company's estimation of future taxable income, if necessary, and is adequate to reduce the total deferred tax asset to an amount that will more likely than not be realized. [Complete with appropriate wording detailing how the entity determined the valuation allowance against the deferred tax asset.]</p> <p>or</p> <p>A valuation allowance against deferred tax assets at the balance-sheet date is not considered necessary because it is more likely than not the deferred tax asset will be fully realized.</p>

<b>Liabilities</b>	
<b>Condition</b>	<b>Illustrative Examples</b>
<p>Debt Short-term debt could be refinanced on a long-term basis and management intends to do so.</p>	<p>The company has excluded short-term obligations totaling \$[<i>amount</i>] from current liabilities because it intends to refinance the obligations on a long-term basis. [<i>Complete with appropriate wording detailing how amounts will be refinanced as follows:</i>]</p> <ul style="list-style-type: none"> <li>• The Company has issued a long-term obligation [<i>debt security</i>] after the date of the balance sheet but prior to the issuance of the financial statements for the purpose of refinancing the short-term obligations on a long-term basis.</li> <li>• The Company has the ability to consummate the refinancing by using the financing agreement referred to in Note [X] to the financial statements.</li> </ul>
<p>Tax-exempt bonds have been issued.</p>	<p>Tax-exempt bonds issued have retained their tax-exempt status.</p>
<p>Taxes Management intends to reinvest undistributed earnings of a foreign subsidiary.</p>	<p>We intend to reinvest the undistributed earnings of [<i>name of foreign subsidiary</i>].</p>
<p>Contingencies Estimates and disclosures have been made of environmental remediation liabilities and related loss contingencies.</p>	<p>Provision has been made for any material loss that is probable from environmental remediation liabilities associated with [<i>name of site</i>]. We believe that such estimate is reasonable based on available information and that the liabilities and related loss contingencies and the expected outcome of uncertainties have been adequately described in the company's financial statements.</p>
<p>Agreements may exist to repurchase assets previously sold.</p>	<p>Agreements to repurchase assets previously sold have been properly disclosed.</p>
<p>Pension and Postretirement Benefits An actuary has been used to measure pension liabilities and costs.</p>	<p>We believe that the actuarial assumptions and methods used to measure pension liabilities and costs for financial accounting purposes are appropriate in the circumstances.</p>

(continued)

<b><i>Liabilities</i></b>	
<b><i>Condition</i></b>	<b><i>Illustrative Examples</i></b>
There is involvement with a multiemployer plan.	We are unable to determine the possibility of a withdrawal liability in a multiemployer benefit plan. or We have determined that there is the possibility of a withdrawal liability in a multiemployer plan in the amount of \$[XX].
Postretirement benefits have been eliminated.	We do not intend to compensate for the elimination of postretirement benefits by granting an increase in pension benefits. or We plan to compensate for the elimination of postretirement benefits by granting an increase in pension benefits in the amount of \$[XX].
Employee layoffs that would otherwise lead to a curtailment of a benefit plan are intended to be temporary.	Current employee layoffs are intended to be temporary.
Management intends to either continue to make or not make frequent amendments to its pension or other postretirement benefit plans, which may affect the amortization period of prior service cost, or has expressed a substantive commitment to increase benefit obligations.	We plan to continue to make frequent amendments to its pension or other postretirement benefit plans, which may affect the amortization period of prior service cost. or We do not plan to make frequent amendments to its pension or other postretirement benefit plans.
<b><i>Equity</i></b>	
<b><i>Condition</i></b>	<b><i>Illustrative Example</i></b>
There are capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements.	Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements have been properly disclosed.

<i>Income Statement</i>	
<i>Condition</i>	<i>Illustrative Examples</i>
There may be a loss from sales commitments.	Provisions have been made for losses to be sustained in the fulfillment of or from inability to fulfill any sales commitments.
There may be losses from purchase commitments.	Provisions have been made for losses to be sustained as a result of purchase commitments for inventory quantities in excess of normal requirements or at prices in excess of prevailing market prices.
Nature of the product or industry indicates the possibility of undisclosed sales terms.	We have fully disclosed to you all sales terms, including all rights of return or price adjustments and all warranty provisions.

[Paragraph renumbered and amended, effective November 2002, by SSARS No. 9. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by the issuance of SSARS No. 15. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17. Paragraph revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

## Appendix G

### Review of Financial Statements—Illustrative Updating Management Representation Letter

The following letter is presented for illustrative purposes only. It may be used in the circumstances described in paragraph .40 of this section. Management need not repeat all of the representations made in the previous representation letter.

If matters exist that should be disclosed to the accountant, they should be indicated by listing them following the representation. For example, if an event subsequent to the date of the accountant's review report is disclosed in the financial statements, the final paragraph could be modified as follows: "To the best of our knowledge and belief, except as discussed in Note X to the financial statements, no events have occurred. . ."

[Date]<sup>1</sup>

To [Accountant]

In connection with your review(s) of the [*identification of financial statements*] of [*name of entity*] as of [*dates*] and for the [*periods of review*] for the purpose of expressing limited assurance that there are no material modifications that should be made to the statements for them to be in conformity with generally accepted accounting principles, you were previously provided with a representation letter under date of [*date of previous representation letter*]. No information has come to our attention that would cause us to believe that any of those previous representations should be modified.

To the best of our knowledge and belief, no events have occurred subsequent to [*date of latest balance sheet reported on by the accountant or date of previous representation letter*] and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.

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[*Name of Owner or Chief Executive Officer and Title*]

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[*Name of Chief Financial Officer and Title, where applicable*]

[Paragraph added, effective for reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

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<sup>1</sup> The accountant has two methods available for dating the report when a subsequent event requiring disclosure occurs after the completion of the review but before issuance of the report on the related financial statements. The accountant may use "dual dating," for example, "February 16, 20XX, except for Note Y, as to which the date is March 1, 20XX," or may date the report as of the later date. [Footnote added, effective for reviews of financial statements for periods ending after December 15, 2005, by SSARS No. 12.]

[.104]

## Appendix H

### **Rule 201 of the AICPA Code of Professional Conduct [ET section 201.01]**

[Paragraph renumbered and deleted by the issuance of SSARS No. 8, October 2000. Paragraph subsequently renumbered by the issuance of SSARS No. 9, November 2002. Paragraph subsequently renumbered by the issuance of SSARS No. 10, May 2004. Paragraph subsequently renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered by the issuance of SSARS No. 15, July 2007. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]



## Appendix I

### Analytical Procedures the Accountant May Consider Performing When Conducting a Review of Financial Statements

Analytical procedures are designed to identify relationships and individual items that appear to be unusual and that may reflect a material misstatement of the financial statements. The analytical procedures performed in a review of financial statements are a matter of the accountant's professional judgment. In determining the appropriate analytical procedures, an accountant may consider (a) the nature and materiality of the items reflected in the financial statements, (b) the likelihood of a misstatement in the financial statements, (c) knowledge obtained during current and previous engagements, (d) the stated qualifications of the entity's accounting personnel, (e) the extent to which a particular item is affected by management's judgment, and (f) inadequacies in the entity's underlying financial data.

The following list of analytical procedures is for illustrative purposes only. These analytical procedures will not necessarily be applicable in every review engagement, nor are these analytical procedures meant to be all-inclusive. These illustrative analytical procedures are not intended to serve as a program or checklist to be utilized in performing a review engagement. Examples of analytical procedures an accountant may consider performing in a review of financial statements include:

- Comparing financial statements with statements for comparable prior period(s).
- Comparing current financial information with anticipated results, such as budgets or forecasts (for example, comparing tax balances and the relationship between the provision for income taxes and pretax income in the current financial information with corresponding information in (a) budgets, using expected rates, and (b) financial information for prior periods).<sup>1</sup>
- Comparing current financial information with relevant nonfinancial information.
- Comparing ratios and indicators for the current period with expectations based on prior periods, for example, performing gross profit analysis by product line and operating segment using elements of the current financial information and comparing the results with corresponding information for prior periods. Examples of key ratios and indicators are the current ratio, receivables turnover or days' sales outstanding, inventory turnover, depreciation to average fixed assets, debt to equity, gross profit percentage, net income percentage, and plant operating rates.

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<sup>1</sup> The accountant should exercise caution when comparing and evaluating current financial information with budgets, forecasts, or other anticipated results because of the inherent lack of precision in estimating the future and the susceptibility of such information to manipulation and misstatement by management to reflect desired results. [Footnote added, effective for reviews of financial statements for periods ending on or after December 15, 2004, by SSARS No. 10.]

- Comparing ratios and indicators for the current period with those of entities in the same industry.
- Comparing relationships among elements in the current financial information with corresponding relationships in the financial information of prior periods, for example, expense by type as a percentage of sales, assets by type as a percentage of total assets, and percentage of change in sales to percentage of change in receivables.

Analytical procedures may include such statistical techniques as trend analysis or regression analysis and may be performed manually or with the use of computer-assisted techniques.

[Paragraph added, effective for reviews of financial statements for periods ending on or after December 15, 2004, by SSARS No. 10. Paragraph renumbered by the issuance of SSARS No. 12, July 2005. Paragraph renumbered and amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by the issuance of SSARS No. 15. Paragraph renumbered by the issuance of SSARS No. 17, February 2008.]

## Appendix J\*

### Sources of Generally Accepted Accounting Principles

Accountants agree on the existence of a body of generally accepted accounting principles, and they are knowledgeable about these principles and in the determination of their general acceptance. Nevertheless, the determination that a particular accounting principle is generally accepted may be difficult because no single reference source exists for all such principles. The sources of generally accepted accounting principles are:

- a. Accounting principles promulgated by a body designated by the AICPA Council to establish such principles, pursuant to Rule 203 [ET section 203.01] of the *AICPA Code of Professional Conduct*. Rule 203 [ET section 203.01] provides that an accountant should state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles unless, due to unusual circumstances, adherence to the pronouncements would make the statements misleading. Rule 203 [ET section 203.01] implies that application of officially established accounting principles almost always results in the fair presentation of financial position, results of operations, and cash flows, in conformity with generally accepted accounting principles. Nevertheless, Rule 203 [ET section 203.01] provides for the possibility that literal application of such a pronouncement might, in unusual circumstances, result in misleading financial statements.
- b. Pronouncements of bodies, composed of expert accountants, that deliberate accounting issues in public forums for the purpose of

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\* The AICPA Accounting and Review Services Committee expects to withdraw this section in the second half of 2009 subsequent to the anticipated issuance by the Federal Accounting Standards Advisory Board of a Statement of Federal Financial Accounting Standards that will incorporate its hierarchy of generally accepted accounting principles (GAAP hierarchy) into its authoritative literature. The GAAP hierarchy consists of the sources of accounting principles used in the preparation of financial statements of federal reporting entities that are presented in conformity with U.S. GAAP, and the framework for selecting those principles.

In May 2008, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, to incorporate its GAAP hierarchy into its authoritative literature. The GAAP hierarchy consists of the sources of accounting principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with U.S. GAAP, and the framework for selecting those principles.

In July 2009, FASB approved an online *Accounting Standards Codification*<sup>TM</sup> (ASC), effectively superseding FASB Statement No. 162 because all of the FASB ASC content carries the same level of authority. FASB ASC is now the single authoritative source for nongovernmental U.S. GAAP and supersedes existing sources of nongovernmental U.S. GAAP—except for guidance issued by the Securities and Exchange Commission.

In March 2009, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, to incorporate its GAAP hierarchy into its authoritative literature. The GAAP hierarchy consists of the sources of accounting principles used in the preparation of financial statements of state and local governmental entities that are presented in conformity with U.S. GAAP, and the framework for selecting those principles. GASB Statement No. 55 is effective upon issuance.

As a result of these developments, this appendix has not been conformed to reflect FASB ASC.

establishing accounting principles or describing existing accounting practices that are generally accepted, provided those pronouncements have been exposed for public comment and have been cleared by a body referred to in category (a).<sup>1</sup>

- c. Pronouncements of bodies, organized by a body referred to in category (a) and composed of expert accountants, that deliberate accounting issues in public forums for the purpose of interpreting or establishing accounting principles or describing existing accounting practices that are generally accepted, or pronouncements referred to in category (b) that have been cleared by a body referred to in category (a) but have not been exposed for public comment.
- d. Practices or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry or the knowledgeable application to specific circumstances of pronouncements that are generally accepted.

Generally accepted accounting principles recognize the importance of reporting transactions and events in accordance with their substance. The accountant should consider whether the substance of transactions or events differs materially from their form.

If the accounting treatment of a transaction or event is not specified by a pronouncement covered by Rule 203 [ET section 203.01], the accountant should consider whether the accounting treatment is specified by another source of established accounting principles. If an established accounting principle from one or more sources in category (b), (c), or (d) is relevant to the circumstances, the accountant should be prepared to justify a conclusion that another treatment is generally accepted. If there is a conflict between accounting principles relevant to the circumstances from one or more sources in category (b), (c), or (d), the accountant should follow the treatment specified by the source in the higher category, for example, follow category (b) treatment over category (c), or be prepared to justify a conclusion that a treatment specified by a source in the lower category better presents the substance of the transaction in the circumstances.

The accountant should be aware that the accounting requirements adopted by regulatory agencies for reports filed with them may differ from generally accepted accounting principles in certain respects.

Because of developments such as new legislation or the evolution of a new type of business transaction, there sometimes are no established accounting principles for reporting a specific transaction or event. In those instances, it might be possible to report the event or transaction on the basis of its substance by selecting an accounting principle that appears appropriate when applied in a manner similar to the application of an established principle to an analogous transaction or event.

## Application to Nongovernmental Entities

For financial statements of entities other than governmental entities:

- a. Category (a), officially established accounting principles, consists of Financial Accounting Standards Board (FASB) Statements of

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<sup>1</sup> For purposes of this section, the word *cleared* means that a body referred to in subparagraph (a) has indicated that it does not object to the issuance of the proposed pronouncement.

Financial Accounting Standards and Interpretations, Accounting Principles Board (APB) Opinions, and AICPA Accounting Research Bulletins.

- b. Category (b) consists of FASB technical bulletins and, if cleared<sup>2</sup> by the FASB, AICPA Industry Audit and Accounting Guides, and AICPA Statements of Position.
- c. Category (c) consists of AICPA Accounting Standards Executive Committee (AcSEC) practice bulletins that have been cleared<sup>3</sup> by the FASB and consensus positions of the FASB Emerging Issues Task Force.
- d. Category (d) includes AICPA accounting interpretations and implementation guides ("Qs and As") published by the FASB staff, and practices that are widely recognized and prevalent either generally or in the industry.

In the absence of a pronouncement covered by Rule 203 [ET section 203.01] or another source of established accounting principles, the accountant performing the compilation or review of financial statements of entities other than governmental entities may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, FASB Statements of Financial Accounting Concepts; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; Governmental Accounting Standards Board (GASB) statements, interpretations, and technical bulletins; Federal Accounting Standards Advisory Board (FASAB) statements, interpretations, and technical bulletins; pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, FASB Statements of Financial Accounting Concepts would normally be more influential than other sources in this category.

## **Application to State and Local Governmental Entities**

For financial statements of state and local governmental entities:<sup>4</sup>

- a. Category (a), officially established accounting principles, consists of GASB Statements and Interpretations, as well as AICPA and FASB pronouncements specifically made applicable to state and local governmental entities by GASB Statements or Interpretations. GASB Statements and Interpretations are periodically incorporated in the *Codification of Governmental Accounting and Financial Reporting Standards*.
- b. Category (b) consists of GASB technical bulletins and, if specifically made applicable to state and local governmental entities by

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<sup>2</sup> The accountant should assume that such pronouncements have been cleared by the FASB unless the pronouncement indicates otherwise.

<sup>3</sup> The accountant should assume that such pronouncements have been cleared by the FASB unless the pronouncement indicates otherwise.

<sup>4</sup> State and local governmental entities include public benefit corporations and authorities; public employee retirement systems; and governmental utilities, hospitals and other health care providers, and colleges and universities.

the AICPA and cleared<sup>5</sup> by the GASB, AICPA Industry Audit and Accounting Guides, and AICPA Statements of Position.

- c. Category (c) consists of AICPA AcSEC practice bulletins if specifically made applicable to state and local governmental entities and cleared<sup>6</sup> by the GASB, as well as consensus positions of a group of accountants organized by the GASB that attempts to reach consensus positions on accounting issues applicable to state and local governmental entities.<sup>7</sup>
- d. Category (d) includes implementation guides ("Qs and As") published by the GASB staff, as well as practices that are widely recognized and prevalent in state and local government.

In the absence of a pronouncement covered by Rule 203 [ET section 203.01] or another source of established accounting principles, the accountant of compiled or reviewed financial statements of state and local governmental entities may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, GASB concepts statements; the pronouncements referred to in categories (a) through (d) when not specifically made applicable to state and local governmental entities either by the GASB or by the organization issuing them; FASB concepts statements; FASAB statements, interpretations, technical bulletins, and concepts statements; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, GASB concepts statements would normally be more influential than other sources in this category.

## Application to Federal Governmental Entities

For financial statements of federal governmental entities:<sup>8</sup>

- a. Category (a), officially established accounting principles, consists of FASAB statements and interpretations, as well as AICPA and FASB pronouncements specifically made applicable to federal governmental entities by FASAB statements or interpretations. FASAB statements and interpretations will be periodically incorporated in a publication by the FASAB.
- b. Category (b) consists of FASAB technical bulletins and, if specifically made applicable to federal governmental entities by the AICPA and cleared by the FASAB, AICPA Industry Audit and Accounting Guides and AICPA Statements of Position.<sup>9</sup>

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<sup>5</sup> The accountant should assume that such pronouncements specifically made applicable to state and local governments have been cleared by the GASB unless the pronouncement indicates otherwise.

<sup>6</sup> The accountant should assume that such pronouncements specifically made applicable to state and local governments have been cleared by the GASB unless the pronouncement indicates otherwise.

<sup>7</sup> As of the date of this appendix, the GASB had not organized such a group.

<sup>8</sup> Federal Accounting Standards Advisory Board (FASAB) Concepts Statement No. 2, *Entity and Display*, defines federal governmental entities.

<sup>9</sup> The accountant should assume that such pronouncements specifically made applicable to federal governmental entities have been cleared by the FASAB unless the pronouncement indicates otherwise.

## 1482 Statements on Standards for Accounting and Review Services

- c. Category (c) consists of AICPA AcSEC practice bulletins if specifically made applicable to federal governmental entities and cleared by the FASAB, as well as Technical Releases of the Accounting and Auditing Policy Committee of the FASAB.
- d. Category (d) includes implementation guides published by the FASAB staff, as well as practices that are widely recognized and prevalent in the federal government.

In the absence of a pronouncement covered by Rule 203 [ET section 203.01] or another source of established accounting principles, the accountant of compiled or reviewed financial statements of a federal governmental entity may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes, for example, FASAB concepts statements; the pronouncements referred to in categories (a) through (d) when not specifically made applicable to federal governmental entities by the FASAB; FASB concepts statements; GASB statements, interpretations, technical bulletins, and concepts statements; AICPA Issues Papers; International Accounting Standards of the International Accounting Standards Committee; pronouncements of other professional associations or regulatory agencies; Technical Information Service Inquiries and Replies included in AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles. The appropriateness of other accounting literature depends on its relevance to particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, FASAB concepts statements would normally be more influential than other sources in this category. [Paragraph added, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by the issuance of SSARS No. 15.]

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## AR Section 9100

# ***Compilation and Review of Financial Statements: Accounting and Review Services Interpretations of Section 100***

### **1. Omission of Disclosures in Reviewed Financial Statements**

**.01 Question**—Paragraphs 19.–22. of Statement on Standards for Accounting and Review Services (SSARS) No. 1, *Compilation and Review of Financial Statements* (sec. 100 par. .19–.22), provides guidance to the accountant when a departure from GAAP relates to the omission of substantially all disclosures in the financial statements that he has compiled. Paragraph 56 of SSARS No. 1 (sec. 100 par. .56) states that, in all other circumstances, an accountant should consider whether modification of his standard report is adequate to disclose a departure from generally accepted accounting principles (GAAP). When a departure from GAAP relates to the omission of substantially all disclosures in financial statements that the accountant has reviewed, is disclosure of such omission in a separate paragraph of the accountant's report similar to the example in paragraph 22. of SSARS No. 1 (sec. 100 par. .22) an adequate modification of his report?

**.02 Interpretation**—No. The guidance in paragraphs 19.–22. of SSARS No. 1 (sec. 100 par. .19–.22) only applies when financial statements that the accountant has *compiled* omit substantially all of the disclosures required by GAAP or an other comprehensive basis of accounting. Because of the reporting requirements of SSARS No. 1 [sec. 100], an accountant ordinarily would not accept an engagement to review financial statements that omit substantially all of the disclosures required by GAAP. When an accountant who undertakes to *review* financial statements subsequently finds that his client declines to include substantially all required disclosures, his review report should include the disclosures omitted from the statements. However, if the information required to be disclosed has not been determined by management or is not known as the result of the accountant's procedures, the accountant is not required to determine the specific information that should be disclosed. In that circumstance, the accountant's report should specifically identify the nature of the omitted disclosures.

[Issue Date: December 1979; Revised: November 2002; Revised: May 2004; Revised: July 2005.]

### **[2.] Financial Statements Included in SEC Filings**

**[.03–.05]** [Withdrawn, December 2008, by the Accounting and Review Services Committee.]

### **3. Reporting on the Highest Level of Service**

**.06 Question**—Paragraphs 4. and 9. of SSARS No. 1 (sec. 100 par. .04 and par. .09) recognize that an accountant may consider it necessary to perform other accounting services to enable him to compile financial statements. Paragraph 2 of SSARS No. 1 (sec 100 par. .02) provides that when an accountant performs more than one service with respect to the financial statements of an



entity he should issue the report that is appropriate for the highest level of service rendered. Does paragraph 2. of SSARS No. 1 (sec. 100 par. .02) require the accountant to evaluate the extent of other accounting services he has performed in a compilation engagement to report on financial statements and to decide whether a review report should be issued instead of a compilation report?

**.07 Interpretation**—No. SSARS No. 1 (sec. 100) requires the accountant to issue a report whenever he completes and reports on a compilation or performs a review of the financial statements of a nonissuer. The statement that the accountant should issue a report that is appropriate for the highest level of service rendered is intended to make clear that if, for example, the accountant has both reported on compiled financial statements and reviewed the financial statements that he was engaged to review, he would need to issue only a review report.

**.08** SSARS No. 1 (sec. 100) imposes no requirement for the accountant to "upgrade" his report because he has performed other accounting services. However, the accountant may wish to evaluate whether, as a result of performing such services, he is in a position to issue a review report when he was engaged only to report on a compilation. In such circumstances, he may wish to discuss the matter with his client and they may decide to revise their understanding regarding the nature of the services to be rendered.

**.09 Question**—An entity may wish to engage an accountant to report on compiled financial statements each month and also to review the financial statements of the entity for a quarterly or an annual period. May an accountant issue a compilation report on the monthly financial statements and a review report on quarterly or annual financial statements for a period ending on the same date as one of the monthly financial statements?

**.10 Interpretation**—Yes. An accountant may accept an engagement to report on compiled financial statements for an interim period and an engagement to review the financial statements for another period that ends on the same date, provided he complies with the applicable standards for each engagement.

**.11 Question**—An accountant who has been engaged to report on a compilation or review of the financial statements of an entity may also be requested to perform a higher level of service with respect to the same financial statements. Is the acceptance of such an engagement appropriate?

**.12 Interpretation**—Yes. SSARS No. 1 (sec. 100) does not prohibit the accountant from accepting an engagement to perform a higher level of service with respect to financial statements that have been previously compiled or reviewed.

[Issue Date: December 1979; Revised: October 2000;  
Revised: February 2008.]

#### **[4.] Discovery of Information After the Date of the Accountant's Report**

[**.13-.15**] [Rescinded, July 2007, by Statement on Standards for Accounting and Review Services No. 15.]

### **5. Planning and Supervision**

**.16 Question**—Rule 201C, *General Standards* [ET sec. 201 par. .01C] states: "Adequately plan and supervise the performance of professional services." Although SAS No. 22, *Planning and Supervision* (AU sec. 311), deals with these matters in the context of an audit in accordance with generally accepted auditing standards, SSARS No. 1 (sec. 100) does not provide specific

guidance for the planning and supervision of a compilation or review engagement. In the absence of specific guidance on planning and supervision in SSARS No. 1 (sec. 100), is an accountant required to follow the guidance provided in SAS No. 22 (AU sec. 311) in the context of a compilation or review engagement for a nonissuer?

**.17 Interpretation**—No. SASs do not govern engagements to compile or review financial statements of a nonissuer. However, an accountant may wish to consider SAS No. 22 [AU sec. 311] or other reference sources, such as textbooks and articles, when he needs additional information on planning and supervision. [As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by SSARS No. 17.]

[Issue Date: August 1981; Revised: November 2002; Revised: February 2008.]

## 6. Withdrawal From Compilation or Review Engagement

**.18 Question**—Paragraph 58 of SSARS No. 1 [sec. 100 par. .58] states: "If the accountant believes that modification of his standard report is not adequate to indicate the deficiencies in the financial statements taken as a whole, he should withdraw from the compilation or review engagement and provide no further services with respect to those financial statements." Under what circumstances would the accountant ordinarily conclude that it is necessary to withdraw from a compilation or review engagement?

**.19 Interpretation**—Modification of the accountant's standard report as described in paragraph 57. of SSARS No. 1 [sec. 100 par. .57] ordinarily should be adequate to indicate the deficiencies in the financial statements taken as a whole. However, in some circumstances, likely to be rare and unusual, the nature, extent, and probable effect of the departures from GAAP or an other comprehensive basis of accounting might cause the accountant to question whether the departures were undertaken with the intention of misleading those who might reasonably be expected to use such financial statements. In those circumstances, withdrawal from the compilation or review engagement might be necessary; however, the accountant ordinarily would not make a decision to withdraw when the client agreed that the effects of the departures should be determined and disclosed in the accountant's report.

**.20** As an illustration, the client may have entered into a number of leasing arrangements that might be required to be capitalized under Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 840, *Leases*. The client may not wish to capitalize such leases and may not have determined the effect of this departure from GAAP. However, the client may be willing to disclose in the financial statements information such as the nature of the leased property, the payments required under the leases, and other important terms of the leases. In those circumstances, the accountant is not likely to conclude that the departure was undertaken with the intention of misleading users, even though the effect of the departure is not quantified in the financial statements or the accountant's report.

**.21** On the other hand, the client may have failed, for example, to make provision for doubtful accounts and probable sales returns in the face of significant adverse business and economic conditions and may be unwilling to acknowledge that an adjustment should be considered. This might cause the accountant to question whether other information provided by the client is incorrect, incomplete, or otherwise unsatisfactory. Also, the accountant's general knowledge of the entity's business and related matters might lead him to conclude that this position indicates an intention of misleading users, particularly if the effects of the departure are not determined.

**.22** The accountant would also withdraw from the compilation or review engagement when the financial statements, including disclosures, are not revised and the client refuses to accept the modified standard report that the accountant believes is appropriate.

[Issue Date: August 1981; Revised: November 2002; Revised: May 2004; Revised: July 2005; Revised: June 2009.]

## **7. Reporting When There Are Significant Departures From GAAP**

**.23 Question**—When the financial statements include significant departures from GAAP or an other comprehensive basis of accounting, may the accountant modify his standard report under paragraph 57. of SSARS No. 1 [sec. 100 par. .57] to include a statement that the financial statements are not in conformity with GAAP or an other comprehensive basis of accounting?

**.24 Interpretation**—No. Including such a statement in the accountant's compilation or review report would be tantamount to expressing an adverse opinion on the financial statements taken as a whole. Such an opinion can be expressed only in the context of an audit engagement. Furthermore, such a statement in a review report would confuse users because it would contradict the expression of limited assurance required by paragraph 46.(e) of SSARS No. 1 [sec. 100 par. .46e].

**.25** However, footnote 30 to paragraph 57. of SSARS No. 1 [sec. 100 par. .57, footnote 30] indicates that the accountant is not precluded from emphasizing in a separate paragraph of his report a matter regarding the financial statements. The accountant may wish, therefore, to emphasize the limitations of the financial statements in a separate paragraph of his compilation or review report, depending on his assessment of the possible dollar magnitude of the effects of the departures, the significance of the affected items to the entity, the pervasiveness and overall impact of the misstatements, and whether disclosure has been made of the effects of the departures. Such separate paragraph, which would follow the other modifications of his report (see illustrations in paragraph 57. of SSARS No. 1 [sec. 100 par. .57]), might read as follows:

Because the significance and pervasiveness of the matters previously discussed makes it difficult to assess their impact on the financial statements taken as a whole, users of these financial statements should recognize that they might reach different conclusions about the company's financial position, results of operations, and cash flows if they had access to revised financial statements prepared in conformity with GAAP.

**.26** Inclusion of such a separate paragraph in the accountant's compilation or review report is not a substitute for disclosure of the specific departures or the effects of such departures when they have been determined by management or are known as a result of the accountant's procedures. In this connection, see the interpretation entitled "Omission of Disclosures in Reviewed Financial Statements" (paragraphs .01–.02).

[Issue Date: August 1981; Revised: November 2002; Revised: May 2004; Revised: July 2005.]

## **[8.] Reports on Specified Elements, Accounts, or Items of a Financial Statement**

[.27–.28] [Rescinded, July 2005, by Statement on Standards for Accounting and Review Services No. 13.]

## 9. Reporting When Management Has Elected to Omit Substantially All Disclosures

**.29 Question**—Paragraph 21. of SSARS No. 1 [sec. 100 par. .21] illustrates a form of standard report appropriate when compiled financial statements omit substantially all disclosures. The third paragraph of that illustrative report begins with this sentence: "Management has elected to omit substantially all of the disclosures . . . required by GAAP." Paragraph 19. of SSARS No. 1 [sec. 100 par. .19] requires the accountant to disclose in his report the fact that compiled financial statements omit substantially all disclosures but does not state that there is a need to indicate that "management has elected" to omit such disclosures. May the accountant modify the wording of his report, for example, to state that "Management has not included substantially all of the disclosures . . ." or "The Company has not included substantially all of the disclosures . . . "?

**.30 Interpretation**—Use of the language in the third paragraph of the standard report in paragraph 21. of SSARS No. 1 [sec. 100 par. .21] is encouraged; it was designed to impress upon management and the users of financial statements that omission of substantially all disclosures is the entity's decision, not the accountant's. However, provided the report clearly indicates this, the wording "Management has elected to omit" may be modified. Language such as "These financial statements do not include substantially all of the disclosures . . ." should not be used because some might infer that the decision to omit disclosures was the accountant's.

[Issue Date: May 1982.]

## 10. Reporting on Tax Returns

**.31 Question**—May an accountant comply with a request from a nonissuer to issue a compilation or review report on financial information contained in a tax return, as in Form 1040, *U.S. Individual Income Tax Return*, or Form 1120, *U.S. Corporation Income Tax Return*, or in an information return, as in Form 990, *Return of Organization Exempt from Income Tax*, Form 1065, *U.S. Partnership Return of Income*, or Form 5500, *Return of Employee Benefit Plan*?

**.32 Interpretation**—SSARS No. 1 [sec. 100] imposes no requirement on an accountant to report on financial information contained in a tax return. The fact that a return is subsequently used for a purpose other than submission to taxing authorities does not affect that exception. However, an accountant may decide to accept an engagement to issue a compilation or review report on such a return. In that case, he must comply with the applicable performance and reporting standards.

[Issue Date: November 1982; Revised: February 2008.]

## [11.] Reporting on Uncertainties

**[.33–.40]** [Rescinded, February 2007, by the issuance of Interpretation No. 29.]

## [12.] Reporting on a Comprehensive Basis of Accounting Other Than GAAP

**[.41–.45]** [Rescinded, July 2007, by Statement on Standards for Accounting and Review Services No. 15.]<sup>[1]</sup>

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<sup>[1]</sup> [Footnote deleted by SSARS No. 15, July 2007.]

### 13. Additional Procedures

**.46 Question**—Certain procedures, such as confirmation of receivables and observation of inventories, are customarily performed in an audit but not in compilation or review engagements. If an accountant performs such "auditing procedures" in connection with a compilation or review engagement, is he required to change the engagement to an audit?

**.47 Interpretation**—No. Paragraph 10. of SSARS No. 1 [sec. 100 par. .10] states that in a compilation engagement there is no requirement "to verify, corroborate, or review information," but it does not preclude the accountant from making inquiries or performing additional procedures. Similarly, paragraph 31. of SSARS No. 1 [sec. 100 par. .31] states that a review engagement "does not contemplate obtaining an understanding of internal control or assessing control risk, tests of accounting records and of responses to inquiries by obtaining corroborating evidential matter, and certain other procedures ordinarily performed during an audit." However, it also indicates that there may be circumstances when the accountant "should perform the additional procedures he deems necessary. . . ." These citations make it clear that the standards for performing compilations or reviews of financial statements do not preclude the accountant from performing procedures that he deems necessary or that his client requests.

**.48 Paragraph 5.** of SSARS No. 1 [sec. 100 par. .05] does require the accountant to establish an understanding with the entity regarding the services to be performed, including "a description of the report the accountant expects to render," and this understanding establishes the terms and objectives of the engagement. When the accountant, in connection with a compilation or review engagement, plans to perform procedures that are customarily applied during an audit, he may wish to place additional importance on whether his understanding with the client should be in writing.<sup>2</sup>

**.49** The wording of confirmation requests or other communications related to additional procedures performed in the course of a compilation or review engagement should not use phrases such as "as part of an *audit* of the financial statements" (emphasis supplied).

[Issue Date: March 1983; Revised: October 2000;  
Revised: November 2002; Revised: May 2004.]

### [14.] Reporting on Financial Statements When the Scope of the Accountant's Procedures Has Been Restricted

[.50–.53] [Withdrawn, April 1990, by the Accounting and Review Services Committee.]

### 15. Differentiating a Financial Statement Presentation From a Trial Balance

**.54 Question**—Paragraph 1. of SSARS No. 1 [sec. 100 par. .01] states that the accountant should not submit unaudited financial statements of a non-issuer to his or her client or a third party unless, as a minimum, he or she complies with the provisions of SSARS No. 1 [sec. 100] applicable to a compilation engagement.

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<sup>2</sup> If the engagement is to compile financial statements not expected to be used by a third party, a written communication is required.

**.55** What attributes should an accountant consider when differentiating a financial statement from a trial balance to determine if SSARs apply to the accounting services performed?

**.56 Interpretation**—The accountant should consider, among other matters, the following attributes when (1) determining whether a financial presentation is a financial statement or a trial balance and (2) modifying the presentation to eliminate features in the presentation that blur the distinction between a financial statement and a trial balance.

- Generally, a financial statement features the combination of similar general ledger accounts to create classifications or account groupings with corresponding subtotals and totals of dollar amounts. Some examples of these classifications or account groupings are "current assets," "long-term debt," and "revenues." In addition, contra accounts are generally netted against the related primary accounts in financial statement presentations (that is, "Accounts Receivable Net of Allowance for Bad Debts"). In contrast, a trial balance consists of a listing of all of the general ledger accounts and their corresponding debit or credit balances.
- Financial statements generally contain titles that identify the presentation as one intended to present financial position, results of operations, or cash flows. Typical titles for financial statements include:
  - a. Balance Sheet
  - b. Statement of Income or Statement of Operations
  - c. Statement of Comprehensive Income
  - d. Statement of Retained Earnings
  - e. Statement of Cash Flows
  - f. Statement of Changes in Owners' Equity
  - g. Statement of Assets and Liabilities (with or without owners' equity accounts)
  - h. Statement of Revenue and Expenses
  - i. Statement of Financial Position
  - j. Statement of Activities
  - k. Summary of Operations
  - l. Statement of Operations by Product Lines
  - m. Statement of Cash Receipts and Disbursements

Examples of typical titles for trial balance presentations are:

- a. Trial Balance
  - b. Working Trial Balance
  - c. Adjusted Trial Balance
  - d. Listing of General Ledger Accounts
- The balance sheet in a set of financial statements segregates asset, liability, and owners' equity accounts and presents these three elements based on the following basic example equation:

$$\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$$

The elements of the income statement and their relationship to net income are presented based on the following basic example equation:

$$\text{Revenues} - \text{Expenses} + \text{Gains} - \text{Losses} = \text{Net Income}$$

## 1490 Statements on Standards for Accounting and Review Services

In a trial balance, no attempt is made to establish a mathematical relationship among the elements except that total debits equal total credits.

- The income statement in a set of financial statements generally contains a caption such as "Net Income" or "Net Revenues over Expenses" that identifies the net results of operations. Trial balance presentations generally do not contain similar captions.
- The balance sheet in a set of financial statements usually presents assets in the order of their liquidity and liabilities in the order of their maturity. In a trial balance, the accounts are generally listed in account number order as they appear in the general ledger.
- In a set of financial statements, the income statement articulates with the balance sheet because the net results of operations are added to or subtracted from opening retained earnings. In a trial balance, the net results of operations are generally not closed out to retained earnings.

.57 The accountant should use judgment when considering these attributes to determine whether the financial presentation constitutes a financial statement or a trial balance. When making this determination, the accountant should consider the preponderance of the attributes of the financial presentation. For example, a trial balance that contains one or two attributes of a financial statement may, in the accountant's judgment, still constitute a trial balance. When the presentation is deemed to be a financial statement and the accountant does not modify the presentation to conform with the attributes of a trial balance, the accountant, at a minimum, should compile the financial statements in accordance with SSARS No. 1 [sec. 100].

[Issue Date: September 1990; Revised: October 2000;  
Revised: February 2008.]

### [16.] Determining if the Accountant Has "Submitted" Financial Statements Even When Not Engaged to Compile or Review Financial Statements

[.58–.60] [Withdrawn, November 1992, by SSARS No. 7.]<sup>[3]</sup>

### 17. Submitting Draft Financial Statements

.61 *Question*—Accountants frequently submit draft financial statements (1) because information needed to complete a compilation or review of the financial statements will not be available until a later date or (2) to provide the client with the opportunity to read and analyze the financial statements prior to their final issuance. Is it permissible for the accountant to submit draft financial statements without intending to comply with the reporting provisions of SSARS No. 1 [sec. 100]?

.62 *Interpretation*—Except in those instances where the financial statements are not expected to be used by a third party, as permitted under paragraphs 24–27 of SSARS No. 1 [sec. 100 par. .24–.27], an accountant should not submit draft financial statements without intending to submit those financial statements in final form accompanied by an appropriate compilation or review report prescribed by SSARS No. 1 [sec. 100]. However, as long as the accountant intends to submit the financial statements in final form and labels each page of draft financial statements with words such as "Draft," "Preliminary Draft," "Draft—Subject to Changes," or "Working Draft," the accountant is not required

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<sup>[3]</sup> [Footnote deleted by the issuance of SSARS No. 7, November 1992.]

to comply with the reporting provisions of SSARS No. 1 [sec. 100] with respect to those draft financial statements. In the rare circumstance where the accountant intended to but never submitted final financial statements, the accountant may want to document the reasons why he or she was unable to submit those financial statements.

[Issue Date: September 1990; Revised: October 2000.]

### **[18.] Special-Purpose Financial Presentations to Comply With Contractual Agreements or Regulatory Provisions**

**[.63–.72]** [Rescinded, September 2005, by the Accounting and Review Services Committee.]<sup>[4-9]</sup>

### **19. Reporting When Financial Statements Contain a Departure From Promulgated Accounting Principles That Prevents the Financial Statements From Being Misleading**

**.73 Question**—Rule 203, *Accounting Principles* (ET sec. 203 par. .01), of the AICPA Code of Professional Conduct states:

A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with GAAP or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with GAAP, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

Paragraphs 56–58 of SSARS No. 1 [sec. 100 par. .56–.58] do not address the Rule 203 [ET sec. 203 par. .01] circumstances. When the circumstances contemplated by Rule 203 [ET sec. 203 par. .01] are present, how should the accountant report on the information described in the rule?

**.74 Interpretation**—When the circumstances contemplated by Rule 203 [ET sec. 203 par. .01] are present in a review engagement, the accountant's review report should include, in a separate paragraph or paragraphs, the information required by Rule 203 [ET sec. 203 par. .01]. In such a case, the accountant would not modify the standard review report, except for the addition of the separate paragraph(s) that contains the information required by Rule 203 [ET sec. 203 par. .01], unless there are other reasons to do so that are not associated with the departure from a promulgated principle.

**.75** Rule 203 [ET sec. 203.01] does not apply to engagements to report on a compilation. Accordingly, when the accountant is reporting on a compilation engagement and is confronted with the circumstances contemplated by Rule 203 [ET sec. 203.01], the guidance in paragraphs 56–58 of SSARS No. 1 [sec. 100.56–.58] pertaining to departures from GAAP should be followed.

[Issue Date: February 1991; Revised: October 2000;  
Revised: November 2002; Revised: May 2004; Revised: July 2005.]

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<sup>[4-9]</sup> [Footnotes deleted, September 2005.]



## 20. Applicability of Statements on Standards for Accounting and Review Services to Litigation Services

**.76 Question**—When are litigation services excluded from the applicability of SSARS?

**.77 Interpretation**—SSARS do not apply to financial statements submitted in conjunction with litigation services that involve pending or potential formal legal or regulatory proceedings before a "trier of fact"<sup>10</sup> in connection with the resolution of a dispute between two or more parties when the:

- (a) Service consists of being an expert witness.
- (b) Service consists of being a "trier of fact" or acting on behalf of one.
- (c) Accountant's work under the rules of the proceedings is subject to detailed analysis and challenge by each party to the dispute.
- (d) Accountant is engaged by an attorney to do work that will be protected by the attorney's work product privilege and such work is not intended to be used for other purposes.

When performing such litigation services the accountant should comply with Rule 201 [ET sec. 201 par. .01].

**.78 Question**—When do SSARSs apply to litigation service engagements?

**.79 Interpretation**—SSARSs apply to litigation service engagements when the accountant:

- a. Submits unaudited financial statements of a nonissuer that are the representation of management (owners) to others who under the rules of the proceedings do not have the opportunity to analyze and challenge the accountant's work, or
- b. Is specifically engaged to submit, in accordance with SSARSs, financial statements that are the representation of management (owners).

[Issue Date: May 1991; Revised: October 2000; Revised: February 2008.]

## 21. Applicability of SSARS No. 1 When Performing Controllorship or Other Management Services

**.80 Question**—An accountant is in the practice of public accounting and provides an entity with controllorship or other management services that entail the submission of financial statements. Is the accountant required to follow the requirements of SSARS No. 1 [sec. 100]?

**.81 Interpretation**—If the accountant is in the practice of public accounting as defined by the AICPA's Code of Conduct (ET sec. 92 par. .25) and is not a stockholder, partner, director, officer, or employee of the entity, the accountant is required to follow the performance and communication requirements of SSARS No. 1 [sec. 100], including any requirement to disclose a lack of independence.<sup>11</sup>

**.82** If the accountant is in the practice of public accounting and is also a stockholder, partner, director, officer, or employee of the entity, the accountant may either (1) comply with the requirements of SSARS No. 1 [sec. 100], or (2)

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<sup>10</sup> A "trier of fact" in this section means a court, regulatory body, or government authority; their agents; a grand jury; or an arbitrator or mediator of the dispute. [Footnote renumbered by the revision to Interpretation No. 18, January 2004.]

<sup>11</sup> If the compilation is not intended for third party use, SSARS No. 1 as amended by SSARS No. 8 [sec. 100] may be appropriate. [Footnote renumbered by the revision to Interpretation No. 18, January 2004.]

communicate, preferably in writing, the accountant's relationship to the entity (for example, stockholder, partner, director, officer, or employee).<sup>12</sup>

**.83** The following is an example of the type of communication that may be used by the accountant:

The accompanying balance sheet of Company X as of December 31, 20XX, and the related statements of income and cash flows for the year then ended have been prepared by [name of accountant], CPA. I have prepared such financial statements in my capacity [describe capacity, for example, as a director] of Company X.

**.84** If an accountant is not in the practice of public accounting, the issuance of a report under SSARS would be inappropriate; however, the previously mentioned communication may be used.

[Issue Date: July 2002.]

## **22. Use of "Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included"**

**.85 Question**—Can an accountant label notes to the financial statements "Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included" when the client includes more than a few required disclosures?

**.86 Interpretation**—No. As discussed in paragraph 19. of SSARS No. 1 [sec. 100 par. .19], when the entity wishes to include disclosures about only a few matters in the form of notes to the financial statements, such disclosures should be labeled "Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included."

**.87** When the financial statements include more than a few disclosures, this guidance is not appropriate. The omission of one or more notes, when substantially all other disclosures are presented, should be treated in a compilation or review report like any other departure from GAAP, and the nature of the departure and its effects, if known, should be disclosed.

**.88** The label "Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included" should not be used in situations where substantially all disclosures are included. The label "Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included" is not intended to be used for the omission of (intentionally or unintentionally) one or more disclosures and the accountant should use his or her judgment in determining the appropriateness of the label.

[Issue Date: December 2002.]

## **23. Applicability of Statements on Standards for Accounting and Review Services When an Accountant Engaged to Perform a Business Valuation Derives Information From an Entity's Tax Return**

**.89 Question**—When an accountant is engaged to perform a business valuation of an entity, it may be necessary for the accountant to derive financial information to be used in that business valuation from the client's tax return.

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<sup>12</sup> The accountant should refer to Ruling No. 10, "Submission of Financial Statement by a Member in Public Practice," of ET section 291, *Ethics Rulings on General and Technical Standards* [ET sec. 291 par. .019-.020], for additional guidance. [Footnote renumbered by the revision to Interpretation No. 18, January 2004.]

This is particularly true if the entity does not have audited, reviewed, or compiled financial statements. If an accountant derives financial information from an entity's tax return, and such information is presented as part of the business valuation report, do SSARSs apply?

**.90 Interpretation**—No. As discussed in paragraph 4. of SSARS No. 1 [sec. 100 par. .04], under the definition of a financial statement, "Financial forecasts, projections and similar presentations, and financial presentations included in tax returns are not financial statements for purposes of this Statement." Therefore, even if the accountant has prepared the tax return, he or she has not prepared financial statements in accordance with SSARSs and the financial information derived from the tax return and presented as part of a business valuation is not deemed to be submission of financial statements as contemplated by SSARS No. 1 [sec. 100].

**.91** When an accountant, in the course of performing a business valuation engagement, derives financial information from the client's tax return, or another accountant's audited, reviewed, or compiled financial statements, or client-prepared financial statements, the accountant should refer to the source of the financial information and include an indication in the business valuation report that the accountant has not audited, reviewed, or compiled the financial information and that the accountant assumes no responsibility for the information. (See paragraph 3. of SSARS No. 1 [sec. 100 par. .03].) The following is an example of wording that may be included in the business valuation report which incorporates the requirements of paragraph 3. of SSARS No. 1 [sec. 100 par. .03]:

In preparing our business valuation report, we have relied upon historical financial information provided to us by management and derived from [*refer to the appropriate source of the information, such as tax return, audit report issued by another auditor, and so on*]. This financial information has not been audited, reviewed, or compiled by us and accordingly we do not express an opinion or any form of assurance on this financial information.

**.92** However, if the accountant submits financial statements in the course of performing a business valuation as defined in paragraph 4. of SSARS No. 1 [sec. 100 par. .04], then, at a minimum, the accountant should comply with the provisions of SSARSs applicable to a compilation engagement.

[Issue Date: August 2003.]

## **24. Reference to the Country of Origin in a Review or Compilation Report**

**.93 Question**—When issuing a compilation or review report, may the accountant reference the country of origin of the accounting principles used to prepare the financial statements?

**.94 Interpretation**—Yes. Although SSARSs do not require the reference to the country of origin, there is no prohibition to referencing the country of origin in either a compilation or review report.

Because a compilation report does not reference the accounting criteria, the accountant may include a reference to the country of origin in an emphasis of matter paragraph such as the following:

As disclosed in note X, the accompanying financial statements were prepared in accordance with accounting principles generally accepted in the United States of America.

The accountant may modify the third paragraph of the standard review report to read as follows:

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

[Issue Date: September 2003; Revised: May 2008]

## 25. Omission of the Display of Comprehensive Income in a Compilation

**.95 Question**—When an element of comprehensive income is present, can the display of comprehensive income be omitted when issuing a compilation report with substantially all disclosures omitted?

**.96 Interpretation**—Yes. FASB ASC 220, *Comprehensive Income*, requires the display of comprehensive income when a full set of financial statements is presented in conformity with GAAP. However, the display of comprehensive income may be omitted by identifying the omission in the compilation report or engagement letter (SSARS No. 8, *Amendment to Statement on Standards for Accounting and Review Services No. 1, Compilation and Review of Financial Statements* [sec. 100]). The following is suggested modified wording (shown in *italic*) to the standard compilation report found in paragraph 21. of SSARS No. 1 [sec. 100 par. .21]:

Management has elected to omit substantially all the disclosures, the statement of cash flows, *and the display of comprehensive income* required by GAAP. If the omitted disclosures, the statement of cash flows, *and the display of comprehensive income* were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

**.97** In addition, if the accountant issues a compilation report on financial statements that omit substantially all disclosures and the display of comprehensive income but include the statement of cash flows, the following is suggested modified wording (shown in *italic*) to the compilation report found in paragraph 21. of SSARS No. 1 [sec. 100 par. .21]:

Management has elected to omit substantially all the disclosures *and the display of comprehensive income* required by GAAP. If the omitted disclosures *and the display of comprehensive income* were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

**.98** If the accountant compiles financial statements that include all disclosures but omit the display of comprehensive income, the omission should be treated as a departure from GAAP.

**.99** Additionally, if an element of comprehensive income has not been computed, for example, unrealized gains and losses arising from investments in marketable securities classified as "available for sale" then the accountant should consider a departure from GAAP and follow the guidance in paragraphs 56.–58. of SSARS No. 1 [sec. 100 par. .56–.58].

[Issue Date: September 2003; Revised: May 2004; Revised: July 2005; Revised: June 2009.]

## [26.] Communicating Possible Fraud and Illegal Acts to Management and Others

[.100–.103]<sup>[13-14]</sup> [Rescinded, July 2005, by SSARS No. 12.]

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<sup>[13-14]</sup> [Footnotes deleted by the issuance of SSARS No. 12, July 2005.]

## 27. Applicability of Statements on Standards for Accounting and Review Services to Reviews of Nonissuers Who Are Owned by or Controlled by an Issuer

**.104 Question**—A subsidiary of an issuer<sup>15</sup> has requested that its financial statements be reviewed for the purpose of providing those subsidiary financial statements and the accountant's review report to a local bank as a condition of a new borrowing arrangement. Because the entity is a subsidiary of a public company, its auditors have applied auditing and review procedures in accordance with the professional standards of the Public Company Accounting Oversight Board (PCAOB) at the subsidiary level.

What authoritative standards should an accountant follow when engaged to review the separate financial statements of a subsidiary, which itself is not an issuer?

**.105 Interpretation**—SSARS No. 1 [sec. 100 par. .04] defines an issuer as:

Any entity other than (a) one whose securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally; (b) one that makes a filing with a regulatory agency in preparation for the sale of any class of its securities in a public market; or (c) a subsidiary, corporate joint venture, or other entity controlled by an entity covered by (a) or (b).

**.106** The condition set forth in (c) is intended to be read in the context of when the review of the subsidiary, corporate joint venture, or other entity is being performed for the purpose of the controlling entity (the issuer) meeting its reporting obligations as a result of conditions (a) or (b).

**.107** For example, if a subsidiary is being reviewed at an interim period as part of an entity's filing of its consolidated interim financial statements with the SEC, then the review should be performed in accordance with PCAOB standards and SSARSs are not applicable because the review is in the context of the issuer meeting its reporting obligations as a result of conditions (a) or (b).

**.108** However, in the situation where an accountant is engaged to review the financial statements of a subsidiary, corporate joint venture, or other entity that is not itself an issuer and the review report and reviewed financial statements are not being filed with the SEC, or another regulatory agency that requires the accountant to prepare the review report in accordance with PCAOB standards, the accountant should perform the review in accordance with SSARSs since the review engagement is not being performed in the context of the issuer meeting its reporting obligations as a result of conditions (a) or (b).

[Issue Date: August 2005.]

## 28. Special-Purpose Financial Statements to Comply With Contractual Agreements or Regulatory Provisions

**.109 Question**—An accountant may be asked to compile or review special-purpose financial statements prepared to comply with a contractual agreement or regulatory provision that specifies a special basis of presentation. In most

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<sup>15</sup> An "issuer" as defined in Section 2 of The Sarbanes-Oxley Act of 2002 means "an issuer (as defined in Section 3 of the Securities and Exchange Act of 1934), the securities of which are registered under Section 12 of that act, or that is required to file reports under Section 15(d), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933, and that it has not withdrawn."

circumstances, these financial statements are intended solely for the use of the parties to the agreement, regulatory bodies, or other specified parties. How should the accountant modify the standard compilation or review report when reporting on these special-purpose financial statements?

**.110 Interpretation**—An accountant who is asked to compile or review special-purpose financial statements prepared to comply with a contractual agreement<sup>16</sup> or a regulatory provision that specifies a special basis of presentation<sup>17</sup> may issue a compilation or review report on those financial statements in accordance with SSARS 1, as amended [sec. 100] as described in this interpretation. This interpretation describes reporting on:

- a. Special-purpose financial statements prepared in compliance with a contractual agreement or regulatory provision that does not constitute a complete presentation of the entity's assets, liabilities, revenues and expenses, but is otherwise prepared in conformity with GAAP or an other comprehensive basis of accounting.

or

- b. A special-purpose financial presentation (may be a complete set of financial statements or a single financial statement) prepared on a basis of accounting prescribed in an agreement that does not result in a presentation in conformity with GAAP or an other comprehensive basis of accounting.

***Financial Statements Prepared on a Basis of Accounting Prescribed in a Contractual Agreement or Regulatory Provision That Results in an Incomplete Presentation but One That Is Otherwise in Conformity With GAAP or an Other Comprehensive Basis of Accounting***

**.111** An entity may engage an accountant to compile or review a special-purpose financial statement prepared in compliance with a contractual agreement or regulatory provision that does not constitute a complete presentation of the entity's assets, liabilities, revenues, or expenses, but is otherwise prepared in conformity with GAAP or Other Comprehensive Basis of Accounting (OCBOA). For example, a governmental agency may require a statement of gross income and certain expenses of an entity's real estate operation in which income and expenses are measured in conformity with GAAP, but expenses are defined to exclude certain items such as interest, depreciation, and income taxes. Such a statement may also present the excess of gross income over defined expenses. Also, a buy-sell agreement may specify a statement of gross assets and liabilities of the entity measured in conformity with GAAP, but limited to the assets to be sold and liabilities to be transferred pursuant to the agreement.

**.112** When the accountant submits compiled or reviewed special-purpose financial statements prepared on a basis of accounting prescribed in a contractual agreement or regulatory provision that results in an incomplete presentation but one that is otherwise prepared in conformity with GAAP or OCBOA,

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<sup>16</sup> A contractual agreement as discussed in this interpretation is an agreement between the client and one or more third parties other than the accountant.

<sup>17</sup> When the contractual agreement or regulatory provision specifies the use of a prescribed form for which the accountant has been engaged to compile the financial statements identified therein, the accountant should reference SSARS 3, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms* [sec. 300], for an alternative form of standard compilation report when the prescribed form calls for a departure from GAAP or an other comprehensive basis of accounting.

## 1498 Statements on Standards for Accounting and Review Services

the accountant's report should be modified to include an explanatory paragraph with the following information:

- An explanation of what the financial statement is intended to present and a reference to the note to the special-purpose financial statement that describes the basis of presentation.
- If the basis of presentation is in conformity with GAAP or OCBOA, a statement that the presentation is not intended to be a complete presentation of the entity's assets, liabilities, revenues, and expenses.
- A separate paragraph at the end of the report stating that the report is intended solely for the information and use of those within the entity, the parties to the contract or agreement, the regulatory agency with which the report is being filed, or those with whom the entity is negotiating directly, and is not intended to be and should not be used by anyone other than these specified parties.

**.113** The following is an illustrative example of a compilation report on special-purpose financial statements:

I (we) have compiled the accompanying statement of net assets sold of XYZ Company as of December 31, 20X1, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying statement and, accordingly, do not express an opinion or any other form of assurance on it.

The accompanying statement was prepared for the purpose of presenting the net assets of XYZ Company sold to ABC Company pursuant to the purchase agreement described in Note A, and is not intended to be a complete presentation of XYZ Company's assets and liabilities.

This report is intended solely for the information and use of [*the specified parties*]<sup>18</sup> and is not intended to be and should not be used by anyone other than these specified parties.

**.114** The following is an illustrative example of a review report on special-purpose financial statements:

I (we) have reviewed the accompanying statement of gross income and direct operating expenses of XYZ Company for the year ended December 31, 20X1, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in this statement is the representation of management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

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<sup>18</sup> The report may list the specified parties or refer the reader to the specified parties listed elsewhere in the report.

The accompanying statement was prepared for the purpose of presenting gross income and direct operating expenses of XYZ Company pursuant to the regulatory provision described in Note A, and is not intended to be a complete presentation of XYZ Company's income and expenses.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying statement of gross income and direct operating expenses in order for it to be in conformity with GAAP.

This report is intended solely for the information and use of [*the specified parties*]<sup>19</sup> and is not intended to be and should not be used by anyone other than these specified parties.

### ***Financial Statements Prepared on a Basis of Accounting Prescribed in an Agreement That Results in a Presentation That Is Not in Conformity With GAAP or an OCBOA***

**.115** An entity may engage an accountant to compile or review a special-purpose financial statement prepared in conformity with a basis of accounting that departs from GAAP or an OCBOA. A loan agreement, for example, may require the borrower to prepare consolidated financial statements in which assets, such as inventory, are presented on a basis that is not in conformity with GAAP or an OCBOA. Also, an acquisition agreement may require the financial statements of the entity being acquired (or a segment of it) to be prepared in conformity with GAAP except for certain assets, such as receivables, inventories, and properties for which a valuation basis is specified in the agreement.

**.116** Financial statements prepared under a basis of accounting as discussed in the preceding are not considered to be prepared in conformity with an OCBOA because the criteria used to prepare such financial statements do not meet the requirement of being "criteria having substantial support," even though the criteria are definite.

**.117** When the accountant submits compiled or reviewed special-purpose financial statements prepared on a basis of accounting prescribed in an agreement that results in a presentation that is not in conformity with GAAP or OCBOA, the accountant's report should be modified to include an explanatory paragraph with the following information:

- An explanation of what the presentation is intended to present and a reference to the note to the special-purpose financial statements that describes the basis of presentation.
- A statement that the financial statement is not intended to be a presentation in conformity with GAAP or an OCBOA.
- A description and the source of significant interpretations, if any, made by the Company's management relating to the provisions of a relevant agreement.
- A separate paragraph at the end of the report stating that the report is intended solely for the information and use of those within the entity, the parties to the contract or agreement, the regulatory agency with which the report is being filed, or those with whom the entity is negotiating directly, and is not intended to be and should not be used by

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<sup>19</sup> The report may list the specified parties or refer the reader to the specified parties listed elsewhere in the report.



## 1500 Statements on Standards for Accounting and Review Services

anyone other than these specified parties. For example, if the financial statements have been prepared for the specified purpose of obtaining bank financing, the report's use should be restricted to the various banks with whom the entity is negotiating the proposed financing.

**.118** The following is an illustrative example of a compilation report on special-purpose financial statements:

I (we) have compiled the special-purpose statement of assets and liabilities of XYZ Company as of December 31, 20X1, and the related special-purpose statements of revenue and expenses and of cash flows for the year then ended in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying statement and, accordingly, do not express an opinion or any other form of assurance on it.

The accompanying special-purpose financial statements were prepared for the purpose of complying with the acquisition agreement between ABC Company and XYZ Company as discussed in Note A, and are not intended to be a presentation in conformity with GAAP.

This report is intended solely for the information and use of [*the specified parties*]<sup>20</sup> and is not intended to be and should not be used by anyone other than these specified parties.

**.119** The following is an illustrative example of a review report on special-purpose financial statements:

I (we) have reviewed the accompanying special-purpose statement of assets and liabilities of XYZ Company as of December 31, 20X1 and the related special-purpose statements of revenue and expenses and of cash flows for the year then ended in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

The accompanying special-purpose financial statements were prepared for the purpose of complying with Section 4 of a loan agreement between DEF Bank and the Company as discussed in Note A, and are not intended to be a presentation in conformity with GAAP.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying special-purpose financial statements in order for them to be in conformity with the basis of accounting described in Note A.

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<sup>20</sup> The report may list the specified parties or refer the reader to the specified parties listed elsewhere in the report.

This report is intended solely for the information and use of the [specified parties]<sup>21</sup> and should not be used by anyone other than these specified parties.

[Issue Date: December 2006.]

## 29. Reporting on an Uncertainty, Including an Uncertainty About an Entity's Ability to Continue as a Going Concern

**.120 Question**—How should an accountant modify the standard compilation or review report when, during the performance of compilation or review procedures, evidence or information comes to the accountant's attention that there may be an uncertainty about the entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being compiled or reviewed?

**.121 Interpretation**—As stated in footnote 30 in paragraph .57 of section 100, "Normally, neither an uncertainty, including an uncertainty about an entity's ability to continue as a going concern, nor an inconsistency in the application of accounting principles would cause the accountant to modify the standard report provided the financial statements appropriately disclose such matters." Disclosure requirements with respect to uncertainties are included in FASB ASC 275, *Risks and Uncertainties*, FASB ASC 450, *Contingencies*, and other authoritative accounting literature. However, the accounting literature does not provide specific guidance on disclosure of uncertainties caused by concern about an entity's ability to continue as a going concern.

**.122** Continuation of an entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. The accountant should follow the guidance in paragraphs .69–.72 of section 100 with respect to his or her consideration of the entity's ability to continue as a going concern during the performance of compilation or review procedures.

**.123** If the accountant concludes that management's disclosure of the uncertainty regarding the entity's ability to continue as a going concern is adequate but further decides to include an emphasis of a matter paragraph with respect to the uncertainty in the accountant's compilation or review report, he or she may use the following language:

As discussed in Note X, certain conditions indicate that the Company may be unable to continue as a going concern. The accompanying financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

**.124 Question**—If the accountant, while performing a compilation or review, becomes aware of a material uncertainty other than a going concern uncertainty (for example, an uncertainty regarding pending or threatened litigation), what should the accountant consider in deciding whether a report modification is necessary?

**.125 Interpretation**—As stated in footnote 30 in paragraph .57 of section 100, "Normally, neither an uncertainty, including an uncertainty about an entity's ability to continue as a going concern, nor an inconsistency in the application of accounting principles would cause the accountant to modify the standard report provided the financial statements appropriately disclose such matters." Disclosure requirements with respect to uncertainties are included in FASB ASC 275, 450, and other authoritative accounting literature.

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<sup>21</sup> The report may list the specified parties or refer the reader to the specified parties listed elsewhere in the report.

## 1502 Statements on Standards for Accounting and Review Services

**.126** If the accountant determines that the disclosure of the uncertainty is not in accordance with GAAP, he or she should follow the guidance in paragraphs .46–.48 of section 100.

**.127** If the accountant concludes that management's disclosure of the uncertainty is in accordance with GAAP but further decides to include an emphasis of a matter paragraph with respect to the uncertainty in the accountant's compilation or review report, he or she may use the following language:

As discussed in Note X, the Company is currently named in a legal action. The Company has determined that it is not possible to predict the eventual outcome of the legal action but has determined that the resolution of the action will not result in an adverse judgment that would materially affect the financial statements. Accordingly, the accompanying financial statements do not include any adjustments related to the legal action under FASB ASC 450.

**.128 Question**—Paragraph .19 of section 100 allows the accountant, when he or she is requested to do so, to compile financial statements that omit substantially all of the disclosures required by GAAP, provided the report clearly indicates the omission and the client's decision to omit the disclosures was not, to the accountant's knowledge, undertaken with the intention of misleading users of the statements. Should disclosure of an uncertainty be considered so significant that it also could never be omitted?

**.129 Interpretation**—No. The user is adequately warned of the limitations of the financial statements by the report language suggested in paragraph .22 of section 100.

[Issue date: February 2007; Revised: February 2008; Amended: December 2008; Revised: June 2009]

### 30. Considerations Related to Financial Statements Prepared in Accordance With International Financial Reporting Standards and Compilations and Reviews Performed in Accordance With International Standards

**.130 Question**—Section 100 provides guidance regarding accountant's reports issued in connection with compilations and reviews of historical financial statements prepared in accordance with either GAAP or an other comprehensive basis of accounting. May an accountant apply the reporting guidance in section 100 when engaged to report on financial statements presented in accordance with International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB)?

**.131 Interpretation**—Yes. The IASB has been designated by the Council of the AICPA as the body to establish international financial reporting standards for both private and public entities pursuant to Rule 202, *Compliance With Standards*, and Rule 203, *Accounting Principles*, of the AICPA Code of Professional Conduct (ET sec. 202 par. .01 and ET sec. 203 par. .01) as of May 18, 2008. Accordingly, an accountant may apply the reporting guidance in section 100 when reporting on financial statements presented in accordance with IFRS as issued by the IASB.

When the accountant compiles financial statements prepared in accordance with IFRS as issued by the IASB, the accountant may wish to add an emphasis of matter paragraph such as the following:

As disclosed in note X, the accompanying financial statements were prepared in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

When the accountant compiles financial statements that omit substantially all disclosures but are otherwise in conformity with IFRS as issued by the IASB, the accountant may wish to modify the third paragraph of the standard report as follows:

Management has elected to omit substantially all disclosures (and the statement of cash flows) required by International Financial Reporting Standards as issued by the International Accounting Standards Board. If the omitted disclosures and statement were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

When the accountant reviews financial statements prepared in accordance with IFRS as issued by the IASB, an example of the third paragraph of the accountant's review report follows:

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

**.132** An entity may prepare financial statements in conformity with a jurisdictional variation of IFRS such that the entity's financial statements do not contain an explicit and unreserved statement of compliance with IFRS as issued by the IASB. Because the council of the AICPA has not designated bodies other than the IASB to establish IFRS, paragraphs .56–.58 of section 100 apply.

**.133** If financial statements are presented in conformity with both IFRS as issued by the IASB and a jurisdictional variation of IFRS (for example, financial statements prepared in conformity with IFRS as issued by the IASB and with IFRS as endorsed by the European Union), an accountant may follow the guidance as described previously.

**.134** *Question*—May a U.S. accountant perform a compilation or review of historical financial statements of a U.S. entity<sup>22</sup> in accordance with International Standard on Related Service (ISRS) 4410, *Engagements to Compile Financial Statements*, or International Standard on Review Engagements (ISRE) 2400, *Engagements to Review Financial Statements*, respectively? The financial statements may have been prepared in accordance with IFRS or accounting principles generally accepted in the United States of America.

**.135** *Interpretation*—Yes. An accountant performing a compilation or review of historical financial statements of a U.S. entity is required to follow the compilation and review standards as promulgated by the AICPA's Accounting and Review Services Committee. However, those standards do not prohibit an accountant from indicating that the compilation or review also was conducted in accordance with another set of compilation or review standards. In an engagement to compile the historical financial statements in accordance with ISRS 4410, the accountant may perform the compilation in accordance with section 100 as well as ISRS 4410. Such a compilation report may read as follows:

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X1, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards

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<sup>22</sup> A U.S. entity is an entity that is either organized or domiciled in the United States of America.

## 1504 Statements on Standards for Accounting and Review Services

for Accounting and Review Services issued by the American Institute of Certified Public Accountants and in accordance with the International Standard on Related Services applicable to compilation engagements.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

In an engagement to review the historical financial statements in accordance with ISRE 2400, the accountant may perform the review in accordance with section 100 as well as ISRE 2400. Such a review report may read as follows:

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X1, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants and in accordance with International Standard on Review Engagement 2400. All information included in these financial statements is the representation of management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with auditing standards generally accepted in the United States of America or in accordance with International Standards on Auditing, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America (or International Financial Reporting Standards as issued by the International Accounting Standards Board).

[Issue Date: May 2008.]

### 31. Preparation of Financial Statements for Use by an Entity's Auditors

**.136 Question**—Paragraph .24 of section 100 states in part:

"When an accountant submits unaudited financial statements to his or her client that are not expected to be used by a third party, he or she should either

- issue a compilation report in accordance with the reporting requirements discussed in paragraphs .11–.21 or
- document an understanding with the entity through the use of an engagement letter, preferably signed by management, regarding the services to be performed and the limitations on the use of those financial statements."

In the situation where a client engages an accountant, other than its auditor, to prepare unaudited financial statements on behalf of management and where those financial statements are provided by management to its outside auditor for the purposes of the annual audit, is the client's outside auditor deemed to be a third party using the financial statements?

**.137 Interpretation**—No. Although the client's outside auditor is a third party, the auditor is not deemed to be using the financial statements. The

auditor's role is to apply auditing procedures to those statements in order to obtain sufficient appropriate audit evidence to support his or her opinion on those statements. Accordingly, the requirements in section 100 paragraphs .24-.27 are applicable.

[Issue Date: December 2008.]

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## AR Section 110

# ***Compilation of Specified Elements, Accounts, or Items of a Financial Statement***

Issue date, unless otherwise indicated: July, 2005

Source: SSARS No. 13, SSARS No. 17

**.01** Statements on Standards for Accounting and Review Services (SSARS) currently provide guidance concerning the standards and procedures applicable when an accountant submits unaudited financial statements to his or her client or third parties. By definition, presentations of specified elements, accounts, or items of a financial statement are not financial statements. This Statement expands SSARS to apply when an accountant is engaged to compile or issues a compilation report on one or more specified elements, accounts, or items of a financial statement.

**.02** A compilation of one or more specified elements, accounts, or items of a financial statement is limited to presenting financial information that is the representation of management (owners) without undertaking to express any assurance on that information. (The accountant might consider it necessary to perform other accounting services to compile the financial information.)

**.03** Examples of specified elements, accounts, or items of a financial statement that an accountant may compile include schedules of rentals, royalties, profit participation, or provision for income taxes.

## **Conditions for Compiling Specified Elements, Accounts, or Items of a Financial Statement**

**.04** Nothing in this Statement is intended to preclude an accountant from preparing or assisting in the preparation of one or more specified elements, accounts, or items of a financial statement and submitting such specified elements, accounts, or items of a financial statement to the client without the issuance of a compilation report, unless the accountant has been engaged to compile such specified elements, accounts, or items of a financial statement. If an accountant prepares or assists a client in preparing a schedule of one or more specified elements, accounts, or items of a financial statement,<sup>1</sup> the accountant should consider how such a presentation of specified elements, accounts, or items will be used. The accountant should consider the potential of being associated with the schedule and the likelihood that the user may inappropriately infer, through that association, an unintended level of assurance. If the accountant believes that he or she will be associated with the information, the accountant should consider issuing a compilation report so a user will not infer a level of assurance that does not exist.

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<sup>1</sup> If the specified element, account, or item of a financial statement is included as accompanying information to the basic financial statements, the accountant should refer to Statement on Standards for Accounting and Review Services (SSARS) No. 1, *Compilation and Review of Financial Statements* [section 100.70], as amended.



.05 An engagement to compile one or more specified elements, accounts, or items of a financial statement may be undertaken as a separate engagement or in conjunction with a compilation of financial statements.

## Understanding With the Entity

.06 When an accountant is engaged to compile one or more specified elements, accounts, or items of a financial statement, the accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. The understanding should include a description of the nature and limitations of the services to be performed and a description of the report. The understanding should also provide:

- a. That the engagement cannot be relied upon to disclose errors, fraud,<sup>2</sup> or illegal acts,<sup>3</sup> and
- b. That the accountant will inform the appropriate level of management of any material errors and of any evidence or information that comes to the accountant's attention during the engagement to compile one or more specified elements, accounts, or items of a financial statement<sup>4</sup> that fraud or an illegal act may have occurred.<sup>5</sup> The accountant need not report any matters regarding illegal acts that may have occurred that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such matters to be communicated.

.07 When the accountant is engaged to compile one or more specified elements, accounts, or items of a financial statement and evidence or information comes to his or her attention during the engagement that fraud or an illegal act may have occurred, the accountant must adhere to the communication requirements contained in SSARS No. 1, *Compilation and Review of Financial Statements* [section 100.84–.85], as amended.

## Performance Requirements

.08 When the accountant is engaged to compile or issues a compilation report on one or more specified elements, accounts, or items of a financial statement, he or she must adhere to the compilation performance requirements contained in SSARS No. 1 [section 100.08–.11], as amended.

.09 Before issuance of a compilation report on one or more specified elements, accounts, or items of a financial statement, the accountant should read such compiled specified elements, accounts, or items of a financial statement and consider whether the information appears to be appropriate in form and

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<sup>2</sup> For purposes of this Statement, *fraud* is an intentional act that results in a misstatement in compiled specified elements, accounts, or items of a financial statement.

<sup>3</sup> For purposes of this Statement, illegal acts are violations of laws or government regulations, excluding fraud.

<sup>4</sup> Performance requirements with respect to an engagement to compile one or more specified elements, accounts, or items of a financial statement are contained in paragraphs .08 and .09.

<sup>5</sup> Whether the act is, in fact, fraudulent or illegal is a determination that is normally beyond the accountant's professional competence. An accountant, in reporting on one or more specified elements, accounts, or items of a financial statement, presents himself or herself as one who is proficient in accounting and compilation services. The accountant's training, experience, and understanding of the client and its industry may provide a basis for recognition that some client acts coming to his or her attention may be fraudulent or illegal. However, the determination as to whether a particular act is fraudulent or illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law.

free of obvious material errors. In this context, the term *error* refers to mistakes in the compilation of the specified elements, accounts, or items of a financial statement, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including disclosures, if presented.

## Reporting Requirements

**.10** When the accountant is engaged to compile or issues a compilation report on one or more specified elements, accounts, or items of a financial statement, the basic elements of the report are as follows:

- a. A statement that the specified element(s), account(s), or item(s) identified in the report were compiled. If the compilation was performed in conjunction with a compilation of the company's financial statements, the paragraph should so state and indicate the date of the accountant's compilation report on those financial statements. Furthermore, any departure from the standard report on those statements should also be disclosed if considered relevant to the presentation of the specified element(s), account(s), or item(s).
- b. A statement that the compilation was performed in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.
- c. A description of the basis on which the specified element(s), account(s), or item(s) are presented if that basis is not generally accepted accounting principles and a statement that that basis of presentation is a comprehensive basis of accounting other than generally accepted accounting principles.
- d. A statement that a compilation is limited to presenting financial information that is the representation of management (owners).
- e. A statement that the specified element(s), account(s), or item(s) have not been audited or reviewed and, accordingly, the accountant does not express an opinion or any other form of assurance on it (them).
- f. A signature of the accounting firm or the accountant as appropriate. (The signature could be manual, stamped, electronic, or typed.)
- g. The date of the compilation report. (The date of completion of the compilation should be used as the date of the accountant's report.)

Any other procedures that the accountant might have performed before or during the compilation engagement should not be described in the report.

**.11** Each page of the compiled specified elements, accounts, or items of a financial statement should include a reference, such as "See Accountant's Compilation Report."

**.12** Following are illustrations of accountant's compilation reports on specified elements, accounts, or items of a financial statement.

### Report Related to Accounts Receivable

I (we) have compiled the accompanying schedule of accounts receivable of XYZ Company as of December 31, 20XX, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

## 1510 Statements on Standards for Accounting and Review Services

A compilation is limited to presenting financial information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying schedule of accounts receivable and, accordingly, do not express an opinion or any other form of assurance on it.

### **Report Related to the Schedule of Depreciation—Income Tax Basis**

I (we) have compiled the accompanying schedule of depreciation—income tax basis of XYZ Company as of December 31, 20XX, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The schedule of depreciation—income tax basis has been prepared on the accounting basis used by the Company for federal income tax purposes, which is a comprehensive basis of accounting other than generally accepted accounting principles.

A compilation is limited to presenting financial information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying schedule of depreciation—income tax basis and, accordingly, do not express an opinion or any other form of assurance on it.

**.13** An accountant is not precluded from issuing a compilation report on one or more specified elements, accounts, or items of a financial statement for an entity with respect to which the accountant is not independent.<sup>6</sup> If the accountant is not independent, he or she should specifically disclose the lack of independence. However, the reason for the lack of independence should not be described. When the accountant is not independent, the following should be included as the last paragraph of the report:

I am (we are) not independent with respect to XYZ Company.

**.14** This Statement is effective for engagements entered into after December 15, 2005. Early application is permitted.

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<sup>6</sup> In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA *Code of Professional Conduct*.

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## Appendix

### Compilation of Specified Elements, Accounts, or Items of a Financial Statement—Illustrative Engagement Letter

*[Appropriate Salutation]*

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, *[identify specified element, account, or item of the financial statement, e.g. schedule of accounts receivable or schedule of depreciation – income tax basis]* of XYZ Company as of December 31, 20XX.

We will compile the *[identify specified element, account, or item of the financial statement]* and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to present financial information that is the representation of management (owners) without undertaking to express any assurance on the information.

A compilation differs significantly from a review or an audit of financial information. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; tests of accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Therefore, a compilation does not provide a basis for expressing any level of assurance on the financial information being compiled.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts that may exist. However, we will inform the appropriate level of management of any material errors, and of any evidence or information that comes to our attention during the performance of our compilation procedures, that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

As part of our engagement, we will also *[list any nonattest services to be performed, if applicable, such as income tax preparation and bookkeeping services]*.

You are responsible for:

- a. Making all management decisions and performing all management functions;
- b. Designating an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;
- c. Evaluating the adequacy and results of the services performed;

**1512**      **Statements on Standards for Accounting and Review Services**

- d. Accepting responsibility for the results of the services; and
- e. Establishing and maintaining internal controls, including monitoring ongoing activities.

If, for any reason, we are unable to complete the compilation of your [*identify specified element, account, or item of the financial statement*], we will not issue a report on such schedule as a result of this engagement.

Our fees for these services . . . .

We will be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us. \*

Sincerely yours,

\_\_\_\_\_  
[Signature of accountant]

Acknowledged:  
XYZ Company

\_\_\_\_\_  
President

\_\_\_\_\_  
Date

[As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008, by Statement on Standards for Accounting and Review Services No. 17.]

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\* Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning, "If the foregoing..." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement..."

## AR Section 120

# *Compilation of Pro Forma Financial Information*

**Issue date, unless otherwise indicated: July, 2005**

**Source: SSARS No. 14, SSARS No. 17**

**.01** Statements on Standards for Accounting and Review Services (SSARS) currently provide guidance concerning the standards and procedures applicable when an accountant submits unaudited financial statements to his or her client or third parties. By definition, presentations of pro forma financial information are not financial statements. This Statement expands SSARS to apply when an accountant is engaged to compile or issues a compilation report on pro forma financial information.

**.02** A compilation of pro forma financial information is limited to presenting financial information that is the representation of management (owners) without undertaking to express any assurance on that information. (The accountant might consider it necessary to perform other accounting services to compile the financial information.)

**.03** The objective of pro forma financial information is to show what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date. Pro forma financial information is commonly used to show the effects of transactions such as the following:

- Business combination
- Change in capitalization
- Disposition of a significant portion of the business
- Change in the form of business organization or status as an autonomous entity
- Proposed sale of securities and the application of the proceeds

**.04** This objective is achieved primarily by applying pro forma adjustments to historical financial information. Pro forma adjustments should be based on management's assumptions and give effect to all significant effects directly attributable to the transaction (or event).

**.05** Pro forma financial information should be labeled as such to distinguish it from historical financial information. This presentation should describe the transaction (or event) that is reflected in the pro forma financial information, the source of the historical financial information on which it is based, the significant assumptions used in developing the pro forma adjustments, and any significant uncertainties about those assumptions. The presentation should also indicate that the pro forma financial information should be read in conjunction with the related historical financial information and that the pro forma financial information is not necessarily indicative of the results (such as financial position and results of operations, as applicable) that would have been attained had the transaction (or event) actually taken place earlier.

## Conditions for Compiling Pro Forma Financial Information

**.06** Nothing in this Statement is intended to preclude an accountant from preparing or assisting in the preparation of pro forma financial information and submitting such pro forma financial information to the client without the issuance of a compilation report, unless the accountant has been engaged to compile such pro forma financial information. If an accountant prepares or assists a client in preparing pro forma financial information,<sup>1</sup> the accountant should consider how such a presentation of pro forma financial information will be used. The accountant should consider the potential of being associated with pro forma financial information and the likelihood that the user may inappropriately infer, through that association, an unintended level of assurance. If the accountant believes that he or she will be associated with the information, the accountant should consider issuing a compilation report so a user will not infer a level of assurance that does not exist.

**.07** An engagement to compile pro forma financial information may be undertaken as a separate engagement or in conjunction with a compilation of financial statements. The accountant may agree to compile pro forma financial information if the document that contains the pro forma financial information includes (or incorporates by reference) complete historical financial statements of the entity for the most recent year (or for the preceding year if financial statements for the most recent year are not yet available) and, if pro forma financial information is presented for an interim period, the document also includes (or incorporates by reference) historical interim financial information for that period (which may be presented in condensed form). In the case of a business combination, the document should include (or incorporate by reference) the appropriate historical financial information for the significant constituent parts of the combined entity.

**.08** Additionally, the historical financial statements of the entity (or, in the case of a business combination, of each significant constituent part of the combined entity) on which the pro forma financial information is based must have been compiled, reviewed, or audited. The accountant's compilation or review report or the auditor's report on the historical financial statements should be included (or incorporated by reference) in the document containing the pro forma financial information.

## Understanding With the Entity

**.09** When an accountant is engaged to compile pro forma financial information, the accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. The understanding should include a description of the nature and limitations of the services to be performed and a description of the report. The understanding should also provide:

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<sup>1</sup> If the pro forma financial information is included as accompanying information to the basic financial statements, the accountant should refer to Statement on Standards for Accounting and Review Services (SSARS) No. 1, *Compilation and Review of Financial Statements* [section 100.83], as amended.

- a. That the engagement cannot be relied upon to disclose errors, fraud,<sup>2</sup> or illegal acts<sup>3</sup> and
- b. That the accountant will inform the appropriate level of management of any material errors and of any evidence or information that comes to the accountant's attention during the engagement to compile pro forma financial information<sup>4</sup> that fraud or an illegal act may have occurred.<sup>5</sup> The accountant need not report any matters regarding illegal acts that may have occurred that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such matters to be communicated.

.10 When the accountant is engaged to compile pro forma financial information and evidence or information comes to his or her attention during the engagement that fraud or an illegal act may have occurred, the accountant must adhere to the communication requirements contained in SSARS No. 1, *Compilation and Review of Financial Statements* [section 100.84–.85], as amended.

## Performance Requirements

.11 When the accountant is engaged to compile or issues a compilation report on pro forma financial information, he or she must adhere to the compilation performance requirements contained in SSARS No. 1 [section 100.08–.11], as amended.

.12 Before issuance of a compilation report on pro forma financial information, the accountant should read such compiled pro forma financial information, including the summary of significant assumptions,<sup>6</sup> and consider whether the information appears to be appropriate in form and free of obvious material errors. In this context, the term *error* refers to mistakes in the compilation of the pro forma financial information, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including disclosures, if presented.

## Reporting Requirements

.13 When the accountant is engaged to compile or issues a compilation report on pro forma financial information, the basic elements of the report are as follows:

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<sup>2</sup> For purposes of this Statement, *fraud* is an intentional act that results in a misstatement in compiled pro forma financial information.

<sup>3</sup> For purposes of this Statement, *illegal* acts are violations of laws or government regulations, excluding fraud.

<sup>4</sup> Performance requirements with respect to an engagement to compile pro forma financial information are contained in paragraphs .11 and .12.

<sup>5</sup> Whether the act is, in fact, fraudulent or illegal is a determination that is normally beyond the accountant's professional competence. An accountant, in reporting on pro forma financial information, presents himself or herself as one who is proficient in accounting and compilation services. The accountant's training, experience, and understanding of the client and its industry may provide a basis for recognition that some client acts coming to his or her attention may be fraudulent or illegal. However, the determination as to whether a particular act is fraudulent or illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law.

<sup>6</sup> The accountant may not report on compiled pro forma financial information if the summary of significant assumptions is not presented. Nothing in this Statement should be interpreted to preclude the accountant from reporting on compiled pro forma financial information when management elects to omit substantially all disclosures. In that situation, the accountant should follow the guidance in SSARS No. 1 [section 100.19–.21], as amended.



## 1516 Statements on Standards for Accounting and Review Services

- a. An identification of the pro forma financial information.
- b. A statement that the compilation was performed in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.
- c. A reference to the financial statements from which the historical financial information is derived and a statement on whether such financial statements were compiled, reviewed, or audited. (The report on pro forma financial information should refer to any modifications in the accountant's or auditor's report on historical financial statements.)
- d. A statement that the pro forma financial information was compiled. If the compilation was performed in conjunction with a compilation of the company's financial statements, the paragraph should so state and indicate the date of the accountant's compilation report on those financial statements. Furthermore, any departure from the standard report on those statements should also be disclosed if considered relevant to the presentation of the pro forma financial information.
- e. A description of the basis on which the pro forma financial information is presented if that basis is not generally accepted accounting principles and a statement that that basis of presentation is a comprehensive basis of accounting other than generally accepted accounting principles.
- f. A statement that a compilation is limited to presenting pro forma financial information that is the representation of management (owners).
- g. A statement that the pro forma financial information has not been audited or reviewed and, accordingly, the accountant does not express an opinion or any other form of assurance on it.
- h. A separate paragraph explaining the objective of pro forma financial information and its limitations.
- i. A signature of the accounting firm or the accountant as appropriate. (The signature could be manual, stamped, electronic, or typed.)
- j. The date of the compilation report. (The date of completion of the compilation should be used as the date of the accountant's report.)

Any other procedures that the accountant might have performed before or during the compilation engagement should not be described in the report.

**.14** Each page of the compiled pro forma financial information should include a reference, such as "See Accountant's Compilation Report."

**.15** The following is an illustration of an accountant's compilation report on pro forma financial information.

I (we) have compiled the accompanying pro forma financial information as of and for the year ended December 31, 20XX, reflecting the business combination of the Company and ABC Company in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The historical condensed financial statements are derived from the historical unaudited financial statements of XYZ Company,

which were compiled by me (us), and of ABC Company, which were compiled by another (other) accountant(s).<sup>7</sup>

A compilation is limited to presenting pro forma financial information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying pro forma financial information and, accordingly, do not express an opinion or any other form of assurance on it.

The objective of this pro forma financial information is to show what the significant effects on the historical financial information might have been had the transaction (or event) occurred at an earlier date. However, the pro forma financial information is not necessarily indicative of the results of operations or related effects on financial position that would have been attained had the above-mentioned transaction (or event) actually occurred earlier.

*[If the presentation does not include all applicable disclosures, the following paragraph should be added.]*<sup>8</sup>

Management has elected to omit all of the disclosures ordinarily included in pro forma financial information. The omitted disclosures might have added significant information regarding the company's pro forma financial position and results of operations. Accordingly, this pro forma financial information is not designed for those who are not informed about such matters.

**.16** An accountant is not precluded from issuing a compilation report on pro forma financial information for an entity with respect to which the accountant is not independent.<sup>9</sup> If the accountant is not independent, he or she should specifically disclose the lack of independence. However, the reason for the lack of independence should not be described. When the accountant is not independent, the following should be included as the last paragraph of the report:

I am (we are) not independent with respect to XYZ Company.

**.17** This Statement is effective for engagements entered into after December 15, 2005. Early application is permitted.

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<sup>7</sup> Where one set of historical financial statements is audited or reviewed and the other is audited, reviewed, or compiled, wording similar to the following would be appropriate:

The historical condensed financial statements are derived from the historical financial statements of XYZ Company, which were compiled by me (us), and of ABC Company, which were reviewed by another (other) accountant(s), appearing elsewhere herein (or incorporated by reference).

If either accountant's review report or auditor's report includes an explanatory paragraph or is modified, that fact should be referred to within this report.

<sup>8</sup> The accountant may not report on compiled pro forma financial information if the summary of significant assumptions is not presented.

<sup>9</sup> In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA Code of Professional Conduct.

## Appendix

### Compilation of Pro Forma Financial Information—Illustrative Engagement Letter

*[Appropriate Salutation]*

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, the pro forma financial information of XYZ Company as of December 31, 20XX.

We will compile the pro forma financial information and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to present financial information that is the representation of management (owners) without undertaking to express any assurance on the information.

A compilation differs significantly from a review or an audit of financial information. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; tests of accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Therefore, a compilation does not provide a basis for expressing any level of assurance on the financial information being compiled.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts that may exist. However, we will inform the appropriate level of management of any material errors, and of any evidence or information that comes to our attention during the performance of our compilation procedures, that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

As part of our engagement, we will also *[list any nonattest services to be performed, if applicable, such as income tax preparation and bookkeeping services]*.

You are responsible for:

- a. Making all management decisions and performing all management functions;
- b. Designating an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;
- c. Evaluating the adequacy and results of the services performed;
- d. Accepting responsibility for the results of the services; and
- e. Establishing and maintaining internal controls, including monitoring ongoing activities.

If, for any reason, we are unable to complete the compilation of your pro forma financial information, we will not issue a report on such schedule as a result of this engagement.

Our fees for these services . . . .

We will be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.\*

Sincerely yours,

\_\_\_\_\_  
 [*Signature of accountant*]

Acknowledged:

XYZ Company

\_\_\_\_\_  
 President

\_\_\_\_\_  
 Date

[As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2008, by Statement on Standards for Accounting and Review Services No. 17.]

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\* Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning, "If the foregoing..." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement..."



**AR Section 200****Reporting on Comparative Financial Statements**

Issue date, unless  
otherwise indicated:  
October, 1979

Source: SSARS No. 2;  
SSARS No. 3; SSARS No. 4;  
SSARS No. 5; SSARS No. 7;  
SSARS No. 11; SSARS No. 12;  
SSARS No. 15; SSARS No. 17

**.01** This Section establishes standards for reporting on comparative financial statements<sup>1</sup> of a nonissuer when financial statements of one or more periods presented have been compiled and reported on or reviewed in accordance with SSARS No. 1 [AR section 100].<sup>2</sup> [Revised, October 2000, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 8. As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by Statement on Standards for Accounting and Review Services No. 17.]

**.02** When comparative financial statements are presented, the accountant should issue an appropriate report(s) covering each period presented in accordance with the provisions of this Section.<sup>[3]</sup>

**.03** Client-prepared financial statements of some periods that have not been audited, reviewed, or compiled may be presented on separate pages of a document that also contains financial statements of other periods on which the accountant has reported if they are accompanied by an indication by the client that the accountant has not audited, reviewed, or compiled those financial statements and that the accountant assumes no responsibility for them. Whenever the accountant becomes aware that financial statements of other periods that have not been audited, reviewed, or compiled have been presented in columnar form in a document with financial statements on which he has reported and that his name has been used or his report included in the document, he should advise his client that the use of his name or report is inappropriate and should consider what other actions might be appropriate, including consultation with his attorney.

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<sup>1</sup> This Section supersedes Statement on Standards for Accounting and Review Services No. 1, as amended, paragraph 79 [section 100[.92]]. [Footnote revised, May 2004, to reflect the conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 10.]

<sup>2</sup> The terms *nonissuer*, *financial statements*, *compilation*, and *review* are defined in paragraph 4 of AR section 100. [As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by Statement on Standards for Accounting and Review Services No. 17.]

<sup>[3]</sup> [Footnote deleted to reflect the conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 8.]

**.04** An accountant may modify his report with respect to one or more financial statements for one or more periods while issuing an unmodified report on the other financial statements presented.

**.05** Compiled financial statements that omit substantially all of the disclosures required by generally accepted accounting principles<sup>4</sup> are not comparable to financial statements that include such disclosures. Accordingly, the accountant should not issue a report on comparative financial statements when statements for one or more, but not all, of the periods presented omit substantially all of the disclosures required by generally accepted accounting principles. (See paragraphs .30 and .31 for guidance on reporting on financial statements that previously did not omit substantially all of the disclosures required by generally accepted accounting principles.) [As amended by the issuance of Statement on Standards for Accounting and Review Services No. 15, July 2007.]

**.06** Each page of the comparative financial statements compiled or reviewed by the accountant should include a reference such as "See Accountant's Report."

## Definitions

**.07** The following definitions apply for purposes of this Section:

*Comparative financial statements.* Financial statements of two or more periods presented in columnar form.

*Continuing accountant.* An accountant who has been engaged to audit, review, or compile and report on the financial statements of the current period and one or more consecutive periods immediately prior to the current period.

*Updated report.* A report issued by a continuing accountant that takes into consideration information that he becomes aware of during his current engagement and that re-expresses his previous conclusions or, depending on the circumstances, expresses different conclusions on the financial statements of a prior period as of the date of his current report.<sup>5</sup>

*Reissued report.* A report issued subsequent to the date of the original report that bears the same date as the original report. A reissued report may need to be revised for the effects of specific events; in these circumstances, the report should be dual-dated with the original date and a separate date that applies to the effects of such events.

## Continuing Accountant's Standard Report

**.08** A continuing accountant who performs the same or a higher level of service with respect to the financial statements of the current period should update his report on the financial statements of a prior period presented with those of the current period.<sup>6</sup> A continuing accountant who performs a lower

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<sup>4</sup> For purposes of this Section, reference to generally accepted accounting principles includes, where applicable, an other comprehensive basis of accounting as defined in AR section 100.04. [Footnote amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by the issuance of Statement on Standards for Accounting and Review Services No. 15.]

<sup>5</sup> See paragraphs .13 and .45 of AR section 100, as amended. [Footnote revised, November 2002, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 9. Footnote revised, May 2004, to reflect the conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 10.]

<sup>6</sup> For purposes of this Section, a *review* is a higher level of service and a *compilation* is a lower level of service. When one of the periods is audited, see paragraphs .28 and .29.

level of service with respect to the financial statements of the current period should either (a) include as a separate paragraph of his report a description of the responsibility assumed for the financial statements of the prior period (see paragraphs .11 and .12) or (b) reissue his report on the financial statements of the prior period.

**.09** Examples of a continuing accountant's standard report on comparative financial statements when the same level of service has been performed for both periods are presented below:

#### **Compilation Each Period**

I (we) have compiled the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

February 1, 20X3

#### **Review Each Period**

I (we) have reviewed the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

March 1, 20X3

[As amended, effective for periods ending after December 15, 1993, by Statement on Standards for Accounting and Review Services No. 7.]

**.10** An example of a continuing accountant's standard report on comparative financial statements for two periods when the financial statements of the current period have been reviewed and those of the prior period have been compiled is presented below:

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an



## 1524 Statements on Standards for Accounting and Review Services

audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the 20X2 financial statements in order for them to be in conformity with generally accepted accounting principles.

The accompanying 20X1 financial statements of XYZ Company were compiled by me (us). A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the 20X1 financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

March 1, 20X3

[As amended, effective for periods ending after December 15, 1993, by Statement on Standards for Accounting and Review Services No. 7.]

**.11** A continuing accountant who performs a compilation of the current-period financial statements and has previously reviewed one or more prior-period financial statements should report as indicated in either (a) or (b) below:

- a. Issue a compilation report on the current-period financial statements that includes a description of the responsibility assumed for the financial statements of the prior period. The description should include the original date of the accountant's report and should also state that he has not performed any procedures in connection with that review engagement after that date.
- b. Combine his compilation report on the financial statements of the current period with his reissued review report on the financial statements of the prior period or present them separately. The combined report should state that the accountant has not performed any procedures in connection with that review engagement after the date of his review report.

**.12** An example of a paragraph that may be added to a compilation report on the current-period financial statements describing the responsibilities assumed when prior-period financial statements were reviewed is presented below:

The accompanying 20X1 financial statements of XYZ Company were previously reviewed by me (us) and my (our) report dated March 1, 20X2, stated that I was (we were) not aware of any material modifications that should be made to those statements in order for them to be in conformity with generally accepted accounting principles. I (we) have not performed any procedures in connection with that review engagement after the date of my (our) report on the 20X1 financial statements.

### Continuing Accountant's Changed Reference to a Departure From Generally Accepted Accounting Principles

**.13** During his current engagement, the accountant should be aware that circumstances or events may affect the prior-period financial statements presented, including the adequacy of informative disclosures. The accountant should consider the effects on his report on the prior-period financial statements of circumstances or events coming to his attention.

**.14** When the accountant's report on the financial statements of the prior period contains a changed reference to a departure from generally accepted accounting principles,<sup>7</sup> his report should include a separate explanatory paragraph indicating—

- a. The date of the accountant's previous report.
- b. The circumstances or events that caused the reference to be changed.
- c. When applicable, that the financial statements of the prior period have been changed.

**.15** The following is an example of an explanatory paragraph appropriate when an accountant's report contains a changed reference to a departure from generally accepted accounting principles:

In my (our) previous (compilation) (review) report dated March 1, 20X2, on the 20X1 financial statements, I (we) referred to a departure from generally accepted accounting principles because the company carried its land at appraised values. However, as disclosed in note X, the company has restated its 20X1 financial statements to reflect its land at cost in accordance with generally accepted accounting principles.

## Predecessor's Compilation or Review Report

**.16** A predecessor may reissue his report at the client's request if he is able to make satisfactory arrangements with his former client and if he complies with the provisions of paragraphs .20 to .24. However, a predecessor is not required to reissue his compilation or review report on the financial statements of a prior period. If he does not reissue his compilation or review report on the financial statements of a prior period, a successor should either (a) make reference to the report of the predecessor in accordance with the provisions of paragraphs .17 to .19 or (b) perform a compilation, review, or audit of the financial statements of the prior period and report on them accordingly.<sup>[8]</sup>

## Predecessor's Compilation or Review Report Not Presented

**.17** When the financial statements of a prior period have been compiled or reviewed by a predecessor whose report is not presented and the successor has not compiled or reviewed those financial statements, the successor should make reference in an additional paragraph(s) of his report on the current-period financial statements to the predecessor's report on the prior-period financial statements. This reference should include the following matters:

- a. A statement that the financial statements of the prior period were compiled or reviewed by another accountant (other accountants).<sup>9</sup>
- b. The date of his (their) report.
- c. A description of the standard form of disclaimer or limited assurance, as applicable, included in the report.

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<sup>7</sup> A changed reference includes the removal of a prior reference or the inclusion of a new reference.

<sup>[8]</sup> [Footnote deleted by the issuance of Statement on Standards for Accounting and Review Services No. 4, December 1981.]

<sup>9</sup> The successor accountant should not name the predecessor accountant in his or her report; however, the successor accountant may name the predecessor accountant if the predecessor accountant's practice was acquired by, or merged with, that of the successor accountant. [As amended, effective May 2004, by Statement on Standards for Accounting and Review Services No. 11.]

- d.* A description or a quotation of any modifications of the standard report and of any paragraphs emphasizing a matter regarding the financial statements.

**.18** When the predecessor reviewed the financial statements of the prior period, an example of the last paragraph of the successor's report is as follows:

The 20X1 financial statements of XYZ Company were reviewed by other accountants whose report dated March 1, 20X2, stated that they were not aware of any material modifications that should be made to those statements in order for them to be in conformity with generally accepted accounting principles.

**.19** When the predecessor compiled the financial statements of the prior period, an example of the last paragraph of the successor's report is as follows:

The 20X1 financial statements of XYZ Company were compiled by other accountants whose report dated February 1, 20X2, stated that they did not express an opinion or any other form of assurance on those statements.

### **Predecessor's Compilation or Review Report Reissued**

**.20** Before reissuing a compilation or review report on the financial statements of a prior period, a predecessor should consider whether his report is still appropriate. In making this determination, the predecessor should consider (a) the current form and manner of presentation of the prior-period financial statements, (b) subsequent events not previously known, and (c) changes in the financial statements that require the addition or deletion of modifications to the standard report.

**.21** A predecessor should perform the following procedures before reissuing his compilation or review report on the financial statements of a prior period:

- a.* Read the financial statements of the current period and the successor's report.
- b.* Compare the prior-period financial statements with those previously issued and with those of the current period.
- c.* Obtain a letter from the successor that indicates whether he is aware of any matter that, in his opinion, might have a material effect on the financial statements, including disclosures, reported on by the predecessor. The predecessor should not refer in his reissued report to this letter or to the report of the successor.

**.22** If a predecessor becomes aware of information, including information about events or transactions occurring subsequent to the date of his previous report, that he believes may affect the prior-period financial statements or his report on them, he should (a) make inquiries or perform analytical procedures similar to those he would have performed if he had been aware of such information at the date of his report on the prior-period financial statements and (b) perform any other procedures he considers necessary in the circumstances. For example, the predecessor may wish to discuss this information with the successor or to review the working papers of the successor as they relate to the matters affecting the prior-period financial statements. If the predecessor decides, based on the information obtained, that his report on the prior-period financial statements should be revised, he should follow the guidance in paragraphs .14, .15, .23, and .24.

**.23** A predecessor's knowledge of the current affairs of his former client is obviously limited in the absence of a continuing relationship. Consequently, when reissuing his report on the prior-period financial statements, a predecessor should use the date of his previous report to avoid any implication that

he has performed procedures after that date other than those described in paragraphs .20 to .22. If the predecessor revises his report or if the financial statements are restated, he should dual-date his report (for example, "March 1, 20X1, except for note X, as to which the date is March 15, 20X2"). The predecessor's responsibility for events occurring subsequent to the completion of his engagement is limited to the specific event referred to in the note or otherwise disclosed. He should also obtain a written statement from the former client setting forth the information currently acquired and its effect on the prior-period financial statements and, if applicable, expressing an understanding of its effect on the predecessor's reissued report.

.24 If a predecessor is unable to complete the procedures described in paragraphs .20 to .23, he should not reissue his report and may wish to consult with his attorney regarding the appropriate course of action.

## Restated Prior-Period Financial Statements

.25 When prior-period financial statements have been restated,<sup>10</sup> the predecessor accountant would normally reissue his or her report following the guidance in paragraph .22. If the predecessor decides not to reissue his or her report, the successor accountant may be engaged to report on the financial statements for the prior year. If the predecessor accountant does not reissue his or her report and the successor accountant is not engaged to report on the prior year financial statements, the successor accountant should indicate in the introductory paragraph of his or her compilation or review report that a predecessor accountant reported on the financial statements of the prior period before restatement. In addition, if the successor accountant is engaged to compile or review the restatement adjustment(s), he or she may also indicate in the accountant's report that he or she compiled or reviewed the adjustment(s) that was (were) applied to restate prior-year financial statements. [As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by Statement on Standards for Accounting and Review Services No. 12.]

.26 The following is an example of a successor accountant's compilation report when the predecessor accountant's report is not presented and the successor accountant is engaged to compile the restatement adjustment(s):

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. I (we) also compiled the adjustment(s) described in Note X that was (were) applied to restate the 20X1 financial statements. The 20X1 financial statements of XYZ Company, before the adjustment(s) described in Note X<sup>11</sup> that was (were) applied to restate the 20X1 financial statements,

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<sup>10</sup> See AR section 400.10–.11, *Communications Between Predecessor and Successor Accountants* for guidance regarding communication to the predecessor accountant with respect to information that leads the successor accountant to believe that the financial statements reported on by the predecessor accountant may require revision. [Footnote added, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by Statement on Standards for Accounting and Review Services No. 12.]

<sup>11</sup> In the situation where management elects to omit substantially all disclosures, the accountant should follow the guidance in AR section 100, *Compilation and Review of Financial Statements* [section 100.19–.22], as amended. [Footnote added, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by Statement on Standards for Accounting and Review Services No. 12.]

## 1528 Statements on Standards for Accounting and Review Services

were compiled by other accountants whose report dated March 31, 20X2, did not express an opinion or any other form of assurance on those financial statements.

*[Same second paragraph as the standard report]*

[As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by Statement on Standards for Accounting and Review Services No. 12.]

**.27** The following is an example of a successor accountant's review report when the predecessor accountant's report is not presented and the successor accountant is engaged to review the restatement adjustment(s).<sup>12</sup>

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company. The 20X1 financial statements of XYZ before the adjustment(s) described in Note X that was (were) applied to restate the 20X1 financial statements were reviewed by other accountants whose report dated March 31, 20X2, stated that they were not aware of any material modifications that should be made to those financial statements in order for them to be in conformity with generally accepted accounting principles.

*[Same second and third paragraphs as the standard report]*

I (we) also reviewed the adjustment(s) as described in Note X that was (were) applied to restate the 20X1 financial statements. Based on my (our) review, nothing came to my (our) attention to indicate that the adjustment(s) is (are) not appropriate and properly applied.

[Paragraph added, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by Statement on Standards for Accounting and Review Services No. 12.]

## Reporting When One Period Is Audited

**.28** Notwithstanding the provisions of paragraph .08, the accountant should follow the guidance in statements on auditing standards, which provide guidance on reporting on comparative financial statements when the current-period financial statements have been audited and those for one or more prior periods have been compiled or reviewed. [Paragraph renumbered by the issuance of Statement on Standards for Accounting and Review Services No. 12, July 2005.]

**.29** When the current-period financial statements of a nonissuer have been compiled or reviewed and those of the prior period have been audited, the accountant should issue an appropriate compilation or review report on the current-period financial statements and either (a) the report on the prior period should be reissued or (b) the report on the current period should include as a separate paragraph an appropriate description of the responsibility assumed

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<sup>12</sup> The accountant should follow the performance requirements in AR section 100.29–.43, as amended. [Footnote added, effective for compilations and reviews of financial statements for periods ending after December 15, 2005, by Statement on Standards for Accounting and Review Services No. 12.]

for the financial statements of the prior period. In the latter case, the separate paragraph should indicate (a) that the financial statements of the prior period were audited previously, (b) the date of the previous report, (c) the type of opinion expressed previously, (d) if the opinion was other than unqualified, the substantive reasons therefor, and (e) that no auditing procedures were performed after the date of the previous report. An example of such a separate paragraph is the following:

The financial statements for the year ended December 31, 20X1, were audited by us (other accountants) and we (they) expressed an unqualified opinion on them in our (their) report dated March 1, 20X2, but we (they) have not performed any auditing procedures since that date.

[Paragraph renumbered by the issuance of Statement on Standards for Accounting and Review Services No. 12, July 2005. As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by Statement on Standards for Accounting and Review Services No. 17.]

## Reporting on Financial Statements That Previously Did Not Omit Substantially All Disclosures

**.30** An accountant who has compiled, reviewed, or audited financial statements that did not omit substantially all of the disclosures required by generally accepted accounting principles may subsequently be requested to compile statements for the same period that do omit substantially all of those disclosures when they are to be presented in comparative financial statements. Notwithstanding the provisions of AR section 100, paragraph 2, in these circumstances the accountant may report on comparative compiled financial statements that omit such disclosures if he includes in his report an additional paragraph indicating the nature of the previous service rendered with respect to those financial statements and the date of his previous report. [Paragraph renumbered by the issuance of Statement on Standards for Accounting and Review Services No. 12, July 2005.]

**.31** An example of a report appropriate when prior-period financial statements that omit substantially all disclosures have been compiled from previously reviewed financial statements for the same period is presented below:

I (we) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

## 1530 Statements on Standards for Accounting and Review Services

The accompanying 20X1 financial statements were compiled by me (us) from financial statements that did not omit substantially all of the disclosures required by generally accepted accounting principles and that I (we) previously reviewed as indicated in my (our) report dated March 1, 20X2.

February 1, 20X3

[As amended, effective for periods ending after December 15, 1993, by Statement on Standards for Accounting and Review Services No. 7. Paragraph renumbered by the issuance of Statement on Standards for Accounting and Review Services No. 12, July 2005.]

### Change of Status—Issuer/Nonissuer

**.32** When reporting on comparative financial statements for either interim or annual periods, the current status of the entity should govern whether the accountant is guided by statements on auditing standards or statements on standards for accounting and review services. A previously issued report that is not appropriate for the current status of the entity should not be reissued or referred to in the report on the financial statements of the current period. [Paragraph renumbered by the issuance of Statement on Standards for Accounting and Review Services No. 12, July 2005. Section head amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by Statement on Standards for Accounting and Review Services No. 17.]

**.33** For example, if the entity is an issuer in the current period and was a nonissuer in the prior period, a compilation or review report previously issued on the financial statements of the prior period should not be reissued or referred to in the report on the financial statements of the current and one or more prior periods.<sup>13</sup> If an entity is a nonissuer in the current period and was an issuer in the prior period, the annual financial statements of the prior period may have been audited.<sup>14</sup> In these circumstances, the accountant should refer to paragraph .29 for guidance on the appropriate method of reporting on the comparative financial statements. [Paragraph renumbered by the issuance of Statement on Standards for Accounting and Review Services No. 12, July 2005. As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by Statement on Standards for Accounting and Review Services No. 17.]

### Transition

[**.34–.36**] [Paragraphs deleted to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services

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<sup>13</sup> In these circumstances, the accountant should refer to auditing standards promulgated by the Public Company Accounting Oversight Board for guidance on the appropriate method of reporting on the comparative financial statements. [Footnote renumbered by the issuance of Statement on Standards for Accounting and Review Services No. 12, July 2005. As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by Statement on Standards for Accounting and Review Services No. 17.]

<sup>14</sup> If an unaudited disclaimer of opinion was previously issued on the financial statements of the prior period, it should not be reissued or referred to in the report on the financial statements of the current period. In these circumstances, the accountant should comply with the compilation or review standards in AR section 100 (or perform an audit) and report accordingly on the financial statements of the prior period. [Footnote renumbered by the issuance of Statement on Standards for Accounting and Review Services No. 12, July 2005. As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by Statement on Standards for Accounting and Review Services No. 17.]

No. 8. Paragraphs renumbered by the issuance of Statement on Standards for Accounting and Review Services No. 12, July 2005.]

## Effective Date

.37 This Section will be effective for reports on comparative financial statements for periods ending on or after November 30, 1979. However, earlier application is encouraged for periods ending on or after July 1, 1979. [Paragraph renumbered by the issuance of Statement on Standards for Accounting and Review Services No. 12, July 2005.]

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## AR Section 9200

# Reporting on Comparative Financial Statements: Accounting and Review Services Interpretations of Section 200

### 1. Reporting on Financial Statements That Previously Did Not Omit Substantially All Disclosures

**.01 Question**—Paragraph 30 of SSARS No. 2 [section 200.30], *Reporting on Comparative Financial Statements*, states that an accountant who has compiled, reviewed, or audited financial statements that do not omit substantially all of the disclosures required by generally accepted accounting principles may subsequently compile financial statements for the same period that do omit substantially all of those disclosures when they are to be presented in comparative financial statements. In these circumstances, SSARS No. 2 [section 200] requires the accountant's compilation report to include an additional paragraph indicating (a) the nature of the service rendered with respect to the financial statements that previously did not omit substantially all disclosures and (b) the date of his previous report.

**.02** When the accountant has previously audited such financial statements, he may have issued a qualified opinion (see paragraphs 38 and 39 of SAS No. 58 [AU section 508.38–.39], *Reports on Audited Financial Statements*) or an adverse opinion (see paragraphs 67 to 69 of SAS No. 58) [AU section 508.67–.69], or he may have disclaimed an opinion (see paragraphs 70 to 72 of SAS No. 58 [AU section 508.70–.72]). What effect, if any, should this have on the accountant's report on the comparative compiled financial statements? Also, when the accountant has previously compiled or reviewed such financial statements, what effect should a modification to his compilation or review report (see paragraphs 51 to 53 of SSARS No. 1 [section 100.51–.53]) have on the accountant's report on the comparative compiled financial statements?

**.03 Interpretation**—If financial statements that omit substantially all disclosures are compiled from financial statements that the accountant has previously audited, his report on the comparative compiled financial statements should indicate whether he expressed a qualified or adverse opinion, or disclaimed an opinion, on the audited financial statements, and the substantive reasons therefor. Similarly, if the accountant issued a modified compilation or review report or a report containing any paragraphs emphasizing a matter regarding the financial statements (see paragraphs 51 to 53 of SSARS No. 1 [section 100.51–.53]) on financial statements that previously did not omit substantially all disclosures, the accountant's reference to that report in his report on the comparative compiled financial statements should include a description or a quotation of any modifications of the standard report and of any paragraphs emphasizing a matter regarding the financial statements.

**.04** Statements on standards for accounting and review services do not require an accountant to modify the standard compilation or review report for an uncertainty or an inconsistency in the application of generally accepted accounting principles. When the accountant's report on comparative compiled financial statements that omit substantially all of the disclosures required by generally

**1534**      **Statements on Standards for Accounting and Review Services**

accepted accounting principles includes a reference to a previous audit report that includes an explanatory paragraph describing an uncertainty, users may assume, in the absence of an indication to the contrary, that the uncertainty has been resolved. Thus, in such circumstances, the accountant should consider the desirability of emphasizing the uncertainty in a separate paragraph of that portion of his report that relates to the financial statements for the current period.

[Issue Date: November, 1980; Revised: November, 2002;  
Revised: May, 2004; Revised: July, 2005.]

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## AR Section 300

# Compilation Reports on Financial Statements Included in Certain Prescribed Forms

Issue date, unless  
otherwise indicated:  
December, 1981

Source: SSARS No. 3; SSARS No. 5;  
SSARS No. 7; SSARS No. 15; SSARS No. 17

**.01** The requirements of AR section 100 and AR section 200 are applicable when the unaudited financial statements of a nonissuer are included in a prescribed form. This Section amends AR section 100 and AR section 200 to provide for an alternative form of standard compilation report when the prescribed form or related instructions call for departure from generally accepted accounting principles by specifying a measurement principle not in conformity with generally accepted accounting principles or by failing to request the disclosures required by generally accepted accounting principles.<sup>1</sup> This section also provides additional guidance applicable to reports on financial statements included in a prescribed form.<sup>[2]</sup> [As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by Statement on Standards for Accounting and Review Services No. 17.]

**.02** For purposes of this section, a *prescribed form* is any standard preprinted form designed or adopted by the body to which it is to be submitted, for example, forms used by industry trade associations, credit agencies, banks, and governmental and regulatory bodies other than those concerned with the sale or trading of securities. A form designed or adopted by the entity whose financial statements are to be compiled is not considered to be a prescribed form. The terms *financial statement*, *issuer* and *nonissuer* are defined in paragraph .04 of AR section 100. [As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by Statement on Standards for Accounting and Review Services No. 17.]

**.03** There is a presumption that the information required by a prescribed form is sufficient to meet the needs of the body that designed or adopted the form and that there is no need for that body to be advised of departures from generally accepted accounting principles required by the prescribed form or related instructions. Therefore, in the absence of a requirement or a request for a review report on the financial statements included in a prescribed form, the following form of standard compilation report may be used when the unaudited

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<sup>1</sup> For purposes of this section, reference to generally accepted accounting principles includes, where applicable, an other comprehensive basis of accounting as defined in AR section 100.04. Disclosure of the basis of accounting should be made when an other comprehensive basis of accounting is used. [Footnote amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by the issuance of Statements on Standards for Accounting and Review Services No. 15.]

<sup>[2]</sup> [Deleted to reflect the incorporation of material into relevant sections of the Statements on Standards for Accounting and Review Services.]

financial statements of a nonissuer are included in a prescribed form that calls for departure from generally accepted accounting principles:

I (we) have compiled the (identification of financial statements, including period covered and name of entity) included in the accompanying prescribed form in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

My (our) compilation was limited to presenting in the form prescribed by (name of body) information that is the representation of management (owners). I (we) have not audited or reviewed the financial statements referred to above and, accordingly, do not express an opinion or any other form of assurance on them.

These financial statements (including related disclosures) are presented in accordance with the requirements of (name of body), which differ from generally accepted accounting principles. Accordingly, these financial statements are not designed for those who are not informed about such differences.

[As amended, effective for periods ending after December 15, 1993, by Statement on Standards for Accounting and Review Services No. 7. As amended, effective for compilations and reviews of financial statements for periods ending after December 15, 2008, by Statement on Standards for Accounting and Review Services No. 17.]

**.04** If the accountant becomes aware of a departure from generally accepted accounting principles other than departures that may be called for by the prescribed form or related instructions (see paragraph .01), he should follow the guidance in AR section 100.56–58, as amended, regarding such departures. (The sentence introducing the separate paragraph of his report disclosing the departure might read as follows: "However, I did become aware of a departure from generally accepted accounting principles that is not called for by the prescribed form or related instructions, as described in the following paragraph.") If the accountant becomes aware of a departure from the requirements of the prescribed form or related instructions, he should consider that departure as the equivalent of a departure from generally accepted accounting principles in determining its effect on his report. [Revised, November 2002, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 9. Revised, May 2004, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 10. Revised, July 2005, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 12.]

**.05** The accountant should not sign a preprinted report form that does not conform with the guidance in this Section or AR section 100, as amended, whichever is applicable. In such circumstances, the accountant should append an appropriate report to the prescribed form.

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## AR Section 9300

# ***Compilation Reports on Financial Statements Included in Certain Prescribed Forms: Accounting and Review Services Interpretations of Section 300***

### **1. Omission of Disclosures in Financial Statements Included in Certain Prescribed Forms**

**.01 Question**—The accountant may have reviewed financial statements including disclosures required by generally accepted accounting principles and be asked to compile financial statements included in a prescribed form which does not request such disclosures. If the measurement principles to be used do not cause the compiled financial statements in the prescribed form to be materially different from the reviewed statements, can the accountant's compilation report on the prescribed form refer to the accountant's report on the reviewed financial statements?

**.02 Interpretation**—Yes. The footnote to paragraph 2 of SSARS No. 1 [section 100.02] (as amended) permits an accountant who has reviewed the financial statements of a nonissuer to issue a compilation report on financial statements for the same period that are included in a prescribed form that calls for a departure from generally accepted accounting principles. When the difference between the previously reviewed financial statements and the financial statements included in the prescribed form is limited to the omission of disclosures not requested by the form, the accountant may wish to refer to his review report in his report on the compiled financial statements included in the prescribed form. This might be accomplished by adding a sentence such as the following to the second paragraph of the report illustrated in paragraph 3 of SSARS No. 3 [section 300.03] or as a separate paragraph: "These financial statements were compiled by me (us) from financial statements for the same period which I (we) previously reviewed, as indicated in my (our) report dated\_\_\_\_."\* The reference to a previous review report should include a description or a quotation of any modifications of the standard review report previously issued and of any paragraphs emphasizing a matter regarding the financial statements.

**.03** If the measurement principles used in the compiled financial statements in the prescribed form cause such financial statements to be materially different from the previously reviewed financial statements, no reference should be made to the review engagement.

[Issue Date: May, 1982. Revised: February, 2008.]

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\* The report included in paragraph 3 of SSARS No. 3 [section 300.03] is an alternate form of report. If the accountant elects to use the standard compilation report included in SSARS No. 1, paragraph 18 [section 100.20] this sentence may be added to that report.



**AR Section 400****Communications Between Predecessor and Successor Accountants**

Issue date, unless  
otherwise indicated:  
December, 1981

Source: SSARS No. 4; SSARS No. 7;  
SSARS No. 9; SSARS No. 15; SSARS No. 17

**.01** This Section provides guidance on communications between a predecessor and successor accountant when the successor accountant decides to communicate with the predecessor accountant regarding acceptance of an engagement to compile or review the financial statements of a nonissuer.<sup>[1]</sup> This Section also provides guidance on inquiries a successor accountant may wish to make of a predecessor, and the predecessor's responses, to facilitate the conduct of the successor's compilation or review engagement. It also requires a successor accountant who becomes aware of information that leads him or her to believe the financial statements reported on by the predecessor accountant may require revision to request that the client communicate this information to the predecessor accountant. [As amended, effective for periods ending after December 15, 1993, by Statement on Standards for Accounting and Review Services No. 7. As amended, effective November 2002, by Statement on Standards for Accounting and Review Services No. 9.]

**.02** The following definitions apply for purposes of this Section:

*Successor accountant.* An accountant who has been invited to make a proposal for an engagement to compile or review financial statements and is considering accepting the engagement or an accountant who has accepted such an engagement.

*Predecessor accountant.* An accountant who (a) has reported on the most recent compiled or reviewed financial statements or was engaged to perform but did not complete a compilation or review of the financial statements, and (b) has resigned, declined to stand for reappointment, or been notified that his or her services have been or may be terminated.

[As amended, effective November 2002, by Statement on Standards for Accounting and Review Services No. 9.]

**Inquiries Regarding Acceptance of an Engagement**

**.03** A successor accountant is not required to communicate with a predecessor accountant in connection with acceptance of a compilation or review engagement, but he or she may believe it is beneficial to obtain information that will assist in determining whether to accept the engagement. The successor

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<sup>[1]</sup> [Footnote deleted by the issuance of Statement on Standards for Accounting and Review Services No. 9, November 2002.]



## 1540 Statements on Standards for Accounting and Review Services

accountant may consider making inquiries of the predecessor accountant when circumstances such as the following exist:<sup>[2]</sup>

- a. The information obtained about the prospective client and its management and principals is limited or appears to require special attention.
- b. The change in accountants takes place substantially after the end of the accounting period for which statements are to be compiled or reviewed.
- c. There have been frequent changes in accountants.

The successor accountant should bear in mind that the predecessor accountant and the client may have disagreed about accounting principles, procedures applied by the predecessor accountant, or similarly significant matters. [As amended, effective November 2002, by Statement on Standards for Accounting and Review Services No. 9.]

**.04** The successor accountant should request permission from the prospective client to make any inquiries of the predecessor accountant. Except as permitted by the AICPA Code of Professional Conduct, an accountant is precluded from disclosing any confidential information obtained in the course of an engagement unless the client specifically consents. Accordingly, if the successor accountant decides to communicate with the predecessor, the successor accountant should request the client to (a) permit the successor accountant to make inquiries of the predecessor accountant and (b) authorize the predecessor accountant to respond fully to those inquiries.<sup>3</sup> If the prospective client refuses to permit the predecessor accountant to respond or limits the response, the successor accountant should inquire about the reasons and consider the implications of that refusal in connection with acceptance of the engagement. [As amended, effective November 2002, by Statement on Standards for Accounting and Review Services No. 9.]

**.05** When the successor accountant decides to communicate with the predecessor accountant, the inquiries may be oral or written. The inquiries should be specific and reasonable regarding matters that will assist the successor accountant in determining whether to accept the engagement. Matters subject to inquiry would include (a) information that might bear on the integrity of management (owners), (b) disagreements with management (owners) about accounting principles or the necessity for the performance of certain procedures or similarly significant matters, (c) the cooperation of management (owners) in providing additional or revised information, if necessary, (d) the predecessor's knowledge of any fraud or illegal acts perpetrated within the client, and (e) the predecessor's understanding of the reason for the change of accountants. [As amended, effective November 2002, by Statement on Standards for Accounting and Review Services No. 9.]

**.06** The predecessor accountant should respond promptly and fully to the inquiries, on the basis of known facts. However, if the predecessor accountant decides, due to unusual circumstances<sup>4</sup> such as impending, threatened, or potential litigation; disciplinary proceedings; or other unusual circumstances, not

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<sup>[2]</sup> [Footnote deleted by the issuance of Statement on Standards for Accounting and Review Services No. 7, November 1992.]

<sup>3</sup> The successor accountant is not precluded from making these inquiries before making a proposal for the engagement.

<sup>4</sup> Unpaid fees, as discussed in paragraph .08, are not considered to be an unusual circumstance for purposes of this paragraph; however, see paragraph .08.

to respond fully to the inquiries, the predecessor accountant should indicate that the response is limited. The successor accountant should consider the reasons and consider the implications of such a response in connection with acceptance of the engagement. [As amended, effective November 2002, by Statement on Standards for Accounting and Review Services No. 9.]

## Other Inquiries

[.07] [Paragraph deleted by the issuance of Statement on Standards for Accounting and Review Services No. 9, November 2002.]

.08 The successor accountant also may wish to review the predecessor's working papers.<sup>5</sup> In these circumstances, the successor accountant should request the client to authorize the predecessor accountant to allow access. It is customary in such circumstances for the predecessor accountant to make himself or herself available to the successor accountant for consultation and to make available for review certain working papers. The predecessor accountant should determine which working papers are to be made available for review and which may be copied. Ordinarily, the predecessor accountant should provide the successor accountant access to working papers relating to matters of continuing accounting significance and those relating to contingencies. Valid business reasons (including but not limited to unpaid fees), however, may lead the predecessor to decide not to allow access to the working papers.<sup>6</sup> The predecessor accountant may decide to reach an understanding with the successor accountant about the use of the working papers.<sup>7</sup> Further, when more than one accountant is considering acceptance of an engagement, the predecessor accountant should not be expected to make himself or herself or his or her working papers available until the client has designated one of those accountants as the successor accountant. [As amended, effective November 2002, by Statement on Standards for Accounting and Review Services No. 9.]

## Successor Accountant's Use of Communications

.09 The successor accountant should not make reference to the report or work of a predecessor accountant in his or her own report, except as specifically permitted by AR section 200 with respect to the financial statements of a prior period. [As amended, effective November 2002, by Statement on Standards for Accounting and Review Services No. 9. As amended, effective for compilations and reviews of financial statements for periods ending on or after December 15, 2007, by Statement on Standards for Accounting and Review Services No. 15.]

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<sup>5</sup> Statement on Standards for Accounting and Review Services do not specify the form or content of the working papers that an accountant should prepare in connection with a review engagement and are silent regarding the working papers, if any, that would be prepared in a compilation engagement. Accordingly, a successor accountant ordinarily would inquire about the nature of the working papers prepared by the predecessor before deciding that access would be helpful.

<sup>6</sup> See Ethics Interpretation 501-1 [ET section 501.02] for guidance on what constitutes an accountant's working papers. [Footnote added April 30, 1982, by the Accounting and Review Services Committee.]

<sup>7</sup> Before permitting access to the working papers, the predecessor accountant may wish to obtain a written communication from the successor accountant regarding the use of the working papers. The Appendix [paragraph .12] contains an illustrative successor accountant acknowledgment letter. [Footnote added, effective November 2002, by Statement on Standards for Accounting and Review Services No. 9.]

## Financial Statements Reported on by Predecessor Accountant

**.10** If, during the engagement, the successor accountant becomes aware of information that leads him or her to believe that financial statements reported on by the predecessor accountant may require revision, the successor accountant should request the client to communicate this information to the predecessor accountant. AR section 100.77 provides guidance to the predecessor accountant in determining an appropriate course of action. [As amended, effective November 2002, by Statement on Standards for Accounting and Review Services No. 9. Revised, May 2004, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 10. Revised, July 2005, to reflect conforming changes necessary due to the issuance of Statement on Standards for Accounting and Review Services No. 12.]

**.11** If the client refuses to communicate with the predecessor accountant or if the successor accountant is not satisfied with the predecessor accountant's course of action, the successor accountant should evaluate (a) possible implications for the current engagement and (b) whether to resign from the engagement. Furthermore, the successor accountant may decide to consult with legal counsel in determining an appropriate course of further action. [Paragraph added, effective November 2002, by Statement on Standards for Accounting and Review Services No. 9.]

.12

## Appendix

### Illustrative Successor Accountant Acknowledgment Letter

Paragraph .08, footnote 7, states, "Before permitting access to the working papers, the predecessor accountant may wish to obtain a written communication from the successor accountant regarding the use of the working papers." The following letter is presented for illustrative purposes only and is not required by professional standards.

[Date]

[Successor Accountant]

[Address]

We have previously [reviewed or compiled], in accordance with Statements on Standards for Accounting and Review Services the December 31, 20X1, financial statements of ABC Enterprises (ABC). In connection with your [review or compilation] of ABC's 20X2 financial statements, you have requested access to our working papers prepared in connection with that engagement. ABC has authorized our firm to allow you to review those working papers.

Our [review or compilation], and the working papers prepared in connection therewith, of ABC's financial statements were not planned or conducted in contemplation of your [review or compilation]. Therefore, items of possible interest to you may not have been specifically addressed. Our use of professional judgment for the purpose of this engagement means that matters may have existed that would have been assessed differently by you. We make no representation about the sufficiency or appropriateness of the information in our working papers for your purposes.

We understand that the purpose of your review is to obtain information about ABC and our 20X1 [compilation or review] procedures to assist you in planning your 20X2 [compilation or review] of the financial statements of ABC. For that purpose only, we will provide you access to our working papers that relate to that objective.

Upon request, we will provide copies of those working papers that provide factual information about ABC. You agree to subject any such copies or information otherwise derived from our working papers to your normal policy for retention of working papers and protection of confidential client information. Furthermore, in the event of a third-party request for access to your working papers prepared in connection with your (reviews or compilations) of ABC, you agree to obtain our permission before voluntarily allowing any such access to our working papers or information otherwise derived from our working papers, and to obtain on our behalf any releases that you obtain from such third party. You agree to advise us promptly and provide us a copy of any subpoena, summons, or other court order for access to your working papers that include copies of our working papers or information otherwise derived therefrom.

Please confirm your agreement with the foregoing by signing and dating a copy of this letter and returning it to us.

Very truly yours,

[Predecessor Accountant]

By: \_\_\_\_\_

Accepted:

[Successor Accountant]

By: \_\_\_\_\_ Date: \_\_\_\_\_

## 1544 Statements on Standards for Accounting and Review Services

Even with the client's consent, access to the predecessor accountant's working papers may still be limited. Experience has shown that the predecessor accountant may be willing to grant broader access if given additional assurance concerning the use of the working papers. Accordingly, the successor accountant might consider agreeing to the following limitations on the review of the predecessor accountant's working papers in order to obtain broader access:

- The successor accountant will not comment, orally or in writing, to anyone as a result of the review about whether the predecessor accountant's engagement was performed in accordance with Statements on Standards for Accounting and Review Services.
- The successor accountant will not provide expert testimony or litigation services or otherwise accept an engagement to comment on issues relating to the quality of the predecessor accountant's engagement.

The following paragraph illustrates the above:

Because your review of our working papers is undertaken solely for the purpose described above and may not entail a review of all our working papers, you agree that (1) the information obtained from the review will not be used by you for any other purpose, (2) you will not comment, orally or in writing, to anyone as a result of that review about whether our engagement was performed in accordance with Statements on Standards for Accounting and Review Services, (3) you will not provide expert testimony or litigation services or otherwise accept an engagement to comment on issues relating to the quality of our engagement.

[Paragraph added, effective November 2002, by Statement on Standards for Accounting and Review Services No. 9. Revised, September 2005, to reflect conforming changes necessary due to the Accounting and Review Services Committee.]

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## AR Section 9400

# ***Communications Between Predecessor and Successor Accountants: Accounting and Review Services Interpretations of Section 400***

### **1. Reports on the Application of Accounting Principles**

**.01** *Question*—SSARS No. 4, *Communications Between Predecessor and Successor Accountants* [section 400], provides guidance on communication between a successor accountant and a predecessor accountant. The guidance provided concerns only the situation in which one accountant succeeds another in a compilation or review engagement.

**.02** In other situations, an accountant in public practice may be requested by an entity that has not engaged that accountant to report on its financial statements to provide advice about the application of accounting principles or about the type of report to be issued on its financial statements (compilation, review, or audit report). Such requests are often made to obtain a second opinion about these matters from another accountant. What guidance should be followed by the accountant who is requested to provide advice on these matters?

**.03** *Interpretation*—SAS No. 50, *Reports on the Application of Accounting Principles* [AU section 625], as amended, applies to any accountant in public practice asked to provide written advice on the application of accounting principles to specified transactions involving facts and circumstances of a specific entity, or the type of opinion that may be rendered on a specific entity's financial statements.

**.04** SAS No. 50 [AU section 625] also applies to oral advice that the reporting accountant concludes is intended to be used by a principal to the transaction as an important factor considered in reaching a decision on the application of accounting principles to a specific transaction, or the type of opinion that may be rendered on a specific entity's financial statements.

**.05** Paragraph 9 of SAS No. 50 [AU section 625.09] states that the reporting accountant who is requested to provide such written or oral advice by an entity should consult with that entity's accountant, if any, to ascertain all the available facts relevant to forming a professional judgment. The reporting accountant should follow the performance and reporting guidance in SAS No. 50 [AU section 625] for such engagements.

[Issue Date: August, 1987; Revised: November, 2002.]

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## **AR Section 500**

### ***Reporting on Compiled Financial Statements***

Deleted by the issuance of Statement on Standards for Accounting and Review Services 7, November 1992.

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**AR Section 600****Reporting on Personal Financial Statements  
Included in Written Personal Financial Plans**

Issue date, unless  
otherwise indicated:  
September, 1986

Source: SSARS No. 6

**.01** This statement provides an exemption from Statement on Standards for Accounting and Review Services (SSARS) No. 1 [section 100], as amended, for personal financial statements that are included in written personal financial plans prepared by an accountant, and specifies the form of written report required under the exemption.<sup>1</sup> However, this statement does not preclude an accountant from complying with SSARS No. 1 [section 100] in such engagements.

**.02** Because the purpose of such financial statements is solely to assist in developing the client's personal financial plan, they frequently omit disclosures required by generally accepted accounting principles (GAAP) and contain departures from GAAP or from an established comprehensive basis of accounting other than GAAP.

**.03** An accountant may submit a written personal financial plan containing unaudited personal financial statements to a client without complying with the requirements of SSARS No. 1 [section 100], as amended, when all of the following conditions exist:

- a. The accountant establishes an understanding with the client, preferably in writing, that the financial statements—
  - (i) Will be used solely to assist the client and the client's advisers to develop the client's personal financial goals and objectives.
  - (ii) Will not be used to obtain credit or for any purposes other than developing these goals and objectives.
- b. Nothing comes to the accountant's attention during the engagement that would cause the accountant to believe that the financial statements will be used to obtain credit or for any purposes other than developing the client's financial goals and objectives.

**.04** An accountant using the exemption provided by this statement should issue a written report stating that the unaudited financial statements—

- a. Are designed solely to help develop the financial plan.
- b. May be incomplete or contain other departures from GAAP and should not be used to obtain credit or for any purposes other than developing the personal financial plan.
- c. Have not been audited, reviewed, or compiled.

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<sup>1</sup> For purposes of this statement, personal financial statements are those financial statements of an individual that meet the definition of financial statements in paragraph 4 of SSARS No. 1 [section 100.04], *Compilation and Review of Financial Statements*.

## **1550**      **Statements on Standards for Accounting and Review Services**

**.05** The following is an illustration of an appropriate report when an accountant uses the exemption provided by this statement.

The accompanying Statement of Financial Condition of X, as of December 31, 20XX, was prepared solely to help you develop your personal financial plan. Accordingly, it may be incomplete or contain other departures from generally accepted accounting principles and should not be used to obtain credit or for any purposes other than developing your financial plan. We have not audited, reviewed, or compiled the statement.

**.06** Each of the personal financial statements should include a reference to the accountant's report.

### **Effective Date**

**.07** This statement is effective on September 30, 1986.

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## AR Section 9600

# ***Reporting on Personal Financial Statements Included in Written Personal Financial Plans: Accounting and Review Services Interpretation of Section 600***

### **1. Submitting a Personal Financial Plan to a Client's Advisers**

**.01 Question**—Paragraph 3 of Statements on Standards for Accounting and Review Services (SSARS) No. 6, *Reporting on Personal Financial Statements Included in Written Personal Financial Plans* [section 600.03], states that an accountant may submit a written personal financial plan containing unaudited personal financial statements to a client without complying with the requirements of SSARS No. 1, *Compilation and Review of Financial Statements* [section 100] when, among other conditions, the accountant establishes an understanding with the client that the financial statements will be used solely to assist the client and the client's advisers to develop the client's personal financial goals and objectives. Does developing the client's personal financial goals and objectives encompass implementing the personal financial plan by the client or the client's advisers?

**.02 Interpretation**—Yes. Developing a client's personal financial goals and objectives includes implementing the personal financial plan by the client or the client's advisers because implementing the plan may be considered the culmination of the process of developing personal financial goals and objectives. Therefore, an accountant may submit a written personal financial plan containing unaudited personal financial statements to a client, to be used by the client or the client's advisers to implement the personal financial plan, without complying with the requirements of SSARS No. 1 [section 100], provided the conditions in paragraph 3 of SSARS No. 6 [section 600.03] exist.

**.03** Examples of implementation of a personal financial plan by the client's advisers include use of the plan by:

- an insurance broker who will identify specific insurance products.
- an investment adviser who will provide specific recommendations about the investment portfolio.
- an attorney who will draft a will or trust documents.

[Issue Date: May 1991.]

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**AR****EXHIBITS**

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## TABLE OF CONTENTS

	<i>Page</i>
Exhibit A—Analytical Procedures in a Review Engagement.....	1555
Exhibit B—Going Concern Considerations.....	1561
Exhibit C—Subsequent Events Considerations.....	1565

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## AR Exhibit A

# ***Analytical Procedures in a Review Engagement***

### **Notice to Readers**

The purpose of the documentation guidance contained in this exhibit is to illustrate how an accountant might document expectations in a review engagement. The examples are presented for illustrative purposes only and should not be considered to represent either minimum or maximum documentation requirements.

This exhibit is an other compilation and review publication as defined in AR section 50, *Standards for Accounting and Review Services*. Other compilation and review publications have no authoritative status; however, they may help the accountant understand and apply Statements on Standards for Accounting and Review Services (SSARS). If an accountant applies the guidance included in an other compilation and review publication, the accountant should be satisfied that, in his or her judgment, it is both appropriate and relevant to the circumstances of the subject engagement. This publication was reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA and is presumed to be appropriate.

### **Expectations**

Forming an expectation is an integral phase of the analytical procedure process. Expectations are the accountant's predictions of recorded amounts or ratios developed from recorded amounts. In performing analytical procedures, the accountant develops the expectation in such a way that a material difference between the expectation and the recorded amount or ratio is indicative of a possible misstatement and, therefore, the accountant should obtain explanations for the difference (for example, an unusual event occurred). Expectations are developed by identifying plausible relationships (for example, store square footage and retail sales) that are reasonably expected to exist based on the accountant's understanding of the client and the industry in which the client operates. The accountant selects from a variety of data sources to form expectations. For example, the accountant may use prior-period information (adjusted for expected changes), management's budgets or forecasts, industry data, or nonfinancial data. Additionally, information that is developed when an accountant compiles interim financial statements can be utilized by the accountant in developing expectations associated with the review of financial statements.

An accountant cannot, under any circumstances, perform effective analytical procedures without first developing expectations related to the results of those analytical procedures. Expectations developed by the accountant in performing analytical procedures in connection with a review of financial statements ordinarily are less encompassing than those developed in an audit.



Pursuant to paragraph .45 of AR section 100, *Compilation and Review of Financial Statements*, the accountant should document expectations and factors considered in the development of those expectations where significant expectations are not otherwise readily determinable from the documentation of the work performed.

The following are examples of how an accountant can document expectations. These examples are not intended to be all inclusive.

### Example 1—Expected Increase in Revenue

An accountant is engaged to review the financial statements of a company that manufactures components that are utilized by other companies in customizing vehicles for use by the United States military. Because of various conflicts occurring in the world and the United States' role in those conflicts, the accountant reasonably expects sales to increase. Using his or her knowledge of the client, the client's business, and the industry in which the client operates, the accountant expects a 10 percent to 15 percent increase in sales. Further, the accountant concludes that receivables should increase and that loans payable and interest expense would also increase because the client would need to borrow money to fund the additional production.

#### *Sample documentation*

Teemickmag Military Supply Company  
Analytical Procedures  
For the year ended December 31, 20XX

#### *Expectations*

The following are factors that should affect the relationship between current and prior year amounts:

- Increase in military spending by the government due to world events should result in an increase in sales. Expected increase is between 10 percent and 15 percent. The accountant expects a similar increase in accounts receivable.
- Because of an increase in production of military vehicles, the company had to borrow additional funds. Therefore, expected increase in loans payable and interest expense is between 10 percent and 15 percent.
- No significant change in either days sales in inventory or inventory turnover is expected. Although a build-up in inventory is expected, that build-up is not expected to correspond with the increase in sales because the vehicles are expected to be sold near the date of completion. Any change greater than 5 percent will be subjected to additional inquiries.

Balance sheets and income statements are available for the current year and the two years prior to the current year.

#### *Trend analysis*

	<u>Current Year</u>	<u>Prior Year</u>	<u>Change</u>	<u>% Change</u>
Sales	\$2,500,000	\$2,175,000	\$325,000	14.94%
Cost of goods sold	1,780,000	1,566,000	214,000	13.67%
Gross margin	720,000	609,000		
Gross margin as a % of sales	28.80%	28.00%		
Selling expenses	230,000	184,000	46,000	25.00%
Interest expense	48,000	42,000	6,000	14.29%

*Balance sheet ratio analysis*

	<u>Current Year</u>	<u>Prior Year</u>	<u>Two Years Prior</u>
Accounts receivable, net	\$1,100,000	\$843,000	\$703,000
Inventory	1,000,000	832,000	694,000
Loans payable	498,000	437,000	418,000

*Days sales in receivables*

Days sales in receivables = Accounts receivable, net at end of period / (Net sales/365)

Current year days sales in receivables = \$1,100,000 / (\$2,500,000 / 365) = 161 days

Prior year days sales in receivables = \$843,000 / (\$2,175,000 / 365) = 141 days

The increase of 20 days sales in receivables (161 days – 141 days) represents a 14 percent increase. Because this increase is within the expected range, no further inquiry is necessary.

*Days sales in inventory*

Days sales in inventory = Inventory at the end of period / (Total cost of goods sold / 365)

Current year days sales in inventory = \$1,000,000 / (\$1,780,000 / 365) = 205 days

Prior year days sales in inventory = \$832,000 / (\$1,566,000 / 365) = 194 days

The increase of 11 days sales in inventory (205 days – 194 days) represents a 6 percent increase. Because this increase is greater than expected, the accountant should inquire of the client and document the reason for the unexpected increase.

*Inventory turnover*

Inventory turnover = Cost of goods sold / Average inventory

Current year inventory turnover = \$1,780,000 / ((\$1,100,000 + 832,000) / 2) = 1.84 times

Prior year inventory turnover = \$1,566,000 / ((\$832,000 + 694,000) / 2) = 2.05 times

The inventory turnover decreased 10 percent; therefore, because this decrease is greater than expected, the accountant should inquire of the client and document the reason for the unexpected decrease.

The preceding documentation would be adequate. Further, after performing the trend analysis, the accountant concludes that sales, costs of goods sold, and interest expense are all "reasonable" given the expectations associated with these amounts. In addition, with respect to balance sheet accounts, the increase in loans payable is also reasonable (14 percent increase) when considered with the corresponding increase in interest expense and the expectation associated with the loan payable account; however, because selling expenses increased by 25 percent, the accountant should inquire of the client and document the reason for that unexpected increase (actual increase does not correspond to expected increase).

## Example 2—Expected Decrease in Revenue

An accountant is engaged to review the financial statements of a client that either owns or manages, or both owns and manages, a shopping mall. Due to a poor economy, the mall lost tenants during the year; as such, the accountant reasonably expects revenue to decrease. Using his or her knowledge of the client, the client's business, and the industry in which the client operates, the accountant expects a 5 percent to 10 percent decrease in revenue during the year. Further, the accountant expects that general and administrative expenses should increase due to an increase in leasing and sales expenses and that management fees should decrease due to a decrease in tenants in the building.

### *Sample documentation*

Pearl River Mall  
Analytical Procedures  
For the year ended December 31, 20XX

### *Expectations*

The following are factors that should affect the relationship between current and prior year amounts:

- Loss of tenants due to poor economy should result in a decrease in revenue. Expected decrease is between 5 percent and 10 percent.
- Because of the increased number of vacancies, general and administrative expenses are expected to increase because of an increase in leasing and sales expenses. Expected increase is between 5 percent and 10 percent (corresponds with the decrease in revenue).
- Because of the decrease in the number of tenants in the building, management fees are expected to decrease between 5 percent and 10 percent (corresponds with decrease in revenue).

Balance sheets and income statements are available for the current year and the two years prior to the current year.

### *Trend analysis*

	<u>Current</u> <u>Year</u>	<u>Prior Year</u>	<u>Change</u>	<u>% Change</u>
Tenant revenue	\$7,223,000	\$8,603,000	\$(1,380,000)	(16.04)%
Costs and expenses:				
Management fees	339,000	387,000	(48,000)	(12.40)%
General and administrative	583,000	511,000	72,000	14.09 %

Similar balance sheet analytics should be performed as those performed in Example 1 above.

The preceding documentation would be adequate; however, the results of the analytical procedures do not agree with the documented expectations associated with those procedures. Therefore, the accountant should inquire and document why the decrease in tenant revenue, the decrease in management fees, and the increase in general and administrative expenses exceeded expectations.

### Example 3—No significant change in revenue or expenses expected

An accountant is engaged to review the financial statements of a small, privately held client in the candy store business. The accountant has performed a review of the financial statements of the candy store for each of the past five years with no significant change in revenue or expenses in any of those years. The accountant expects that trend to continue.

#### *Sample documentation*

Mom and Pop Candy Store  
Analytical Procedures  
For the year ended December 31, 20XX

#### *Expectations*

- Based on discussions with the owner and manager, no significant changes from prior year amounts are expected.
- All increases and decreases greater than 5 percent will be subjected to additional inquiries.

#### *Trend analysis*

	<u>Current Year</u>	<u>Prior Year</u>	<u>Change</u>	<u>% Change</u>
Sales	\$44,000	\$39,000	\$5,000	12.82%
Cost of goods sold	32,500	31,000	1,500	4.84%
Gross margin	11,500	8,000		
Gross margin as a % of sales	26.14%	20.51%		
Operating expenses	5,200	4,500	700	15.56%
Net income	6,300	3,500		

Similar balance sheet analytics should be performed as those performed in Example 1 above.

The preceding documentation would be adequate; however, the results of the analytical procedures do not agree with the documented expectations associated with those procedures. Therefore, the accountant may deem it appropriate to inquire and document why sales increased by an amount greater than expected. In addition, the accountant should inquire as to why there was not a comparable increase in cost of goods sold. Also, the accountant should discuss with the owner and manager why there is a greater than expected increase in operating expenses and document the results of the discussion.

### Example 4—Expected Changes in Construction Contracts

An accountant is engaged to review the financial statements of a general construction contractor primarily engaged in the construction of commercial office buildings. The accountant has performed the review of this company's financial statements for several years and expects that the current project in process should yield a 5 percent gross profit margin consistent with similar projects in the past and in accordance with the initial project estimate.

*Sample documentation*

ABC Construction Contractors  
Analytical Procedures  
For the year ended December 31, 20XX

*Expectations*

- Based upon discussions with the project manager, it is believed that the gross margin will be consistent with the 5 percent margin achieved in the past and in accordance with the initial project estimate.
- Any deviation in the margin greater than 1 percent will be subjected to additional inquiries.

*Trend analysis*

<u>Building Contract</u>	<u>Current Year</u>	<u>Prior Year</u>	<u>\$ Change</u>	<u>% Change</u>
Contract value	\$5.0 million	\$5.0 million		
Estimated costs at completion	4.9 million	4.75 million	\$150,000	3.15%
Planned profit	100,000	250,000	150,000	60.00%
Costs incurred	2.5 Million	1.0 million		
Profit recognized contract to date	50,000	50,000		

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## AR Exhibit B

# Going Concern Considerations

### Notice to Readers

The purpose of this nonauthoritative exhibit is to help practitioners better understand the accounting concepts of going concern in performing a compilation or review engagement. This exhibit has been prepared and reviewed by AICPA staff; however, it has not been approved, disapproved, or otherwise acted upon by the Accounting and Review Service Committee or any senior technical committee of the AICPA.

### Going Concern Consideration

Continuation of an entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. Ordinarily, information that indicates an uncertainty about the entity's ability to continue as a going concern for a reasonable period of time, typically not to exceed one year beyond the date of the financial statements, relates to the entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of business, restructuring of debt, externally forced revisions of its operations, or similar actions.

Certain conditions or events, when considered in the aggregate, may indicate there could be substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time. The significance of such conditions and events will depend on the circumstances, and some may have significance only when viewed in conjunction with others. The following are examples of such conditions and events:

- *Negative trends.* For example, recurring operating losses, working capital deficiencies, negative cash flows from operating activities, adverse key financial ratios.
- *Other indications of possible financial difficulties.* For example, default on loan or similar agreements, arrearages in dividends, denial of usual trade credit from suppliers, restructuring of debt, noncompliance with statutory capital requirements, need to seek new sources or methods of financing or to dispose of substantial assets.
- *Internal matters.* For example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project, uneconomic long-term commitments, need to significantly revise operations.
- *External matters that have occurred.* For example, legal proceedings, legislation, or similar matters that might jeopardize an entity's ability to operate; loss of a key franchise, license, or patent; loss of a principal customer or supplier; uninsured or underinsured catastrophe such as a drought, earthquake, or flood.

After identifying adverse conditions and events, management's plans for dealing with the conditions or events may include the following:

- Plans to dispose of assets
  - Restrictions on disposal of assets, such as covenants limiting such transactions in loan or similar agreements or encumbrances against assets
  - Apparent marketability of assets that management plans to sell
  - Possible direct or indirect effects of disposal of assets
- Plans to borrow money or restructure debt
  - Availability of debt financing, including existing or committed credit arrangements, such as lines of credit or arrangements for factoring receivables or sale-leaseback of assets
  - Existing or committed arrangements to restructure or subordinate debt or to guarantee loans to the entity
  - Possible effects on management's borrowing plans of existing restrictions on additional borrowing or the sufficiency of available collateral
- Plans to reduce or delay expenditures
  - Apparent feasibility of plans to reduce overhead or administrative expenditures, to postpone maintenance or research and development projects, or to lease rather than purchase assets
  - Possible direct or indirect effects of reduced or delayed expenditures
- Plans to increase ownership equity
  - Apparent feasibility of plans to increase ownership equity, including existing or committed arrangements to raise additional capital
  - Existing or committed arrangements to reduce current dividend requirements or to accelerate cash distributions from affiliates or other investors

## Financial Statement Effects

When management concludes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, management should consider disclosing the following:

- Pertinent conditions and events giving rise to the assessment of the uncertainty about the entity's ability to continue as a going concern for a reasonable period of time
- The possible effects of such conditions and events
- Management's evaluation of the significance of those conditions and events and any mitigating factors
- Possible discontinuance of operations
- Management's plans (including relevant prospective financial information)
- Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities

When management concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time is alleviated, management should consider the need for disclosure of the principal conditions and events that initially caused it to believe there was an uncertainty. The consideration of disclosure may include the possible effects of such conditions and events, and any mitigating factors, including management's plans.

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## AR Exhibit C

# Subsequent Events Considerations

### Notice to Readers

The purpose of this nonauthoritative exhibit is to help practitioners better understand the accounting concepts of subsequent events in performing a compilation or review engagement. This exhibit has been prepared and reviewed by AICPA staff; however, it has not been approved, disapproved, or otherwise acted upon by the Accounting and Review Service Committee or any senior technical committee of the AICPA.

### Subsequent Events Considerations

Events or transactions sometimes occur subsequent to the balance sheet date, but prior to management's issuance of the financial statements<sup>1</sup> that have a material effect on the financial statements and, therefore, require adjustment to or disclosure in the statements. These occurrences hereinafter are referred to as *subsequent events*.

Two types of subsequent events require consideration by management. The first type consists of those events that provide additional evidence with respect to conditions that existed at the date of the balance sheet and affect the estimates inherent in the process of preparing financial statements. All information that becomes available prior to the issuance of the financial statements should be used by management in its evaluation of the conditions on which the estimates were based. The financial statements should be adjusted for any changes in estimates resulting from the use of such evidence.

Identifying events that require adjustment of the financial statements under the criteria stated above calls for the exercise of judgment and knowledge of the facts and circumstances. For example, a loss on an uncollectible trade account receivable as a result of a customer's deteriorating financial condition leading to bankruptcy subsequent to the balance sheet date would be indicative of conditions existing at the balance sheet date, thereby calling for adjustment of the financial statements before their issuance. On the other hand, a similar loss resulting from a customer's major casualty such as a fire or flood subsequent to the balance sheet date would not be indicative of conditions existing at the balance sheet date, and adjustment of the financial statements would not be appropriate. The settlement of litigation for an amount different from the liability recorded in the accounts would require adjustment of the financial statements if the events, such as personal injury or patent infringement that gave rise to the litigation, had taken place prior to the balance sheet date.

The second type consists of those events that provide evidence with respect to conditions that did not exist at the date of the balance sheet being reported on but arose subsequent to that date. These events should not result in adjustment of the financial statements. Some of these events, however, may be of such

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<sup>1</sup> For purposes of this guidance, the term *issuance of financial statements* is intended to mean the date that the completed and finalized financial statements are used for decision making purposes, either internally or externally.

a nature that disclosure of them is required to keep the financial statements from being misleading. Occasionally such an event may be so significant that disclosure can best be made by supplementing the historical financial statements with pro forma financial data, giving effect to the event as if it had occurred on the date of the balance sheet. It may be desirable to present pro forma statements, usually a balance sheet only, in columnar form on the face of the historical statements.

Examples of events of the second type that require disclosure to the financial statements (but should not result in adjustment) are as follows:

1. Sale of a bond or capital stock issue
2. Purchase of a business
3. Settlement of litigation when the event giving rise to the claim took place subsequent to the balance sheet date
4. Loss of plant or inventories as a result of fire or flood
5. Losses on receivables resulting from conditions (such as a customer's major casualty) arising subsequent to the balance sheet date

Subsequent events affecting the realization of assets, such as receivables and inventories or the settlement of estimated liabilities, ordinarily will require adjustment of the financial statements because such events typically represent the culmination of conditions that existed over a relatively long period of time. Subsequent events such as changes in the quoted market prices of securities ordinarily should not result in adjustment of the financial statements because such changes typically reflect a concurrent evaluation of new conditions.

When financial statements are reissued, for example, in reports filed with regulatory agencies, events that require disclosure in the reissued financial statements to keep them from being misleading may have occurred subsequent to the original issuance of the financial statements. Events occurring between the time of original issuance and reissuance of financial statements should not result in adjustment of the financial statements unless the adjustment meets the criteria for the correction of an error or the criteria for prior period adjustments set forth in Financial Accounting Standards Board *Accounting Standards Codification* 250, *Accounting Changes and Error Corrections*. Similarly, financial statements reissued in comparative form with financial statements of subsequent periods should not be adjusted for events occurring subsequent to the original issuance unless the adjustment meets the criteria stated above.

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

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**AR****APPENDIXES**

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## TABLE OF CONTENTS

	<i>Page</i>
APPENDIX A—Cross-References to Statements on Standards for Accounting and Review Services .....	1569
APPENDIX B—[Reserved] .....	1573
APPENDIX C—Schedule of Changes in Statements on Standards for Accounting and Review Services .....	1575

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## AR Appendix A

## ***Cross-References to Statements on Standards for Accounting and Review Services***

<i>No.</i>	<i>Date Issued</i>	<i>Title</i>	<i>Section</i>
1	Dec. 1978	<b>Compilation and Review of Financial Statements</b>	100
2	Oct. 1979	<b>Reporting on Comparative Financial Statements</b>	200
		Amends section 100.04; Supersedes section 100[.92].	
3	Dec. 1981	<b>Compilation Reports on Financial Statements Included in Certain Prescribed Forms</b>	300
		Amends sections 100.02, .18, .19, .55, and 200.02.	
4	Dec. 1981	<b>Communications Between Predecessor and Successor Accountants</b>	400
		Amends section 200.16.	
5	July 1982	<b>Reporting on Compiled Financial Statements</b>	500
		Deleted by SSARS No. 7, November 1992, because the provisions of SSARS No. 5 have been incorporated into sections 100, 200, and 300.	
6	Sept. 1986	<b>Reporting on Personal Financial Statements Included in Written Personal Financial Plans</b>	600
7	Nov. 1992	<b>Omnibus Statement on Standards for Accounting and Review Services—1992</b>	
		Not published as a stand-alone section; Integrated to amend sections 100, 200, 300, and 400; Deletes SSARS No. 5.	
8	Oct. 2000	<b>Amendment to Statement on Standards for Accounting and Review Services No. 1, <i>Compilation and Review of Financial Statements</i></b>	
		Not published as a stand-alone section; Amends former section 100.01–.27 (subsequent paragraphs and footnotes have been renumbered accordingly); adds a new appendix A [paragraph .97] and D [paragraph .100]; deletes former appendix E [paragraph [.101]].	

(continued)

No.	Date Issued	Title	Section
9	Nov. 2002	<b>Omnibus Statement on Standards for Accounting and Review Services—2002</b>	
		Not published as a stand-alone section; Amends section 100.03, .04, .10, and .13; deletes section 100.14; section 100.29; and section 100.31; adds section 100.39; amends .40 and .46; deletes section 100.47; amends section 100.51 and .83, adds section 100.93–.95 (subsequent paragraphs and footnotes have been renumbered accordingly); amends section 400.01–.06; deletes section 400.07; amends section 400.08–.10; and adds section 400.11 and .12.	
10	May 2004	<b>Performance of Review Engagements</b>	
		Not published as a stand-alone section; Amends section 100.29; amends and transfers section 100.39 to section 100.31; amends section 100.33; adds section 100.36 and .37; amends section 100.38, .39, .41; adds section 100.42; amends section 100.43; adds section 100.44 (subsequent paragraphs have been renumbered accordingly); amends section 100.98; adds a new appendix H [paragraph .104].	
11	May 2004	<b>Standards for Accounting and Review Services</b>	50
		Amends section 200.17.	
12	July 2005	<b>Omnibus Statement on Standards for Accounting and Review Services—2005</b>	
		Not published as a stand-alone section; Amends section 100.05, .10, and .31; adds section 100.40; amends section 100.45; adds section 100.59–.68, .84, and .85 (subsequent paragraphs and footnotes have been renumbered accordingly); adds a new appendix G [paragraph .103] (subsequent paragraphs have been renumbered accordingly); rescinds Accounting and Review Interpretation No. 26 of SSARS No. 1 at section 9100.100–.103; amends section 200.25 and .26; adds section 200.27 (subsequent paragraphs and footnotes have been renumbered accordingly).	
13	July 2005	<b>Compilation of Specified Elements, Accounts, or Items of a Financial Statement</b>	110
		Rescinds Accounting and Review Interpretation No. 8 of SSARS No. 1 at section 9100.27–.28.	

<i>No.</i>	<i>Date Issued</i>	<i>Title</i>	<i>Section</i>
14	July 2005	<b>Compilation of Pro Forma Financial Information</b>	120
15	July 2007	<b>Elimination of Certain References to Statements on Auditing Standards and Incorporation of Appropriate Guidance Into Statements on Standards for Accounting and Review Services</b>	
		Not published as a stand-alone section; Amends section 100.01, .04, and .16; adds section 100.17; amends section 100.20; adds section 100.22; amends section 100.47, adds section 100.50, amends section 100.51–.53, adds section 100.54–.55; amends section 100.64, adds section 100.78–.82; amends section 100.92, and .95 (subsequent paragraphs and footnotes have been renumbered accordingly); rescinds Accounting and Review Interpretations No. 4 of SSARS No. 1 at section 9100.13–.15 and No. 12 at section 9100.41–.45; amends section 200.05; section 300.01; and section 400.09.	
16	December 2007	<b>Defining Professional Requirements in Statements on Standards for Accounting and Review Services</b>	20
17	February 2008	<b>Omnibus Statement on Standards for Accounting and Review Services—2008</b>	
		Not published as a stand-alone section; Amends section 100.01, .03; and .04; adds section 100.06; .12; and .28; amends section 100.29; adds section 100.30; amends section 100.31; adds section 100.32; amends section 100.36 and .41; adds section 100.69; .70; .71; .72; .73; .74; .75; and .76; amends section 100.83; .85; .86; .99; .100; .101; .102 (subsequent paragraphs and footnotes have been renumbered accordingly); amends section 110.15; amends section 120.18; amends section 200.01; .29; and .33; amends section 300.01; .02; and .03; amends section 400.01.	
18	February 2009	<b>Applicability of Statements on Standards for Accounting and Review Services</b>	
		Amends section 100.01.	





## AR Appendix B

*[Reserved.]*

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## AR Appendix C

## ***Schedule of Changes in Statements on Standards for Accounting and Review Services***

<i>Section</i>	<i>Par.</i>	<i>Changes</i>	<i>Date of Change</i>
20		SSARS No. 16 added	December 2007
50		Added by SSARS No. 11	May 2004
50	.01	Amended by SSARS No. 17	December 2008
100	.01	Amended by SSARS No. 8	October 2000
100	.01	Amended by SSARS No. 15	July 2007
100	.01	Amended by SSARS No. 17	February 2008
100	.01	Amended by SSARS No. 18	February 2009
100	.02	Amended by SSARS No. 3	December 1981
100	.02	Amended by SSARS No. 8	October 2000
100	.02	Amended by SSARS No. 17	December 2008
100	.03	Amended by SSARS No. 8	October 2000
100	.03	Amended by SSARS No. 9	November 2002
100	.03	Amended by SSARS No. 17	February 2008
100	.04	Amended by SSARS No. 2	October 1979
100	.04	Amended by SSARS No. 8	October 2000
100	.04	Amended by SSARS No. 9	November 2002
100	.04	Amended by SSARS No. 15	July 2007
100	.04	Amended by SSARS No. 17	February 2008
100	.05	Amended by SSARS No. 8	October 2000
100	.05	Amended by SSARS No. 12	July 2005
100	.06	New paragraph added by issuance of SSARS No. 17; subsequent paragraphs renumbered	February 2008
100	.07	Amended by SSARS No. 8	October 2000
100	.08	Amended by SSARS No. 8	October 2000
100	.09	Amended by SSARS No. 8	October 2000
100	.10	Amended by SSARS No. 8	October 2000
100	.10	Amended by SSARS No. 9	November 2002
100	.10	Amended by SSARS No. 12	July 2005
100	.11	Amended by SSARS No. 8	October 2000
100	.12	New paragraph added by issuance of SSARS No. 17; subsequent paragraphs renumbered	February 2008
100	.13	Amended by SSARS No. 8	October 2000
100	.13	Amended by SSARS No. 9	November 2002

(continued)

<i>Section</i>	<i>Par.</i>	<i>Changes</i>	<i>Date of Change</i>
100	.14	Amended by SSARS No. 8	October 2000
100	.14	Deleted by SSARS No. 9	November 2002
100	.15–.16	Amended by SSARS No. 8	October 2000
100	.16	Amended by SSARS No. 15	July 2007
100	.17	New paragraph added by issuance of SSARS No. 15; subsequent paragraphs renumbered	July 2007
100	.18–.19	Amended by SSARS No. 3	December 1981
100	.20–.21	Amended by SSARS No. 8	October 2000
100	.21	Amended by SSARS No. 15	July 2007
100	.22	New paragraph added by issuance of SSARS No. 15; subsequent paragraphs renumbered	July 2007
100	.23–.27	Amended by SSARS No. 8	October 2000
100	.28	New paragraph added by issuance of SSARS No. 17; subsequent paragraphs renumbered	February 2008
100	.29	Amended by SSARS No. 9	November 2002
100	.29	Amended by SSARS No. 10	May 2004
100	.29	Amended by SSARS No. 17	February 2008
100	.30	New paragraph added by issuance of SSARS No. 17; subsequent paragraphs renumbered	February 2008
100	.31	Amended by SSARS No. 9	November 2002
100	.31	Amended and transferred, from former 100.32, by SSARS No. 10; subsequent paragraphs renumbered	May 2004
100	.31	Amended by SSARS No. 12	July 2005
100	.31	Amended by SSARS No. 17	February 2008
100	.32	New paragraphs added by issuance of SSARS No. 17; subsequent paragraphs renumbered	February 2008
100	.33	Amended by SSARS No. 10	May 2004
100	.36	New paragraphs added by issuance of SSARS No. 10; subsequent paragraphs renumbered	May 2004
100	.36	Amended by SSARS No. 17	February 2008
100	.37–.38	New paragraphs added by issuance of SSARS No. 10; subsequent paragraphs renumbered	May 2004

Schedule of Changes in SSARS

1577

<i>Section</i>	<i>Par.</i>	<i>Changes</i>	<i>Date of Change</i>
100	.38	Amended by SSARS No. 10	May 2004
100	.39	New paragraph added by issuance of SSARS No. 9; subsequent paragraphs renumbered	November 2002
100	.39	Amended by SSARS No. 10	May 2004
100	.40	New paragraph added by issuance of SSARS No. 12; subsequent paragraphs renumbered	July 2005
100	.41	Amended by SSARS No. 9	November 2002
100	.41	Amended by SSARS No. 17	February 2008
100	.42	Amended by SSARS No. 10	May 2004
100	.43	New paragraph added by issuance of SSARS No. 10; subsequent paragraphs renumbered	May 2004
100	.44	Amended by SSARS No. 10	May 2004
100	.45	New paragraph added by issuance of SSARS No. 10; subsequent paragraphs renumbered	May 2004
100	.45	Amended by SSARS No. 12	July 2005
100	.46	Amended by SSARS No. 9	November 2002
100	.47	Deleted by SSARS No. 9	November 2002
100	.49	Amended by SSARS No. 15	July 2007
100	.50	New paragraph added by issuance of SSARS No. 15; subsequent paragraphs renumbered	July 2007
100	.51	Amended by SSARS No. 9	November 2002
100	.53	Amended by SSARS No. 3	December 1981
100	.54-.55	New paragraph added by issuance of SSARS No. 15; subsequent paragraphs renumbered	July 2007
100	.56	Amended by SSARS No. 5	July 1982
100	.56	Amended by SSARS No. 3	December 1981
100	.56-.58	Amended by SSARS No. 15	July 2007
100	.59-.68	New paragraphs added by SSARS No. 12; subsequent paragraphs renumbered	July 2005
100	.69-.76	New paragraphs added by SSARS No. 12; subsequent paragraphs renumbered	February 2008
100	.77	Amended by SSARS No. 9	November 2002

(continued)

<i>Section</i>	<i>Par.</i>	<i>Changes</i>	<i>Date of Change</i>
100	.77	Amended by SSARS No. 15	July 2007
100	.78–.82	New paragraphs added by issuance of SSARS No. 15; subsequent paragraphs renumbered	July 2007
100	.83	Amended by SSARS No. 17	February 2008
100	.84–.85	New paragraphs added by SSARS No. 12; subsequent paragraphs renumbered	July 2005
100	.85–.86	Amended by SSARS No. 17	February 2008
100	.92	Superseded by SSARS No. 2	October 1979
100	.93–.95	New paragraphs added by issuance of SSARS No. 9; subsequent paragraphs renumbered	November 2002
100	.94	Amended by SQCS 7	December 2008
100	.97	New paragraph added by issuance of SSARS No. 8; subsequent paragraphs renumbered	October 2000
100	.98	Amended by SSARS No. 10	May 2004
100	.98	Revised	December 2008
100	.99	Amended by SSARS No. 5	July 1982
100	.99	Amended by SSARS No. 17	February 2008
100	.100	New paragraph added by issuance of SSARS No. 8; subsequent paragraphs renumbered	October 2000
100	.100–.101	Amended by SSARS No. 17	February 2008
100	.102	Amended by SSARS No. 15	July 2007
100	.102	Amended by SSARS No. 17	February 2008
100	.103	New paragraphs added by SSARS No. 12; subsequent paragraphs renumbered	July 2005
100	.104	Deleted by SSARS No. 8	October 2000
100	.105	New paragraph added by issuance of SSARS No. 10; subsequent paragraphs renumbered	May 2004
100	.105	Amended by SSARS No. 15	July 2007
100	.106	New paragraph added by issuance of SSARS No. 15	July 2007
110		SSARS No. 13 added	July 2005
110	.15	Amended by SSARS No. 17	May 2008
120		SSARS No. 14 added	July 2005
120	.18	Amended by SSARS No. 17	May 2008
200	.01	Revised by SSARS No. 8	October 2000

<i>Section</i>	<i>Par.</i>	<i>Changes</i>	<i>Date of Change</i>
200	.01	Amended by SSARS No. 17	February 2008
200	.02	Amended by SSARS No. 3	December 1981
200	.02	Revised by SSARS No. 8	October 2000
200	.05	Amended by SSARS No. 15	July 2007
200	.09	Amended by SSARS No. 5	July 1982
200	.09	Amended by SSARS No. 7	November 1992
200	.10	Amended by SSARS No. 7	November 1992
200	.16	Amended by SSARS No. 4	December 1981
200	.25-.26	Amended by SSARS No. 12	July 2005
200	.27	New paragraph added by SSARS No. 12; subsequent paragraphs renumbered	July 2005
200	.29	Amended by SSARS No. 17	February 2008
200	.30	Amended by SSARS No. 5	July 1982
200	.30	Amended by SSARS No. 7	November 1992
200	.33	Deleted by SSARS No. 8	October 2000
200	.33	Amended by SSARS No. 17	February 2008
200	.34-.35	Deleted by SSARS No. 8	October 2000
300	.01	Amended by SSARS No. 15	July 2007
300	.01-.02	Amended by SSARS No. 17	February 2008
300	.03	Amended by SSARS No. 5	July 1982
300	.03	Amended by SSARS No. 7	November 1992
300	.03	Amended by SSARS No. 17	February 2008
400	.01	Amended by SSARS No. 7	November 1992
400	.01	Amended by SSARS No. 9	November 2002
400	.01	Amended by SSARS No. 17	February 2008
400	.02	Amended by SSARS No. 9	November 2002
400	.03	Amended by SSARS No. 7	November 1992
400	.03-.06	Amended by SSARS No. 9	November 2002
400	.07	Deleted by SSARS No. 9	November 2002
400	.08-.09	Amended by SSARS No. 9	November 2002
400	.09	Amended by SSARS No. 15	July 2007
400	.10	Amended by SSARS No. 9	November 2002
400	.11-.12	New paragraphs added by issuance of SSARS No. 9	November 2002
500	...	Deleted by SSARS No. 7	November 1992

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# AR TOPICAL INDEX

References are to AR section and paragraph numbers.

## A

### ACCOUNTANT, INDEPENDENT

- Association With Financial Statements ..... 200.03
- Business Valuation ..... 9100.89-92
- Change in Engagement ..... 100.86-91; ..... 9100.06-12
- Consultation With Attorney .... 100.03; 100.77
- Continuing—See Continuing Independent Accountant
- Differentiating Between Financial Statement Presentation and Trial Balance ..... 9100.54-57
- Draft Financial Statements ..... 9100.61-62
- Financial Information Derived for Business Valuation ..... 9100.89-92
- Knowledge of Accounting Practices ..... 100.07-09; 100.33-35
- Lack of Independence ..... 100.23; 100.55
- Litigation Services ..... 9100.76-79
- Planning ..... 9100.16-17
- Predecessor—See Predecessor Independent Accountant
- Reference to Country of Origin ... 9100.93-94
- Reporting Obligation ..... 200.08-12; ..... 200.29
- Reporting on Personal Financial Statements ..... 600.01-07
- Submission of Financial Statements to Client ..... 100.07; 9100.61-62
- Subsequent Discovery of Facts ..... 100.77
- Successor—See Successor Independent Accountant
- Supervision ..... 9100.16-17
- Tax Returns, Reporting ..... 9100.31-32
- Understanding With Entity ..... 100.05; ..... 100.22-23; 600.03; 9100.08; ..... 9100.48; 9600.01-03
- Use of “Selected Information” Label ..... 9100.85-88
- Withdrawal From Engagement ..... 100.64; ..... 9100.18-22

### ACCOUNTING

- Changes—See Changes, Accounting
- Principles—See Generally Accepted Accounting Principles

### ACCOUNTING SERVICES

- Applicability to Litigation Services ..... 9100.76-79
- Compilation v. Review Reports .... 9100.06-12
- Controllership Services—See Controllership Services

### ACCOUNTING SERVICES—continued

- Examples ..... 100.02
- Management Services—See Management Services

### ACCOUNTS RECEIVABLE—See Receivables

### ADVERSE OPINIONS

- Applicability ..... 9100.24
- Prior Period Financial Statements ..... 9200.02-03

### AMERICAN INSTITUTE OF CPAs

- Standards for Accounting and Review Services ..... 100.01-03

### ANALYTICAL PROCEDURES

- Definition ..... 100.36
- Predecessor Accountant's Procedures ..... 200.22
- Review Procedures ..... 100.29-55
- Unusual Items ..... 100.36; 100.38

### ATTORNEYS—See Lawyers

### AUDIT ENGAGEMENTS

- Adverse Opinion ..... 9100.24
- Change in Engagement ..... 100.86-91
- Change in Status of Entity ..... 200.32-33
- Compared to Reviews ..... 100.46; 100.52
- Prior Period Compiled ..... 200.28
- Prior Period Reviewed ..... 200.28
- Subsequent Period Compiled ..... 200.29; ..... 9200.01-04
- Subsequent Period Reviewed ..... 200.29

### AUDITING STANDARDS—See Generally Accepted Auditing Standards

### AUDITORS' OPINIONS—See Opinions, Auditors'

### AUTHORITIES, REGULATORY—See Regulatory Agencies

### AUTHORIZATION

- Client's Permission to Predecessor Accountant ..... 400.04; 400.08
- Successor Accountant Acknowledgment Letter ..... 400.12

## B

### BUSINESS VALUATION

- Reporting ..... 9100.89-92
- SSARS Applicability When Financial Information Is Derived From Entity's Tax Return ..... 9100.89-92

References are to AR section and paragraph numbers

**C****CASH FLOWS—See Statements of Cash Flows****CHANGE OF ACCOUNTANTS**

- Predecessor—See Predecessor Independent Accountant
- Successor—See Successor Independent Accountant

**CLIENTS**

- Accountant's Labeling of Financial Statement Notes ..... 9100.85-88
- Accountant's Submission of Financial Statements to Client ..... 100.06
- Accountant's Submission of Written Personal Financial Plan With Unaudited Statements to a Client ..... 9600.01-03
- Audit Procedures ..... 9100.47
- Authorization to Predecessor Accountant ..... 400.04; 400.08
- Change in Engagement ..... 100.86-91
- Change of Accountants ..... 200.16; ..... 200.20-27; 400.03
- Departures From GAAP ..... 9100.19-26
- Improper Use of Accountant's Name ..... 100.03; 200.03
- Reliability of Information ..... 100.83
- Subsequent Discovery of Facts ... 400.10-11
- Understanding With Accountant ..... 100.05; ..... 600.03; 9100.08; ..... 9100.48; 9600.01-03

**CODE OF PROFESSIONAL CONDUCT—See Conduct, Code of Professional****COMMUNICATION**

- Audit Procedures ..... 9100.49
- Between Predecessor and Successor Accountant ..... 400.01-12
- Change of Accountants ..... 400.01-12
- Disclaimer on Compilation Reports, Example Wording ..... 100.03
- Financial Statements Reported on By Predecessor Accountant ..... 400.10-11
- Principal and Reporting Accountant ... 9400.05
- Successor Accountant Acknowledgment Letter ..... 400.12
- Successor Accountant's Use of ..... 400.09
- When Compiled Financial Statements Are Not Expected to Be Used by a Third Party ..... 100.24-27; 9100.136-137
- Written Representations Required From Management ..... 100.39-42

**COMPARABILITY**

- Compiled Financial Statements ..... 200.05

**COMPARATIVE FINANCIAL STATEMENTS**

- Change in Status of Entity ..... 200.32-33
- Compilation Each Period ..... 200.09; ..... 9200.01-04
- Definition ..... 200.07
- Departures From GAAP ..... 200.13-15

**COMPARATIVE FINANCIAL****STATEMENTS—continued**

- Omission of Disclosures ..... 200.05; ..... 200.30-31; 9200.01-04
- One Period Audited ..... 200.28-29
- Prescribed Forms ..... 200.02; 300.01
- Reference to Accountant's Report ..... 200.06; ..... 9200.03-04
- Review Each Period ..... 200.09
- Uncertainties ..... 9200.04

**COMPILATION ENGAGEMENT**

- Audit Procedures ..... 100.09; 9100.46-49
- Change From Audit Engagement ... 100.86-91
- Change to Review Engagement ... 100.86-91; ..... 9100.06-12
- Communication Between Accountants ..... 400.01-12
- Communication of Possible Fraud and Illegal Acts ..... 100.84-85
- Compilation Each Period ..... 9200.01-04
- Compliance With Quality Control Standards ..... 100.93-95
- Date on Report ..... 100.13
- Disclaimer on Compilation Reports ..... 100.03
- Fraud ..... 100.05
- Illegal Acts ..... 100.05
- Illustrative Engagement Letter ... 100.99-100
- Knowledge of Accounting Practices ..... 100.08-09
- Limitations ..... 100.12
- Objectives ..... 100.06
- Planning ..... 9100.16-17
- Prescribed Forms ..... 100.18; 300.01; ..... 9300.01-03
- Prior Period Audited ..... 200.29; 9200.01-04
- Pro Forma Financial Information—See Compilation of Pro Forma Financial Information
- Reports—See Compilation Reports
- Reports on Application of Accounting Principles ..... 9400.01-05
- Reviews of Nonissuers Owned or Controlled by Issuer ..... 9100.104-108
- Rule 201, Compliance With ..... 9100.16-17
- Signature of Firm or Accountant on Report ..... 100.13
- Specified Elements, Accounts, or Items of a Financial Statement—See Compilation of Specified Elements, Accounts, or Items of a Financial Statement
- Subsequent Discovery of Facts ..... 100.77; ..... 400.10-11
- Subsequent Events ..... 200.13-15; ..... 200.20-23
- Subsequent Period Audited ..... 200.28
- Successor Accountant Acknowledgment Letter ..... 400.12
- Supervision ..... 9100.16-17
- Supplementary Information ..... 100.83
- Supplementary Information, Separate Report on ..... 100.83

References are to AR section and paragraph numbers

**COMPILATION ENGAGEMENT—continued**

- Tax Returns, Reporting ..... 9100.31-32
- Uncertainties ..... 9100.120-129
- Understanding With Entity ..... 100.05;  
..... 9100.48
- Withdrawal From Engagement ..... 100.57;  
..... 9100.18-22
- Written Representations Required  
From Management ..... 100.39-42

**COMPILATION OF FINANCIAL STATEMENTS**

- Change of Accountants ..... 400.02
- Communication of Possible Fraud  
and Illegal Acts ..... 100.84-85
- Comparative Financial  
Statements ..... 200.01-37; 9200.01-04
- Compared to Audits and Reviews ..... 100.99;  
..... 100.100; 100.101
- Compliance With Contractual Agreement  
or Regulatory Provision ..... 9100.109-119
- Compliance With Quality Control  
Standards ..... 100.93-95
- Date on Report ..... 100.13
- Definition ..... 100.04
- Departures From GAAP ..... 100.18-19;  
..... 300.01; 300.03-04; 9100.19-20;  
..... 9100.23-26; 9100.95-99;  
..... 9100.109-118; 9300.01-03
- Draft Financial Statements ..... 9100.61-62
- Errors ..... 100.11
- Going Concern ..... 100.69-72
- Illustrative Engagement Letter ..... 100.99-100
- Incomplete Presentation ..... 9100.109-118
- Omission of Disclosures—See Disclosure
- Performance Requirements ..... 100.08-11
- Planning ..... 9100.16-17
- Prescribed Forms ..... 100.02; 100.18-19;  
..... 300.01-05; 9300.01-03
- Pro Forma Financial Information—See  
Compilation of Pro Forma Financial  
Information
- Reporting—See Compilation Reports
- Reviews of Nonissuers Owned or  
Controlled by Issuer ..... 9100.104-108
- Signature of Firm or Accountant  
on Report ..... 100.13
- Specified Elements, Accounts, or Items  
of a Financial Statement—See Compilation of  
Specified Elements, Accounts, or Items of a  
Financial Statement
- Standards and Procedures ..... 100.07-27
- Submission of Financial Statements ... 100.07;  
..... 9100.89-92
- Subsequent Discovery of Facts ..... 100.77;  
..... 400.10-11
- Subsequent Events ..... 100.73-76
- Successor Accountant Acknowledgment  
Letter ..... 400.12
- Supervision ..... 9100.16-17
- Supplementary Information ..... 100.83

**COMPILATION OF FINANCIAL****STATEMENTS—continued**

- When Not Expected to Be Used by a  
Third Party ..... 100.24-27;  
..... 9100.136-137
- Written Representations Required From  
Management ..... 100.39-41

**COMPILATION OF PRO FORMA FINANCIAL INFORMATION**

- Conditions for Compiling ..... 120.06-08
- Distinguished From Historical Financial  
Information ..... 120.05
- Engagement Letter ..... 120.18
- Illustrations—See Illustrations
- Limitations ..... 120.02
- Objectives ..... 120.03-04
- Performance Requirements ..... 120.11-12
- Reporting Requirements ..... 120.13-16
- Understanding With the Entity ..... 120.09-10

**COMPILATION OF SPECIFIED ELEMENTS, ACCOUNTS, OR ITEMS OF A FINANCIAL STATEMENT**

- Components ..... 9100.56
- Conditions for Compiling ..... 110.04-05
- Engagement Letter ..... 110.15
- Examples ..... 110.03
- Illustrations—See Illustrations
- Included as Accompanying Information  
to Basic Financial Statements ..... 110.04
- Limitations ..... 110.02
- Performance Requirements ..... 110.08-09
- Reporting Requirements ..... 110.10-13
- Understanding With the Entity ..... 110.06-07

**COMPILATION REPORTS**

- Accountant's Responsibility ..... 100.01-03;  
..... 100.07-11; 200.03;  
..... 200.11-12; 9100.29-30
- Change to Review Report ..... 100.86-91;  
..... 9100.06-12
- Combined Reports ..... 100.63
- Compilation Each Period ..... 200.09;  
..... 9200.01-04
- Compliance With Quality Control  
Standards ..... 100.93-95
- Date of Report ..... 100.13; 100.46
- Departure From Rule 203 of Code  
of Conduct ..... 9100.75
- Departures From GAAP ..... 100.02;  
..... 100.19-22; 100.56-58;  
..... 200.05; 200.13-15;  
..... 200.30-31; 300.01;  
..... 300.03-05; 9100.18-26;  
..... 9100.29-30; 9100.95-99;  
..... 9200.04; 9300.01-03
- Disclaimer of Opinion ... 100.03; 100.14-25;  
..... 200.31
- Emphasis of a Matter Paragraph ... 9100.123;  
..... 9100.127
- Form and Content ... 100.13-18; 110.10-11;  
..... 120.13-14

References are to AR section and paragraph numbers

**COMPILATION REPORTS—continued**

- General Use and Restricted Use ... 100.59-61
- Illustrations ..... 100.16; 100.21;  
..... 100.99-100; 110.12-13;  
..... 110.15; 120.15-16; 120.18;  
..... 200.09-12; 200.15;  
..... 200.19; 200.29-31; 300.03-04;  
..... 9100.25; 9100.29-30; 9300.01-02
- Lack of Independence ..... 100.23; 100.55;  
..... 110.13; 120.16
- Language, Restricted Use ..... 100.68
- Limited Distribution ..... 100.67
- Modification ..... 100.57; 9100.18-26;  
..... 9100.109-129
- Omission of Disclosures ..... 100.19-22;  
..... 200.05; 200.30-31; 9100.01-02;  
..... 9100.29-30; 9100.85-88;  
..... 9100.95-99; 9200.01-04
- Omission of Display of Comprehensive  
Income ..... 9100.95-99
- Predecessor Independent  
Accountant ..... 200.16-27
- Prescribed Forms ..... 100.02; 100.05;  
..... 100.52-57; 300.01-05;  
..... 9300.01-03
- Prior Period Audited ..... 200.29; 9200.01-04
- Prior Period Reviewed ..... 200.11-12;  
..... 9200.01-04
- Pro Forma Financial Information ... 120.13-16
- Reference to Country of Origin ... 9100.93-94
- Restricted Use ..... 100.59-68
- Scope Limitation ..... 100.52
- Signature of Firm or Accountant ..... 100.13
- Single Financial Statement ..... 100.18
- Specified Elements, Accounts, or  
Items of a Financial Statement ... 110.10-13
- Specified Parties ..... 100.65-66
- Standards and Procedures ..... 100.19-27
- Statement of Comprehensive  
Income ..... 100.16; 100.49
- Subject Matter Based on Measurement  
or Disclosure Criteria Contained in  
Contractual Agreements, Regulatory  
Provisions ..... 100.62
- Subsequent Discovery of Facts ..... 100.77
- Subsequent Period Audited ..... 200.28
- Subsequent Period Reviewed ..... 200.10;  
..... 9100.06-12
- Successor Independent  
Accountant ..... 200.16-27
- Supplementary Information ..... 100.83
- Tax Returns ..... 9100.31-32
- Uncertainties ..... 9100.120-129

**COMPONENTS OF A BUSINESS**

- Reports of Other Accountants ..... 100.38

**COMPREHENSIVE BASIS OF ACCOUNTING**

- Compilation of Financial  
Statements ..... 9100.18-26
- Disclosure of Basis ..... 100.20; 300.01
- Financial Statements Defined ..... 100.04

**COMPREHENSIVE BASIS OF ACCOUNTING—continued**

- Omission of Disclosures ..... 100.19-21;  
..... 200.05; 9100.01-02; 9100.29-30
- Review of Financial Statements ..... 100.35;  
..... 9100.18-26

**COMPREHENSIVE INCOME**

- Omission of Display in a Compilation  
Report ..... 9100.95-99

**CONDUCT, CODE OF PROFESSIONAL**

- Disclosure of Confidential  
Information ..... 400.04
- Interpretation 501-1 ..... 400.08
- Litigation Services ..... 9100.76-77
- Rule 201 ..... 9100.16-17
- Rule 202 ..... 20.08; 50.03
- Rule 203 ..... 9100.73-75
- Working Papers ..... 400.08

**CONFIDENTIAL CLIENT INFORMATION**

- Disclosure of Information ..... 400.04

**CONFIRMATIONS**

- Receivables ..... 9100.46-49

**CONTINGENCIES**

- Communication With Predecessor  
Accountant ..... 400.08

**CONTINUING INDEPENDENT ACCOUNTANT**

- Changed Reference in Report ..... 200.13-15
- Definition ..... 200.07
- Standard Reports ..... 200.08-12

**CORPORATE JOINT VENTURES—See Jointly Owned Companies**

**CORRECTION OF ERROR**

- Restatement of Prior Period ..... 200.25-27

**COUNTRY OF ORIGIN**

- Reference in Compilation or Review  
Report ..... 9100.93-94

**D**

**DATE OF REPORT**

- Completion of Accountant's Review  
Procedures ..... 100.46
- Completion of Compilation ..... 100.13
- Compilation Report ..... 100.13; 100.46
- Review Report ..... 100.46
- Subsequent Discovery of Facts ..... 100.77
- Subsequent Period Compiled ..... 9200.01

**DEFINITIONS—See Terminology**

**DEPARTURES FROM ESTABLISHED PRINCIPLES**

- Compilation of Financial  
Statements ..... 100.18-19;  
..... 100.56-58; 200.05;  
..... 200.13-15; 300.01; 300.03-04;  
..... 9100.18-26; 9100.75; 9100.95-99;  
..... 9100.108-119; 9200.04; 9300.01-03
- Illustrations ..... 9100.20-21; 9100.25;  
..... 9100.118-119; 9300.01-02

References are to AR section and paragraph numbers

**DEPARTURES FROM ESTABLISHED****PRINCIPLES—continued**

- Omission of Disclosures ..... 100.19-22;  
..... 200.30-31; 300.01; 600.02;  
..... 9100.01-02; 9100.29-30;  
..... 9100.85-88; 9100.95-99;  
..... 9300.01-03
- Omission of Display of Comprehensive  
Income ..... 9100.95-99
- Personal Financial Statements ..... 600.02
- Prescribed Forms ..... 100.02; 100.05;  
..... 100.55; 300.01;  
..... 300.03-05; 9300.01-03
- Review of Financial Statements ..... 100.29-55;  
..... 200.13-15; 9100.01-02;  
..... 9100.18-26; 9100.73-74;  
..... 9100.108-119; 9200.04;  
..... 9300.01-03
- Unaudited Financial Statements ..... 300.01;  
..... 300.03

**DISCLAIMER OF OPINION**

- Associated Accountant ..... 100.03
- Compilation and Review  
Engagements ..... 100.03
- Compilation Reports ..... 200.31
- Prior Period Financial Statements ..... 200.02;  
..... 200.17; 200.33; 9200.02-03
- Unaudited Information, Example  
Wording ..... 100.03

**DISCLOSURE**

- Controllership Services, When  
Performing ..... 9100.80-84
- Departures From GAAP ..... 300.01;  
..... 9100.18-26; 9300.01-03
- Errors ..... 100.11
- Illegal Acts ..... 100.05
- Inadequate ..... 100.10-11; 200.13
- Management Services, When  
Performing ..... 9100.80-84
- Omission of Disclosures ..... 100.19-22;  
..... 200.05; 200.30-31; 300.01;  
..... 600.02; 9100.01-02; 9100.29-30;  
..... 9100.85-88; 9100.95-99;  
..... 9100.128-129; 9200.01-04;  
..... 9300.01-03
- Omission of Display of Comprehensive  
Income ..... 9100.95-99
- Prescribed Forms ..... 100.19; 300.01;  
..... 9300.01-03
- Privileged Communication ..... 400.04
- Subsequent Events ..... 200.23
- Uncertainties ..... 9100.122-123;  
..... 9100.125-129
- Use of "Selected Information"  
Label ..... 9100.85-88

**DISCOVERY**

- Financial Statements of  
Predecessor ..... 400.10-11
- Subsequent Discovery of Facts ..... 100.77;  
..... 400.10-11

**DOCUMENTATION**

- Review Engagement ..... 100.43-45

**E****ELEMENTS OF FINANCIAL STATEMENTS—See****Compilation of Specified Elements,  
Accounts, or Items of a Financial  
Statement****EMPHASIS OF A MATTER**

- Departures From GAAP ..... 9100.26
- Prior Period Financial Statements ..... 200.17;  
..... 9200.03
- Uncertainties ..... 9100.123; 9100.127

**ENGAGEMENT**

- Audit—See Audit Engagement
- Compilation—See Compilation Engagement
- Review—See Review Engagement

**ENGAGEMENT LETTERS**

- Compilation of Financial  
Statements ..... 100.99-100; 9100.95-99
- Compilation of Pro Forma Financial  
Information ..... 120.18
- Compilation of Specified Elements, Accounts, or  
Items of a Financial Statement ..... 110.15
- Review of Financial Statements ..... 100.101

**EVENTS**

- Subsequent—See Subsequent Events

**EVIDENTIAL MATTER**

- Documentation, Oral and Written ... 100.43-45;  
..... 9100.47

**EXAMPLES—See Illustrations****F****FAIR PRESENTATION**

- Written Representations Required From  
Management ..... 100.39-42

**FINANCIAL INFORMATION—See Financial  
Statements****FINANCIAL STATEMENTS**

- Accountant's Responsibility ..... 200.03
- Accountant's Review ..... 9100.131
- Comparative—See Comparative Financial  
Statements
- Compilation—See Compilation of Financial  
Statements
- Conformity With GAAP ..... 100.38
- Controllership Services That Entail  
Submission of ..... 9100.80-84
- Definition ..... 100.04
- Differentiating From Trial  
Balance ..... 9100.54-57
- Disclosures—See Disclosure
- Draft ..... 9100.61-62
- Elements—See Compilation of Specified  
Elements, Accounts, or Items of a  
Financial Statement
- Emphasis of Matter ..... 9100.131

References are to AR section and paragraph numbers

**FINANCIAL STATEMENTS—continued**

- Examples ..... 100.04
- Financial Information ..... 9100.31-32
- Incomplete Presentation ..... 9100.109-118
- International Financial Reporting Standards ..... 9100.130-133
- International Standard on Related Service 4410 ..... 9100.134-135
- International Standard on Review Engagements 2400 ..... 9100.134-135
- Investees ..... 100.38
- Litigation Services and Service Engagements ..... 9100.76-79
- Management Services That Entail Submission of ..... 9100.80-84
- Misleading—See Misleading Financial Statements
- Omitted Disclosure ..... 9100.131
- Personal—See Personal Financial Statements
- Pro Forma—See Compilation of Pro Forma Financial Information
- Restatement of Prior Period ..... 200.25-27
- Review—See Review of Financial Statements
- Submission to Client ..... 100.04; 100.07; ..... 9100.89-92
- Subsequent Discovery of Facts ..... 100.77; ..... 400.10-11
- Subsidiaries ..... 100.38
- Unaudited—See Unaudited Financial Statements
- Uncertainties—See Uncertainties
- U.S. Entity ..... 9100.134-135

**FOOTNOTES—See Notes to Financial Statements**

**FRAUD**

- Communication to Management and Others ..... 100.84-85
- Definitions ..... 100.05
- Illustrative Engagement Letter ..... 100.99-101
- Understanding With the Entity ..... 100.05; ..... 100.25

**FUNDS STATEMENT—See Statements of Cash Flows**

**G**

**GENERAL STANDARDS, AUDIT**

- Rule 201, Rules of Conduct ..... 9100.16-17
- Rule 203, Rules of Conduct ..... 9100.73-75

**GENERALLY ACCEPTED ACCOUNTING PRINCIPLES**

- Analytical Procedures ..... 100.36-37
- Basis of Accounting ..... 100.04
- Departures—See Departures From Established Principles
- Disagreement With Management ..... 400.05
- Omission of Disclosures ..... 100.19-22; ..... 200.05; 200.13; 200.30-31; ..... 300.01; 9100.01-02; 9100.29-30; ..... 9100.95-99; 9200.01; 9200.04; ..... 9300.01-02

**GENERALLY ACCEPTED ACCOUNTING PRINCIPLES—continued**

- Omission of Display of Comprehensive Income ..... 9100.95-99
- Reference to Country of Origin ... 9100.93-94
- Reports on Application ..... 9400.01-05
- Review of Financial Statements ... 100.29-55
- Written Representations Required From Management ..... 100.39-42

**GENERALLY ACCEPTED AUDITING STANDARDS**

- Change of Auditors ..... 400.03
- Objective of Audit ..... 100.49
- Planning ..... 9100.16-17
- Supervision ..... 9100.16-17

**GOING CONCERN**

- Disclosure ..... 9100.122-123
- Emphasis of a Matter Paragraph ... 9100.123
- Uncertainties ..... 9100.120-129

**I**

**ILLEGAL ACTS**

- Communication to Management and Others ..... 100.84-85
- Definitions ..... 100.05
- Understanding Concerning Engagement ..... 100.05

**ILLUSTRATIONS**

- Business Valuation Reporting ..... 9100.89-92
- Compilation Engagement Letter ..... 100.99-100; 110.15; 120.18
- Compilation of Financial Statements ... 100.97
- Compilation of Pro Forma Financial Information ..... 120.15-16; 120.18
- Compilation of Specified Elements, Accounts, or Items of a Financial Statement ..... 110.12-13; 110.15
- Compilation Report ..... 100.16; 100.21; ..... 100.57; 100.99-100; ..... 200.09-12; 200.15; ..... 200.19; 200.26; 200.29; ..... 200.31; 300.03-04; 9100.25-26; ..... 9100.29-30; 9100.113; 9100.118; ..... 9300.01-02
- Controllorship Services, Required Communication When Performing ... 9100.83
- Departures From GAAP ..... 100.57; ..... 200.15; 300.03-04; 9100.20-21; ..... 9100.26; 9300.01-02
- Disclaimer on Compilation Reports ..... 100.03
- Emphasis of a Matter Paragraph ... 9100.123; ..... 9100.127
- Implementation of a Personal Financial Plan by Client's Advisers ..... 9600.03
- Inquiries for Review Engagement ..... 100.98
- Management Services, Required Communication When Performing ... 9100.83
- Omission of Disclosures ..... 100.21; 200.31; ..... 9100.01-02

References are to AR section and paragraph numbers

**ILLUSTRATIONS—continued**

- Prior Period Audited ..... 200.29
- Pro Forma Financial Information ..... 120.15-16
- Report on Personal Financial Statements ..... 600.05
- Representation Letters ..... 100.102-103
- Review Engagement Letter ..... 100.101
- Review Reports ..... 100.49; 100.57; 100.101; ..... 200.09-12; 200.15; 200.18; ..... 200.27; 200.29; 9100.25; ..... 9100.114; 9100.119
- Specified Elements, Accounts, or Items of a Financial Statement ..... 110.12-13
- Successor Accountant Acknowledgment Letter ..... 400.12
- Successor Accountant's Report ... 200.18-19; ..... 200.26-27

**INCOME TAX RETURNS—See Tax Returns****INDEPENDENCE**

- Accountant Not Independent ..... 100.23; ..... 100.50; 110.13; 120.15
- Lack of Independence, Disclosure of ..... 9100.81

**INDUSTRY PRACTICES**

- Knowledge Requirements ..... 100.08-09; ..... 100.33-35

**INFORMATION**

- Reliability ..... 100.83
- Subsequent Discovery of Facts ..... 100.77

**INQUIRIES**

- Acceptance of an Engagement ... 400.03-06
- Compilation Procedures ..... 100.10-14; ..... 9100.47
- Illustrative Inquiries ..... 100.98
- Predecessor Accountant's Procedures ..... 200.22
- Review of Working Papers ..... 400.08
- Review Procedures ..... 100.35; 100.38; ..... 100.46
- Successor Accountant's Procedures ... 400.04

**INSTITUTE—See American Institute of CPAs****INTERNAL CONTROL**

- Review of Financial Statements ..... 9100.47

**INTERNATIONAL ACCOUNTING****STANDARDS BOARD**

- Designation by Council ..... 9100.131
- International Financial Reporting Standards ..... 9100.130-133

**INTERNATIONAL FINANCIAL REPORTING****STANDARDS**

- Accountant's Review ..... 9100.131
- Financial Statements ..... 9100.130-135
- Jurisdictional Variation ..... 9100.131

**INTERPRETATIVE PUBLICATIONS**

- Definition and Examples ..... 20.05; 50.05-06

**INVENTORIES**

- Observation ..... 9100.46-49

**INVESTEES**

- Controlled By Publicly Traded Enterprise ..... 100.04; 200.01
- Financial Statements ..... 100.38

**IRREGULARITIES—See Fraud****J****JOINTLY OWNED COMPANIES**

- Controlled by Publicly Traded Enterprise ..... 100.04; 200.01

**JUDGMENT**

- Incomplete Review ..... 100.51
- Independence of Accountant ..... 100.23
- Reports on Application of Accounting Principles ..... 9400.05
- Subsequent Discovery of Facts ..... 100.77
- Use of "Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included" in Notes to Financial Statements ..... 9100.85-88

**K****KNOWLEDGE**

- Industry Accounting Practices ..... 100.08-09; ..... 100.33-35

**L****LAWSUITS—See Litigation****LAWYERS**

- Accountant's Withdrawal From Engagement ..... 100.58
- Client's Improper Use of Statements ..... 100.03; 200.03
- Predecessor Independent Accountant ..... 200.24
- Subsequent Discovery of Facts ..... 100.58; ..... 100.77; 400.11

**LETTERS OF REPRESENTATION—See****Representation Letters****LIMITED ASSURANCE**

- Review of Financial Statements ..... 100.31-33; ..... 9100.24

**LITIGATION**

- Applicability of SSARS to Litigation Services ..... 9100.76-79
- Inquiries From Successor Accountant ..... 400.06
- Responses From Predecessor Accountant ..... 400.06

**M****MANAGEMENT**

- Change of Accountants ..... 400.03
- Communication of Possible Fraud and Illegal Acts ..... 100.84-85



References are to AR section and paragraph numbers

**MANAGEMENT—continued**

- Controllership Services, Provision of ..... 9100.80-84
- Disagreement With Predecessor Accountant ..... 400.05
- Integrity ..... 400.05
- Management Services, Provision of ..... 9100.80-84
- Omission of Disclosures ..... 100.10; 200.31; ..... 9100.02; 9100.26; 9100.29-30
- Representation Letters ..... 100.39-42; ..... 100.102-103
- Responsibility for Financial Statements ..... 100.13; 100.16; 100.21; ..... 100.39-42; 100.46-49; ..... 100.41-44; 9100.29-30
- Written Representations Required From Management ..... 100.39-42

**MEASUREMENT**

- Prescribed Forms ..... 300.01; 9300.01-03

**MISLEADING FINANCIAL STATEMENTS**

- Departures From GAAP ..... 9100.18-22

**MISTAKES—See Fraud****N****NONISSUERS**

- Applicability to Reviews of Interim Financial Information ..... 100.01
- Change in Engagement ..... 100.86-91
- Change of Status of Entity ..... 200.32-33
- Comparative Financial Statements ..... 200.01-37
- Compilation of Financial Statements ..... 100.01; ..... 400.01; 9100.16-17; ..... 9300.01-03
- Definition ..... 100.04; 200.01
- Prescribed Forms ..... 300.01-05; 9300.01-03
- Review of Financial Statements ..... 100.01; ..... 400.01; 9100.16-17; 9300.01-03
- Tax Returns, Reporting ..... 9100.31-32
- Unaudited Financial Statements ..... 100.01; ..... 100.03

**NOTES TO FINANCIAL STATEMENTS**

- Labeling When Client Includes More Than a Few Required Disclosures ..... 9100.85-88
- Omission of ..... 9100.85-88

**O****OPINIONS, AUDITORS'**

- Disclaimer on Compilation Reports ..... 100.03; ..... 100.13-21
- Disclaimer on Review Reports ..... 100.46-49
- Prior Period Audited ..... 200.29
- Supplementary Information ..... 100.83

**OTHER COMPILATION AND REVIEW PUBLICATIONS**

- Definition and Examples ..... 20.05; 50.07-08

**P****PERSONAL FINANCIAL STATEMENTS**

- Departures From GAAP ..... 600.02
- Omission of Disclosures—See Disclosure
- Reports ..... 600.04-06
- Unaudited Statements for a Written Plan ..... 600.03-06; 9600.01-03
- Understanding With Client ..... 600.03; ..... 9600.01-03

**PLANNING**

- General Standards ..... 9100.16-17

**PREDECESSOR INDEPENDENT ACCOUNTANT**

- Availability of Working Papers ..... 400.08
- Communication With Successor Accountant ..... 400.01-12; 9400.01
- Compilation Engagements ..... 400.01-12
- Compilation Report Not Presented ..... 200.16-19
- Compilation Report Reissued ..... 200.16; ..... 200.20-24
- Consultation With Successor ..... 400.08
- Contingencies ..... 400.08
- Definition ..... 400.02
- Disagreement With Client ..... 400.05
- Fees ..... 400.06; 400.08
- Inquiries ..... 400.03-08
- Legal Advice on Reissuance of Report ..... 200.24
- Procedures for Reissuing Report ..... 200.16; ..... 200.20-24
- Referenced in Successor's Report ..... 50.09
- Representation Letters ..... 200.23
- Responses to Successor Accountant ..... 400.01; 400.06
- Restated Prior Period Statements ..... 200.25-27
- Review Engagements ..... 400.01-12
- Review Report Not Presented ..... 200.16-19
- Review Report Reissued ..... 200.20-24
- Subsequent Discovery of Facts ..... 400.10-11
- Working Papers ..... 400.08

**PRESCRIBED REPORT FORMS—See Special Reports****PRINCIPLES, ACCOUNTING—See Generally Accepted Accounting Principles****PRIVILEGED COMMUNICATION—See Confidential Client Information****PUBLICLY TRADED COMPANIES**

- Change of Status of Entity ..... 200.32-33

**Q****QUALIFIED OPINION**

- Prior Period Financial Statements ..... 9200.02-04

References are to AR section and paragraph numbers

**QUALITY CONTROL**

- Compliance With Quality Control Standards ..... 100.93-95
- Engagement Performed in Accordance With Applicable Professional Standards ..... 100.93-95
- Relationship With SSARS ..... 100.93-95
- System of Quality Control—See System of Quality Control

**R****RECEIVABLES**

- Confirmations ..... 9100.46-49

**REGULATORY AGENCIES**

- Filing for Sale of Securities ... 100.04; 200.01
- Prescribed Forms ..... 300.02
- Taxing Authorities ..... 9100.31-32

**RELIABILITY**

- Assertions By Management ..... 100.77

**REPORTS**

- Accountant's Reporting Obligation .... 200.08
- Change of Status of Entity ..... 200.32-33
- Compilation—See Compilation Reports
- Date of Reissued Report ..... 200.23
- Other Accountants ..... 100.38
- Personal Financial Statements ..... 600.04-06
- Reissued ..... 200.07-08; 200.11; ..... 200.20-24; 200.29
- Review—See Review Reports
- Tax Returns ..... 9100.31-32
- Understanding With Entity ... 100.05; 9100.48
- Updated ..... 200.07-08; 200.15

**REPRESENTATION LETTERS**

- Illustrations ..... 100.102-103
- Information for Predecessor Accountant ..... 200.23
- Management Not Present During All Periods of Accountant's Report ... 100.41
- Obtained From Management ..... 100.41
- Required Signature and Date ..... 100.41
- Written Representations Required From Management ..... 100.39-42

**REVIEW ENGAGEMENT**

- Audit Procedures ..... 100.31; 9100.46-49
- Change From Audit Engagement ... 100.86-91
- Communication Between Accountants ..... 400.01-12
- Communication to Management and Others ..... 100.84-85
- Compared to Audit ..... 100.46; 100.49
- Fraud ..... 100.05
- Documentation ..... 100.39-42
- Illegal Acts ..... 100.05
- Illustrative Engagement Letter ..... 100.101
- Illustrative Inquiries ..... 100.98
- Illustrative Representation Letter .... 100.102
- Illustrative Updating Management Representation Letter ..... 100.103

**REVIEW ENGAGEMENT—continued**

- Knowledge of Accounting Practices ..... 100.33-35; 100.42
- Limitations ..... 100.32
- Management Representation Letter ... 100.41
- Nonissuers Owned or Controlled by Issuer ..... 9100.104-108
- Objectives ..... 100.28
- Planning ..... 9100.16-17
- Prescribed Forms ..... 9300.03
- Prior Period Audited ..... 200.29
- Reports—See Review Reports
- Reports on Application of Accounting Principles ..... 9400.01-05
- Rule 201, Compliance With ..... 9100.16-17
- Subsequent Discovery of Facts ..... 100.77; ..... 400.10-11
- Subsequent Events ..... 100.38; 200.13-15; ..... 200.20-23
- Subsequent Period Audited ..... 200.28
- Subsequent Period Compiled .... 200.11-12; ..... 9200.01-04
- Supervision ..... 9100.16-17
- Tax Returns, Reporting ..... 9100.31-32
- Uncertainties ..... 9100.120-129
- Understanding With Entity ..... 100.05; ..... 9100.48
- Withdrawal From Engagement ..... 100.58; ..... 9100.18-22

**REVIEW OF FINANCIAL STATEMENTS**

- Analytical Procedures ..... 100.36-37
- Change of Accountants ..... 400.02
- Communication to Management and Others ..... 100.84-85
- Comparative Financial Statements ..... 200.01-37; 9200.01-04
- Compliance With Contractual Agreement or Regulatory Provision ..... 9100.109-119
- Definition ..... 100.04
- Departures From GAAP ..... 9100.109-118
- Draft Financial Statements ..... 9100.61-62
- Going Concern ..... 100.69-72
- Illustrative Engagement Letter ..... 100.101
- Illustrative Inquiries ..... 100.98
- Illustrative Representation Letter .... 100.102
- Incomplete ..... 100.51
- Incomplete Presentation ..... 9100.109-118
- Inquires and Other Procedures ..... 100.35; ..... 100.38
- Internal Control ..... 100.12
- Knowledge of Accounting Principles and Practices of the Industry ..... 100.33-35
- Limited Assurance ..... 100.29; 100.31-33; ..... 100.51; 100.83; 100.102
- Nonissuers Owned or Controlled by Issuer ..... 9100.104-108
- Omission of Disclosures—See Disclosure
- Planning ..... 9100.16-17
- Prescribed Forms ..... 100.02; 300.01-05; ..... 9300.01-03

References are to AR section and paragraph numbers

**REVIEW OF FINANCIAL****STATEMENTS—continued**

- Reporting—See Review Reports
- Standards and Procedures ..... 100.34-56
- Subsequent Discovery of Facts ..... 100.55;  
..... 400.10-11
- Subsequent Events ..... 100.73-76
- Successor Accountant Acknowledgment  
Letter ..... 400.12
- Supervision ..... 9100.16-17
- Supplementary Information ..... 100.83

**REVIEW REPORTS**

- Accountant's Responsibility ..... 100.01-03;  
..... 100.29-55; 200.03; 200.11-12
- Combined Reports ..... 100.63
- Compliance With Quality Control  
Standards ..... 100.93-95
- Date of Report ..... 100.46
- Departure From Rule 203 of Code  
of Conduct ..... 9100.73-74
- Departures From GAAP ..... 100.56-58;  
..... 200.13-15; 9100.01-02;  
..... 9100.18-26; 9200.04
- Disclaimer of Opinion ..... 100.03; 100.46;  
..... 100.49
- Emphasis of a Matter Paragraph ... 9100.123;  
..... 9100.127
- Form and Content ..... 100.44-48
- General Use and Restricted Use ... 100.59-61
- Illustrations ..... 100.03; 100.49; 100.98;  
..... 100.101-103; 200.09-12; 200.15;  
..... 200.18; 200.29; 9100.25
- Lack of Independence ..... 100.55
- Language, Restricted Use ..... 100.68
- Limited Distribution ..... 100.67
- Modification ..... 100.56; 9100.18-26;  
..... 9100.109-129; 9300.01-03
- Omission of Disclosures ..... 9100.85-88
- Predecessor Independent  
Accountant ..... 200.16-27
- Prescribed Forms ..... 300.03; 9300.01-03
- Prior Period Audited ..... 200.29
- Prior Period Compiled ..... 200.10;  
..... 9100.06-12
- Reference to Country of Origin ... 9100.93-94
- Restricted Use ..... 100.59-68
- Review Each Period ..... 200.09
- Scope Limitation ..... 100.49
- Signature of Firm or Accountant  
on Report ..... 100.46
- Single Financial Statement ..... 100.52
- Specified Parties ..... 100.65-66
- Subject Matter Based on Measurement  
or Disclosure Criteria Contained in  
Contractual Agreements, Regulatory  
Provisions ..... 100.62
- Subsequent Discovery of Facts ..... 100.77
- Subsequent Period Audited ..... 200.28

**REVIEW REPORTS—continued**

- Subsequent Period Compiled ..... 200.11-12;  
..... 9200.01-04
- Successor Independent  
Accountant ..... 200.16-27
- Supplementary Information ..... 100.83
- Tax Returns ..... 9100.31-32
- Uncertainties ..... 9100.124-129
- Understanding of Entity's  
Business ..... 100.33-35
- Written Representations Required  
From Management ..... 100.39-41

**S****SCOPE OF EXAMINATION**

- Restriction on Scope ..... 100.52

**SPECIAL REPORTS**

- Application of Accounting  
Principles ..... 9400.01-05
- Comparative Financial  
Statements ..... 200.02; 300.01
- Compilation of Financial  
Statements ..... 300.01-05;  
..... 9300.01-03
- Departures From GAAP ... 100.05; 100.18-19;  
..... 100.56; 300.01;  
..... 300.03-05; 9300.01-03
- Disclaimer of Opinion ..... 9100.27-28
- Disclosure ..... 100.19; 300.01; 9300.01-03
- Illustrations ..... 300.03-04; 9300.01-02
- Measurement ..... 300.01; 9300.01-03
- Nonissuer ..... 300.02; 9300.01-03
- Prescribed Forms ..... 100.02; 100.18-19;  
..... 100.56; 200.02;  
..... 300.01-05; 9300.01-03
- Regulatory Agencies ..... 300.02
- Unaudited Financial Statements ..... 300.01;  
..... 300.03; 9300.01-03

**STANDARDS FOR ACCOUNTING  
AND REVIEW SERVICES**

- Interpretative Publications ..... 20.05;  
..... 50.05-06
- Other Compilation and Review  
Publications ..... 20.05; 50.07-08
- Predecessor's Compilation or Review  
Report ..... 50.09

**STANDARDS OF REPORTING, AUDIT**

- Compilation of Financial Statements ... 100.13
- Tax Returns ..... 9100.31-32

**STANDARDS, GENERAL—See General  
Standards, Audit****STATEMENTS OF CASH FLOWS**

- Omission in Compilation ..... 100.21

**STATEMENTS OF COMPREHENSIVE INCOME**

- Included in Compilation Report ..... 100.16;  
..... 100.49

References are to AR section and paragraph numbers

**STATEMENTS OF RETAINED EARNINGS**

- Presentation as a Financial Statement ..... 100.16; 100.49

**STATEMENTS ON QUALITY CONTROL****STANDARDS—Also see Quality Control**

- Relationship With SSARS ..... 100.93-95

**STOCK—See Inventories****SUBSEQUENT DISCOVERY OF FACTS—See Discovery****SUBSEQUENT EVENTS**

- Compilation Engagements ..... 200.13-15; 200.20-23
- Review Engagements ..... 100.29-55; 200.13-15; 200.20-23

**SUCCESSOR INDEPENDENT ACCOUNTANT**

- Communication With Predecessor Accountant ..... 400.01-12; 9400.01
- Compilation Engagements ..... 400.01-12
- Consultation With Predecessor ..... 400.08
- Contingencies ..... 400.08
- Definition ..... 400.02
- Inquiries ..... 400.03-08
- Reference to Predecessor's Report ..... 50.09; 200.16-19; 200.21; 200.25-27; 400.09-11
- Relation to Predecessor Accountant ..... 200.16; 200.21-22
- Restated Prior Period Statements ..... 200.25-27
- Review Engagements ..... 400.01-12
- Subsequent Discovery of Facts ..... 400.10-11
- Working Papers of Predecessor ..... 400.08

**SUPERVISION**

- General Standards ..... 9100.16-17

**SUPPLEMENTARY FINANCIAL INFORMATION**

- Compilation of Financial Statements ... 100.83
- Review of Financial Statements ..... 100.83
- Separate Report ..... 100.83

**SYSTEM OF QUALITY CONTROL**

- Deficiencies in ..... 100.95
- Engagement Performed in Accordance With Applicable Professional Standards ..... 100.93-95
- Noncompliance With ..... 100.95
- Responsibility of Firm and Accountant ..... 100.94

**T****TAX RETURNS**

- Relation to Business Valuation ... 9100.89-92
- Relation to Compilation Report ... 9100.31-32
- Relation to Review Report ..... 9100.31-32

**TERMINOLOGY**

- Analytical Procedures ..... 100.36
- Comparative Financial Statements ..... 200.07

**TERMINOLOGY—continued**

- Compilation of Financial Statements ... 100.04
- Continuing Accountant ..... 200.07
- Contractual Agreement ... 100.61; 9100.110
- Explanatory Material ..... 20.05-07
- Financial Statements ..... 100.04
- Fraud ..... 100.05; 100.07; 120.09
- Illegal Acts ..... 100.05; 100.07; 120.09
- Issuer ..... 100.04; 9100.104
- Interpretative Publications ... 20.05; 50.05-06
- Management ..... 100.04
- Nonissuer ..... 100.04; 200.01; 9100.105
- Other Compilation and Review Publications ..... 50.07-08
- Predecessor Accountant ..... 400.02
- Prescribed Form ..... 300.02
- Presumptively Mandatory Requirements ..... 20.04
- Professional Requirements ..... 20.02-04
- Reissued Report ..... 200.07
- Review of Financial Statements ..... 100.04
- Submission of Financial Statements ... 100.07
- Subsequent Events ..... 100.73
- Successor Accountant ..... 400.02
- Third Party ..... 100.04
- Those Charged With Governance ..... 100.04
- Unconditional Requirements ..... 20.04
- Updated Report ..... 200.07

**TRIAL BALANCE**

- Components ..... 9100.56
- Differentiating From Financial Statements ..... 9100.54-57

**U****UNAUDITED FINANCIAL STATEMENTS**

- Accountant's Responsibility ..... 100.01-03; 100.27; 200.03
- Disclaimer of Opinion ..... 200.02
- Litigation Service Engagements ..... 9100.76-79
- Nonissuer ..... 100.01; 100.04
- Personal Financial Plans ..... 600.03-06; 9600.01-03
- Prescribed Forms ..... 300.01; 300.03; 9300.01-03
- Public Entities ..... 100.01

**UNCERTAINTIES**

- Disclosure ..... 9100.122-123; 9100.125-129
- Emphasis of a Matter Paragraph ... 9100.123; 9100.127
- Going Concern ..... 9100.120-123
- Omission of Disclosure ..... 9100.128-129
- Other Than Going Concern ... 9100.124-127
- Prior Period Financial Statements ... 9200.04



# CODE OF PROFESSIONAL CONDUCT

As Adopted January 12, 1988, unless otherwise indicated.

## INTRODUCTION

### Composition, Applicability, and Compliance

The Code of Professional Conduct of the American Institute of Certified Public Accountants consists of two sections—(1) the Principles and (2) the Rules. The Principles provide the framework for the Rules, which govern the performance of professional services by members. The Council of the American Institute of Certified Public Accountants is authorized to designate bodies to promulgate technical standards under the Rules, and the bylaws require adherence to those Rules and standards.

The Code of Professional Conduct was adopted by the membership to provide guidance and rules to all members—those in public practice, in industry, in government, and in education—in the performance of their professional responsibilities.

Compliance with the Code of Professional Conduct, as with all standards in an open society, depends primarily on members' understanding and voluntary actions, secondarily on reinforcement by peers and public opinion, and ultimately on disciplinary proceedings, when necessary, against members who fail to comply with the Rules.

### Other Guidance

*Interpretations of Rules of Conduct* consist of interpretations which have been adopted, after exposure to state societies, state boards, practice units and other interested parties, by the professional ethics division's executive committee to provide guidelines as to the scope and application of the Rules but are not intended to limit such scope or application. A member who departs from such guidelines shall have the burden of justifying such departure in any disciplinary hearing. *Interpretations* which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

*Ethics Rulings* consist of formal rulings made by the professional ethics division's executive committee after exposure to state societies, state boards, practice units and other interested parties. These rulings summarize the application of Rules of Conduct and Interpretations to a particular set of factual circumstances. Members who depart from such rulings in similar circumstances will be requested to justify such departures. *Ethics Rulings* which existed before the adoption of the Code of Professional Conduct on January 12, 1988, will remain in effect until further action is deemed necessary by the appropriate senior technical committee.

Publication of an Interpretation or Ethics Ruling in *The Journal of Accountancy* constitutes notice to members. Hence, the effective date of the pronouncement is the last day of the month in which the pronouncement is published in *The Journal of Accountancy*. The professional ethics division will take into consideration the time that would have been reasonable for the member to comply with the pronouncement.

A member should also consult, if applicable, the ethical standards of his state CPA society, state board of accountancy, the Securities and Exchange Commission, and any other governmental agency which may regulate his client's business or use his report to evaluate the client's compliance with applicable laws and related regulations.

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# ET Section 50

## PRINCIPLES OF PROFESSIONAL CONDUCT

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### TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
51	Preamble .....	.01-.02
52	Article I—Responsibilities .....	.01
53	Article II—The Public Interest .....	.01-.04
54	Article III—Integrity .....	.01-.04
55	Article IV—Objectivity and Independence .....	.01-.04
56	Article V—Due Care .....	.01-.05
57	Article VI—Scope and Nature of Services [Revised] .....	.01-.03

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## ET Section 51

### *Preamble*

**.01** Membership in the American Institute of Certified Public Accountants is voluntary. By accepting membership, a certified public accountant assumes an obligation of self-discipline above and beyond the requirements of laws and regulations.

**.02** These Principles of the Code of Professional Conduct of the American Institute of Certified Public Accountants express the profession's recognition of its responsibilities to the public, to clients, and to colleagues. They guide members in the performance of their professional responsibilities and express the basic tenets of ethical and professional conduct. The Principles call for an unwavering commitment to honorable behavior, even at the sacrifice of personal advantage.

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**ET Section 52*****Article I—Responsibilities***

*In carrying out their responsibilities as professionals, members should exercise sensitive professional and moral judgments in all their activities.*

**.01** As professionals, certified public accountants perform an essential role in society. Consistent with that role, members of the American Institute of Certified Public Accountants have responsibilities to all those who use their professional services. Members also have a continuing responsibility to cooperate with each other to improve the art of accounting, maintain the public's confidence, and carry out the profession's special responsibilities for self-governance. The collective efforts of all members are required to maintain and enhance the traditions of the profession.

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## ET Section 53

### ***Article II—The Public Interest***

*Members should accept the obligation to act in a way that will serve the public interest, honor the public trust, and demonstrate commitment to professionalism.*

**.01** A distinguishing mark of a profession is acceptance of its responsibility to the public. The accounting profession's public consists of clients, credit grantors, governments, employers, investors, the business and financial community, and others who rely on the objectivity and integrity of certified public accountants to maintain the orderly functioning of commerce. This reliance imposes a public interest responsibility on certified public accountants. The public interest is defined as the collective well-being of the community of people and institutions the profession serves.

**.02** In discharging their professional responsibilities, members may encounter conflicting pressures from among each of those groups. In resolving those conflicts, members should act with integrity, guided by the precept that when members fulfill their responsibility to the public, clients' and employers' interests are best served.

**.03** Those who rely on certified public accountants expect them to discharge their responsibilities with integrity, objectivity, due professional care, and a genuine interest in serving the public. They are expected to provide quality services, enter into fee arrangements, and offer a range of services—all in a manner that demonstrates a level of professionalism consistent with these Principles of the Code of Professional Conduct.

**.04** All who accept membership in the American Institute of Certified Public Accountants commit themselves to honor the public trust. In return for the faith that the public reposes in them, members should seek continually to demonstrate their dedication to professional excellence.

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## ET Section 54

### *Article III—Integrity*

*To maintain and broaden public confidence, members should perform all professional responsibilities with the highest sense of integrity.*

**.01** Integrity is an element of character fundamental to professional recognition. It is the quality from which the public trust derives and the benchmark against which a member must ultimately test all decisions.

**.02** Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle.

**.03** Integrity is measured in terms of what is right and just. In the absence of specific rules, standards, or guidance, or in the face of conflicting opinions, a member should test decisions and deeds by asking: "Am I doing what a person of integrity would do? Have I retained my integrity?" Integrity requires a member to observe both the form and the spirit of technical and ethical standards; circumvention of those standards constitutes subordination of judgment.

**.04** Integrity also requires a member to observe the principles of objectivity and independence and of due care.

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**ET Section 55****Article IV—Objectivity and Independence**

*A member should maintain objectivity and be free of conflicts of interest in discharging professional responsibilities. A member in public practice should be independent in fact and appearance when providing auditing and other attestation services.*

**.01** Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may appear to impair a member's objectivity in rendering attestation services.

**.02** Members often serve multiple interests in many different capacities and must demonstrate their objectivity in varying circumstances. Members in public practice render attest, tax, and management advisory services. Other members prepare financial statements in the employment of others, perform internal auditing services, and serve in financial and management capacities in industry, education, and government. They also educate and train those who aspire to admission into the profession. Regardless of service or capacity, members should protect the integrity of their work, maintain objectivity, and avoid any subordination of their judgment.

**.03** For a member in public practice, the maintenance of objectivity and independence requires a continuing assessment of client relationships and public responsibility. Such a member who provides auditing and other attestation services should be independent in fact and appearance. In providing all other services, a member should maintain objectivity and avoid conflicts of interest.

**.04** Although members not in public practice cannot maintain the appearance of independence, they nevertheless have the responsibility to maintain objectivity in rendering professional services. Members employed by others to prepare financial statements or to perform auditing, tax, or consulting services are charged with the same responsibility for objectivity as members in public practice and must be scrupulous in their application of generally accepted accounting principles and candid in all their dealings with members in public practice.

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## ET Section 56

### Article V—Due Care

*A member should observe the profession's technical and ethical standards, strive continually to improve competence and the quality of services, and discharge professional responsibility to the best of the member's ability.*

**.01** The quest for excellence is the essence of due care. Due care requires a member to discharge professional responsibilities with competence and diligence. It imposes the obligation to perform professional services to the best of a member's ability with concern for the best interest of those for whom the services are performed and consistent with the profession's responsibility to the public.

**.02** Competence is derived from a synthesis of education and experience. It begins with a mastery of the common body of knowledge required for designation as a certified public accountant. The maintenance of competence requires a commitment to learning and professional improvement that must continue throughout a member's professional life. It is a member's individual responsibility. In all engagements and in all responsibilities, each member should undertake to achieve a level of competence that will assure that the quality of the member's services meets the high level of professionalism required by these Principles.

**.03** Competence represents the attainment and maintenance of a level of understanding and knowledge that enables a member to render services with facility and acumen. It also establishes the limitations of a member's capabilities by dictating that consultation or referral may be required when a professional engagement exceeds the personal competence of a member or a member's firm. Each member is responsible for assessing his or her own competence—of evaluating whether education, experience, and judgment are adequate for the responsibility to be assumed.

**.04** Members should be diligent in discharging responsibilities to clients, employers, and the public. Diligence imposes the responsibility to render services promptly and carefully, to be thorough, and to observe applicable technical and ethical standards.

**.05** Due care requires a member to plan and supervise adequately any professional activity for which he or she is responsible.

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**ET Section 57****Article VI—Scope and Nature of Services**

*A member in public practice should observe the Principles of the Code of Professional Conduct in determining the scope and nature of services to be provided.*

**.01** The public interest aspect of certified public accountants' services requires that such services be consistent with acceptable professional behavior for certified public accountants. Integrity requires that service and the public trust not be subordinated to personal gain and advantage. Objectivity and independence require that members be free from conflicts of interest in discharging professional responsibilities. Due care requires that services be provided with competence and diligence.

**.02** Each of these Principles should be considered by members in determining whether or not to provide specific services in individual circumstances. In some instances, they may represent an overall constraint on the nonaudit services that might be offered to a specific client. No hard-and-fast rules can be developed to help members reach these judgments, but they must be satisfied that they are meeting the spirit of the Principles in this regard.

**.03** In order to accomplish this, members should

- Practice in firms that have in place internal quality-control procedures to ensure that services are competently delivered and adequately supervised.
- Determine, in their individual judgments, whether the scope and nature of other services provided to an audit client would create a conflict of interest in the performance of the audit function for that client.
- Assess, in their individual judgments, whether an activity is consistent with their role as professionals.

[Revised May 15, 2000.]

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**ET Section 90****RULES: APPLICABILITY AND DEFINITIONS**

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## TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
91	Applicability [Revised] .....	.01-.02
92	Definitions [Revised] .....	.01-.27

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## ET Section 91

### *Applicability*

**As adopted  
January 12, 1988,  
unless otherwise  
indicated**

**.01** The bylaws of the American Institute of Certified Public Accountants require that members adhere to the Rules of the Code of Professional Conduct. Members must be prepared to justify departures from these Rules.

**.02** *Interpretation Addressing the Applicability of the AICPA Code of Professional Conduct.* For purposes of the applicability section of the Code, a "member" is a member, associated member, or international associate of the American Institute of CPAs [ET section 92.20].

1. The Rules of Conduct that follow apply to all professional services performed except (a) where the wording of the rule indicates otherwise and (b) that a member who is practicing outside the United States will not be subject to discipline for departing from any of the rules stated herein as long as the member's conduct is in accord with the rules of the organized accounting profession in the country in which he or she is practicing. However, where a member's name is associated with financial statements under circumstances that would entitle the reader to assume that United States practices were followed, the member must comply with the requirements of rules 202 [ET section 202.01] and 203 [ET section 203.01].
2. A member shall not knowingly permit a person, whom the member has the authority or capacity to control, to carry out on his or her behalf, either with or without compensation, acts which, if carried out by the member, would place the member in violation of the rules. Further, a member may be held responsible for the acts of all persons associated with him or her in the practice of public accounting whom the member has the authority or capacity to control.
3. A member (as defined in ET section 92.20) or a covered member (as defined in ET section 92.06) may be considered to have his or her independence impaired, with respect to a client, as the result of the actions or relationships of certain persons or entities, as described in rule 101 [ET section 101.01] and its interpretations and rulings, whom the member or covered member does not have the authority or capacity to control. Therefore, nothing in this section should lead one to conclude that the member's or covered member's independence is not impaired solely because of his or her inability to control the actions or relationships of such persons or entities.

[Paragraph added, August, 1989, effective November 30, 1989. Revised December, 1998. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]



## ET Section 92

### Definitions

As adopted,  
January 12, 1988,  
unless otherwise  
indicated

*[Pursuant to its authority under the bylaws (BL § 3.6.2.2) to interpret the Code of Professional Conduct, the Professional Ethics Executive Committee has issued the following definitions of terms appearing in the code effective November 30, 1989.]*

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

[Revised November 2001.]

**.02 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 SAS No. 73, *Using the Work of a Specialist* [AU section 336], and individuals who perform only routine clerical functions, such as word processing and photocopying.

[Revised November 2001.]

**.03 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 a person or entity with respect to which professional services are performed. For purposes of this paragraph, the term "employer" does not include—

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

[Revised December 1998.]

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

[Revised November 2001.]

**.05 Council.** The Council of the American Institute of Certified Public Accountants.

**.06 Covered member.** A covered member is—

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

[Revised November 2001.]

**[.07] Enterprise.** [Revised November 2001.]

**.08 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* [ET section 101.07], an entity would be considered a financial institution if it leases automobiles to the general public.

[Revised November 2002 and September 2003.]

**.09 Financial statements.** A presentation of financial data, including accompanying notes, if any, intended to communicate an entity's economic resources and/or obligations at a point in time or the changes therein for a period of time, in accordance with generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles.

Incidental financial data to support recommendations to a client or in documents for which the reporting is governed by Statements on Standards for Attestation Engagements and tax returns and supporting schedules do not, for this purpose, constitute financial statements. The statement, affidavit, or signature of preparers required on tax returns neither constitutes an opinion on financial statements nor requires a disclaimer of such opinion.

**.10 Firm.** A firm is a form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the American Institute of Certified Public Accountants that is engaged in the practice of public accounting. Except for purposes of applying Rule 101: *Independence* [ET section 101.01], the firm includes the individual partners thereof.

[Revised November 2001.]

**.11 Holding out.** In general, any action initiated by a member that informs others of his or her status as a CPA or AICPA-accredited specialist constitutes holding out as a CPA. This would include, for example, any oral or written representation to another regarding CPA status, use of the CPA designation on business cards or letterhead, the display of a certificate evidencing a member's CPA designation, or listing as a CPA in local telephone directories.

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

[Revised November 2001.]

**.13 Individual in a position to influence the attest engagement.** An individual in a position to influence the attest engagement is one who—

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

[Revised November 2001.]

**.14 Institute.** The American Institute of Certified Public Accountants.

**.15 Interpretations of rules of conduct.** Pronouncements issued by the division of professional ethics to provide guidelines concerning the scope and application of the rules of conduct.

**.16 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.

[Revised November 2001.]

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

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

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

[Revised November 2001.]

**.18 Loan.** A loan is a financial transaction, the characteristics of which generally include, but are not limited to, an agreement that provides for 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.

[Revised November 2001.]

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

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

[Revised November 2001.]

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

**.21 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 in which the loan to the covered member is committed. Accordingly, in making such comparison and in evaluating whether a loan was made under "normal lending procedures, terms, and requirements," the covered member should consider all the circumstances under which the loan was granted, including

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

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

[Revised November 2002.]

**.22 Office.** An office is a reasonably distinct subgroup within a firm, whether constituted by formal organization or informal practice, where 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.

[Revised November 2001.]

**.23 Partner.** A partner is a proprietor, shareholder, equity or non-equity partner 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.

[Revised November 2001.]

**.24 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 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, either by 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.

[Revised November 2001.]

**.25 Practice of public accounting.** The practice of public accounting consists of the performance for a client, by a member or a member's firm, while holding out as CPA(s), of the professional services of accounting, tax, personal financial planning, litigation support services, and those professional services for which standards are promulgated by bodies designated by Council. Such standards include Financial Accounting Standards Board (FASB) *Accounting Standards Codification*<sup>TM</sup> (ASC), Statements on Auditing Standards, Statements on Standards for Accounting and Review Services, Statements on Standards for Consulting Services, Statements of Governmental Accounting Standards, International Financial Reporting Standards and International Accounting Standards, Statements on Standards for Attestation Engagements, and Statements on Standards for Valuation Services.

However, a member or a member's firm, while holding out as CPA(s), is not considered to be in the practice of public accounting if the member or the member's firm does not perform, for any client, any of the professional services described in the preceding paragraph.

[Revised June 2009.]

**.26 Professional services.** Professional services include all services performed by a member while holding out as a CPA.

**.27 Significant influence.** The term *significant influence* is as defined in FASB ASC 323-10-15.

[Revised November 2001 and June 2009.]

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## ET Section 100

# INDEPENDENCE, INTEGRITY, AND OBJECTIVITY

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### TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
100.01	Conceptual Framework for AICPA Independence Standards	
	Introduction .....	.01-05
	Definitions .....	.06-26
101	Independence	
	Rule 101—Independence .....	.01
	Interpretations under Rule 101—Independence	
	101-1—Interpretation of Rule 101 [Revised] .....	.02
	[101-1]—[Renumbered as Interpretation 101-4] .....	[.03]
	101-2—Employment or association with attest clients [Revised] .....	.04
	101-3—Performance of nonattest services [Revised] .....	.05
	101-4—Honorary directorships and trusteeships of not-for-profit organization [Revised] .....	.06
	101-5—Loans from financial institution clients and related terminology [Revised] .....	.07
	101-6—The effect of actual or threatened litigation on independence [Revised] .....	.08
	[101-7]—[Deleted] .....	[.09]
	101-8—Effect on independence of financial interests in nonclients having investor or investee relationships with a member’s client [Revised] .....	.10
	[101-9]—[Deleted] .....	[.11]
	101-10—The effect on independence of relationships with entities included in the governmental financial statements [Revised] .....	.12
	101-11—Modified application of rule 101 for certain engagements to issue restricted-use reports under the Statements on Standards for Attestation Engagements [Revised] .....	.13
	101-12—Independence and cooperative arrangements with clients .....	.14
	[101-13]—[Deleted] .....	[.15]
	101-14—The effect of alternative practice structures on the applicability of independence rules [Revised] .....	.16
	101-15—Financial relationships .....	.17
102	Integrity and Objectivity	
	Rule 102—Integrity and objectivity .....	.01

<i>Section</i>	<i>Paragraph</i>	
102	Integrity and Objectivity—continued	
	Interpretations under Rule 102—Integrity and Objectivity	
	102-1—Knowing misrepresentations in the preparation of financial statements or records [Revised] .....	.02
	102-2—Conflicts of interest .....	.03
	102-3—Obligations of a member to his or her employer’s external accountant .....	.04
	102-4—Subordination of judgment by a member .....	.05
	102-5—Applicability of rule 102 to members performing educational services .....	.06
	102-6—Professional services involving client advocacy .....	.07
191	Ethics Rulings on Independence, Integrity, and Objectivity	
	[1.] Acceptance of a Gift [Deleted] .....	[.001-.002]
	2. Association Membership [Revised] .....	.003-.004
	[3.] Member as Signer or Cosigner of Checks [Deleted] .....	[.005-.006]
	[4.] Payroll Preparation Services [Deleted] .....	[.007-.008]
	[5.] Member as Bookkeeper [Deleted] .....	[.009-.010]
	[6.] Member’s Spouse as Accountant of Client [Deleted] .....	[.011-.012]
	[7.] Member Providing Contract Services [Deleted] .....	[.013-.014]
	8. Member Providing Advisory Services .....	.015-.016
	9. Member as Representative of Creditor’s Committee [Revised] .....	.017-.018
	10. Member as Legislator [Revised] .....	.019-.020
	11. Member Designated to Serve as Executor or Trustee [Revised] .....	.021-.022
	12. Member as Trustee of Charitable Foundation [Revised] ...	.023-.024
	[13.] Member as Bank Stockholder [Deleted] .....	[.025-.026]
	14. Member on Board of Federated Fund-Raising Organization .....	.027-.028
	[15.] Retired Partner as Director [Deleted] .....	[.029-.030]
	16. Member on Board of Directors of Nonprofit Social Club [Revised] .....	.031-.032
	17. Member of Social Club .....	.033-.034
	[18.] Member as City Council Chairman [Deleted] .....	[.035-.036]
	19. Member on Deferred Compensation Committee [Revised] .....	.037-.038
	20. Member Serving on Governmental Advisory Unit [Revised] .....	.039-.040
	21. Member as Director and Auditor of an Entity’s Profit Sharing and Retirement Trust [Revised] .....	.041-.042
	[22.] Family Relationship, Brother [Deleted] .....	[.043-.044]
	[23.] Family Relationship, Uncle by Marriage [Deleted] .....	[.045-.046]
	[24.] Family Relationship, Father [Deleted] .....	[.047-.048]
	[25.] Family Relationship, Son [Deleted] .....	[.049-.050]

<i>Section</i>	<i>Paragraph</i>
191	Ethics Rulings on Independence, Integrity, and Objectivity—continued
	[26.] Family Relationship, Son [Deleted] ..... [.051-.052]
	[27.] Family Relationship, Spouse as Trustee [Deleted] ..... [.053-.054]
	[28.] Cash Account With Brokerage Client [Superseded by ethics ruling No. 59] ..... [.055-.056]
	29. Member as Bondholder [Revised] ..... .057-.058
	[30.] Financial Interest by Employee [Deleted] ..... [.059-.060]
	31. Performance of Services for Common Interest Realty Associations (CIRAs), Including Cooperatives, Condominium Associations, Planned Unit Developments Homeowners Associations, and Timeshare Developments, [Revised] ..... .061-.062
	[32.] Mortgage Loan to Member's Corporation [Deleted] .... [.063-.064]
	[33.] Member as Participant in Employee Benefit Plan [Deleted] ..... [.065-.066]
	[34.] Member as Auditor of Common Trust Funds [Deleted]. ... [.067-.068]
	[35.] Stockholder in Mutual Funds [Deleted] ..... [.069-.070]
	[36.] Participant Investment Club [Deleted] ..... [.071-.072]
	[37.] Retired Partners as Co-Trustee [Deleted] ..... [.073-.074]
	38. Member as Co-Fiduciary With Client Bank [Revised] ..... .075-.076
	[39.] Member as Officially Appointed Stock Transfer Agent or Registrar [Deleted] ..... [.077-.078]
	[40.] Controller Entering Public Practice [Deleted] ..... [.079-.080]
	41. Financial Services Company Client Has Custody of a Member's Assets [Revised] ..... .081-.082
	[42.] Member as Life Insurance Policy Holder [Deleted] ..... [.083-.084]
	[43.] Member's Employee as Treasurer of a Client [Deleted] ..... [.085-.086]
	[44.] Past Due Billings [Superseded by ethics ruling No. 52] ..... [.087-.088]
	[45.] Past Due Fees: Client in Bankruptcy [Deleted] ..... [.089-.090]
	[46.] Member as General Counsel [Superseded by ethics ruling No. 51] ..... [.091-.092]
	[47.] Member as Auditor of Mutual Fund and Shareholder of Investment Advisor/Manager [Deleted] ..... [.093-.094]
	48. Faculty Member as Auditor of a Student Fund [Revised]. ... .095-.096
	[49.] Investor and Investee Companies [Superseded by interpretation 101-8] ..... [.097-.098]
	[50.] Family Relationship, Brother-in-Law [Deleted] ..... [.099-.100]
	[51.] Member Providing Legal Services [Deleted] ..... [.101-.102]
	52. Unpaid Fees [Revised] ..... .103-.104
	[53.] Member as Auditor of Employee Benefit Plan and Sponsoring Company [Deleted] ..... [.105-.106]
	[54.] Member Providing Appraisal, Valuation, or Actuarial Services [Deleted] ..... [.107-.108]

<i>Section</i>	<i>Paragraph</i>
191	Ethics Rulings on Independence, Integrity, and Objectivity—continued
	[55.] Independence During Systems Implementation [Deleted] ..... [109-110]
	[56.] Executive Search [Deleted] ..... [111-112]
	[57.] MAS Engagement to Evaluate Service Bureaus [Deleted] ..... [113-114]
	[58.] Member as Lessor [Deleted] ..... [115-116]
	[59.] Account With Brokerage Client [Deleted] ..... [117-118]
	60. Employee Benefit Plans—Member’s Relationships With Participating Employer [Revised] ..... 119-120
	[61.] Participation of Member’s Spouse in Client’s Stock Ownership Plans (Including an ESOP) [Deleted] ..... [121-122]
	[62.] Member and Client Are Limited Partners in a Limited Partnership [Deleted] ..... [123-124]
	[63.] Review of Prospective Financial Information—Member’s Independence of Promoters [Deleted] ..... [125-127]
	64. Member Serves on Board of Organization for Which Client Raises Funds [Revised] ..... 128-129
	65. Use of the CPA Designation By Member Not in Public Practice ..... 130-131
	[66.] Member’s Retirement or Savings Plan Has Financial Interest in Client [Deleted] ..... [132-133]
	67. Servicing of Loan ..... 134-135
	[68.] Blind Trust [Deleted] ..... [136-137]
	69. Investment With a General Partner ..... 138-139
	70. Member’s Depository Relationship With Client Financial Institution [Revised] ..... 140-141
	71. Use of Nonindependent CPA Firm on an Engagement .... 142-143
	72. Member on Advisory Board of Client ..... 144-145
	[73.] Meaning of the Period of a Professional Engagement [Deleted] ..... [146-147]
	74. Audits, Reviews, or Compilations and a Lack of Independence ..... 148-149
	75. Membership in Client Credit Union ..... 150-151
	[76.] Guarantee of Loan [Deleted] ..... [152-153]
	[77.] Individual Considering or Accepting Employment With the Client [Deleted] ..... [154-155]
	[78.] Service on Governmental Board [Deleted] ..... [156-157]
	[79.] Member’s Investment in a Partnership That Invests in Client [Deleted] ..... [158-159]
	[80.] The Meaning of a Joint Closely Held Business Investment [Deleted] ..... [160-161]
	81. Member’s Investment in a Limited Partnership ..... 162-163
	82. Campaign Treasurer ..... 164-165
	[83.] Member on Board of Component Unit and Auditor of Oversight Entity [Deleted] ..... [166-167]
	[84.] Member on Board of Material Component Unit and Auditor of Another Material Component Unit [Deleted] .... [168-169]

<i>Section</i>	<i>Paragraph</i>
191	Ethics Rulings on Independence, Integrity, and Objectivity—continued
	85. Bank Director ..... .170-171
	[86.] Partially Secured Loans [Deleted] ..... [.172-173]
	[87.] Loan Commitment or Line of Credit [Deleted] ..... [.174-175]
	[88.] Loans to Partnership in Which Members Are Limited Partners [Deleted] ..... [.176-177]
	[89.] Loan to Partnership in Which Members Are General Partners [Deleted] ..... [.178-179]
	[90.] Credit Card Balances and Cash Advances [Deleted] ... [.180-181]
	91. Member Leasing Property to or From a Client [Revised] .. .182-183
	92. Joint Interest in Vacation Home ..... .184-185
	93. Service on Board of Directors of Federated Fund-Raising Organization ..... .186-187
	94. Indemnification Clause in Engagement Letters ..... .188-189
	95. Agreement With Attest Client to Use ADR Techniques .... .190-191
	96. Commencement of ADR Proceeding ..... .192-193
	[97.] Performance of Certain Extended Audit Services [Deleted] ..... [.194-195]
	98. Member’s Loan From a Nonclient Subsidiary or Parent of an Attest Client ..... .196-197
	99. Member Providing Services for Company Executives ..... .198-199
	100. Actions Permitted When Independence Is Impaired ..... .200-201
	[101.] Client Advocacy and Expert Witness Services [Deleted] ..... [.202-203]
	102. Indemnification of a Client ..... .204-205
	103. Attest Report on Internal Controls ..... .206-207
	[104.] Operational Auditing Services [Deleted] ..... [.208-209]
	[105.] Frequency of Performance of Extended Audit Procedures [Deleted] ..... [.210-211]
	106. Member Has Significant Influence Over an Entity That Has Significant Influence Over a Client ..... .212-213
	107. Participation in Health and Welfare Plan Sponsored by Client [Revised] ..... .214-215
	[108.] Participation of Member, Spouse or Dependent in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in, Client [Deleted] ..... [.216-217]
	[109.] Member’s Investment in Financial Services Products That Invest in Clients [Deleted] ..... [.218-219]
	110. Member Is Connected With an Entity That Has a Loan to or From a Client ..... .220-221
	111. Employee Benefit Plan Sponsored by Client ..... .222-223
	112. Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services ..... .224-225
	113. Acceptance or Offering of Gifts or Entertainment ..... .226-227
	114. Acceptance or Offering of Gifts and Entertainment to or From an Attest Client ..... .228-229



## ET Section 100.01

# *Conceptual Framework for AICPA Independence Standards*

### Introduction

**.01** This conceptual framework describes the risk-based approach to analyzing independence matters that is used by the Professional Ethics Executive Committee (PEEC) of the AICPA when it develops independence standards. Under that approach, a member's relationship with a client is evaluated to determine whether it poses an unacceptable risk to the member's independence. Risk is unacceptable if the relationship would compromise (or would be perceived as compromising by an informed third party having knowledge of all relevant information) the member's professional judgment when rendering an attest service to the client. Key to that evaluation is identifying and assessing the extent to which a threat to the member's independence exists and, if it does, whether it would be reasonable to expect that the threat would compromise the member's professional judgment and, if so, whether it can be effectively mitigated or eliminated. Under the risk-based approach, steps are taken to prevent circumstances that threaten independence from compromising the professional judgments required in the performance of an attest engagement.

**.02** Professional standards of the AICPA require independence for all attest engagements. The PEEC bases its independence interpretations and rulings under ET section 100 of the AICPA's Code of Professional Conduct on the concepts in this framework. However, in certain circumstances the PEEC has determined that it is appropriate to prohibit or restrict certain relationships notwithstanding the fact that the risk may be at an acceptable level. For example, the PEEC has determined that a covered member should not own even an immaterial direct financial interest in an attest client.

**.03** Because this conceptual framework describes the concepts upon which the AICPA's independence interpretations and rulings are based, it may assist AICPA members and others in understanding those interpretations and rulings. In addition, this conceptual framework should be used by members when making decisions on independence matters that are not explicitly addressed by the Code of Professional Conduct. Under no circumstances, however, may the framework be used to overcome prohibitions or requirements contained in the independence interpretations and rulings.

**.04** The risk-based approach entails evaluating the risk that the member would not be independent or would be perceived by a reasonable and informed third party having knowledge of all relevant information as not being independent. That risk must be reduced to an acceptable level to conclude that a member is independent under the concepts in this framework. Risk is at an acceptable level when threats are at an acceptable level, either because of the types of threats and their potential effect, or because safeguards have sufficiently mitigated or eliminated the threats. Threats are at an acceptable level when it is not reasonable to expect that the threat would compromise professional judgment.

**.05** The risk-based approach involves the following steps.



- a. Identifying and evaluating threats to independence—Identify and evaluate threats, both individually and in the aggregate, because threats can have a cumulative effect on a member's independence. Where threats are identified but, due to the types of threats and their potential effects, such threats are considered to be at an acceptable level (that is, it is not reasonable to expect that the threats would compromise professional judgment), the consideration of safeguards is not required. If identified threats are not considered to be at an acceptable level, safeguards should be considered as described in paragraph .05b.
- b. Determining whether safeguards already eliminate or sufficiently mitigate identified threats and whether threats that have not yet been mitigated can be eliminated or sufficiently mitigated by safeguards—Different safeguards can mitigate or eliminate different types of threats, and one safeguard can mitigate or eliminate several types of threats simultaneously. When threats are sufficiently mitigated by safeguards, the threats' potential to compromise professional judgment is reduced to an acceptable level. A threat has been sufficiently mitigated by safeguards if, after application of the safeguards, it is not reasonable to expect that the threat would compromise professional judgment.<sup>1</sup>
- c. If no safeguards are available to eliminate an unacceptable threat or reduce it to an acceptable level, independence would be considered impaired.

## Definitions

.06 *Independence* is defined as:

- a. *Independence of mind*—The state of mind that permits the performance of an attest service without being affected by influences that compromise professional judgment, thereby allowing an individual to act with integrity and exercise objectivity and professional skepticism.
- b. *Independence in appearance*—The avoidance of circumstances that would cause a reasonable and informed third party, having knowledge of all relevant information, including safeguards<sup>2</sup> applied, to reasonably conclude that the integrity, objectivity, or professional skepticism of a firm or a member of the attest engagement team had been compromised.

.07 This definition reflects the longstanding professional requirement that members who provide services to entities for which independence is required be independent both in fact and in appearance.<sup>3</sup> The state of mind of a member who is independent "in fact" assists the member in performing an attest engagement in an objective manner. Accordingly, independence of mind reflects the longstanding requirement that members be independent in fact.

.08 This definition is used as part of the risk-based approach to analyze independence. Because the risk-based approach requires judgment, the definition should not be interpreted as an absolute. For example, the phrase "without

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<sup>1</sup> In cases where threats to independence are not at an acceptable level, thereby requiring the application of safeguards, the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level should be documented as required under "Other Considerations" of Interpretation 101-1, *Interpretation of Rule 101* [ET section 101.02].

<sup>2</sup> The term *safeguards* is defined in paragraph .20.

<sup>3</sup> ET section 55, *Article IV—Objectivity and Independence*, states, "A member in public practice should be independent in fact and appearance when providing auditing and other attestation services."

being affected by influences that compromise professional judgment" is not intended to convey that the member must be free of any and all influences that might compromise objective judgment. Instead, a determination must be made about whether such influences, if present, create an unacceptable risk that a member would not act with integrity and exercise objectivity and professional skepticism in the conduct of a particular engagement, or would be perceived as not being able to do so by a reasonable and informed third party that has knowledge of all relevant information.

**.09 *Impair***—For purposes of this framework, *impair* means to effectively extinguish (independence). When a member's independence is impaired, the member is not independent.

**.10 *Threats***—Threats to independence are circumstances that could impair independence. Whether independence is impaired depends on the nature of the threat, whether it would be reasonable to expect that the threat would compromise the member's professional judgment and, if so, the specific safeguards applied to reduce or eliminate the threat, and the effectiveness of those safeguards as described in paragraph .21.

**.11** Threats might not involve violations of existing interpretations or rulings. For example, the circumstance described in paragraph .18*b* of this framework is permissible in limited instances under current AICPA independence interpretations and rulings.

**.12** Many different circumstances (or combinations of circumstances) can create threats to independence. It is impossible to identify every situation that creates a threat. However, seven broad categories of threats should always be evaluated when threats to independence are being identified and assessed. They are self-review, advocacy, adverse interest, familiarity, undue influence, financial self-interest, and management participation threats. The following paragraphs define and provide examples, which are not all-inclusive, of each of these threat categories. Some of these examples are the subject of independence interpretations and rulings contained in the Code of Professional Conduct.

**.13 *Self-review threat***—Members reviewing as part of an attest engagement evidence that results from their own, or their firm's, nonattest work such as, preparing source documents used to generate the client's financial statements

**.14 *Advocacy threat***—Actions promoting an attest client's interests or position.<sup>4</sup>

- a. Promoting the client's securities as part of an initial public offering
- b. Representing a client in U.S. tax court

**.15 *Adverse interest threat***—Actions or interests between the member and the client that are in opposition, such as, commencing, or the expressed intention to commence, litigation by either the client or the member against the other.

**.16 *Familiarity threat***—Members having a close or longstanding relationship with an attest client or knowing individuals or entities (including by reputation) who performed nonattest services for the client.

- a. A member of the attest engagement team whose spouse is in a key position at the client, such as the client's chief executive officer

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<sup>4</sup> This threat does not arise from testifying as a fact witness or defending the results of a professional service that the member performed for the client.

- b. A partner of the firm who has provided the client with attest services for a prolonged period
- c. A member who performs insufficient audit procedures when reviewing the results of a nonattest service because the service was performed by the member's firm
- d. A member of the firm having recently been a director or officer of the client
- e. A member of the attest engagement team whose close friend is in a key position at the client

**.17 *Undue influence threat***—Attempts by an attest client's management or other interested parties to coerce the member or exercise excessive influence over the member.

- a. A threat to replace the member or the member's firm over a disagreement with client management on the application of an accounting principle
- b. Pressure from the client to reduce necessary audit procedures for the purpose of reducing audit fees
- c. A gift from the client to the member that is other than clearly insignificant to the member

**.18 *Financial self-interest threat***—Potential benefit to a member from a financial interest in, or from some other financial relationship with, an attest client.

- a. Having a direct financial interest or material indirect financial interest in the client
- b. Having a loan from the client, from an officer or director of the client, or from an individual who owns 10 percent or more of the client's outstanding equity securities
- c. Excessive reliance on revenue from a single attest client
- d. Having a material joint venture or other material joint business arrangement with the client

**.19 *Management participation threat***—Taking on the role of client management or otherwise performing management functions on behalf of an attest client.

- a. Serving as an officer or director of the client
- b. Establishing and maintaining internal controls for the client
- c. Hiring, supervising, or terminating the client's employees

**.20 *Safeguards***—Controls that mitigate or eliminate threats to independence. Safeguards range from partial to complete prohibitions of the threatening circumstance to procedures that counteract the potential influence of a threat. The nature and extent of the safeguards to be applied depend on many factors, including the size of the firm and whether the client is a public interest

entity.<sup>5</sup> To be effective, safeguards should eliminate the threat or reduce to an acceptable level the threat's potential to impair independence.

**.21** The effectiveness of a safeguard depends on many factors, including those listed here:

- a. The facts and circumstances specific to a particular situation
- b. The proper identification of threats
- c. Whether the safeguard is suitably designed to meet its objectives
- d. The party or parties that will be subject to the safeguard
- e. How the safeguard is applied
- f. The consistency with which the safeguard is applied
- g. Who applies the safeguard

**.22** There are three broad categories of safeguards. The relative importance of a safeguard depends on its appropriateness in light of the facts and circumstances.

- a. Safeguards created by the profession, legislation, or regulation
- b. Safeguards implemented by the attest client
- c. Safeguards implemented by the firm, including policies and procedures to implement professional and regulatory requirements

**.23** Examples of various safeguards within each category are presented in the following paragraphs. The examples are not intended to be all-inclusive and, conversely, the examples of safeguards implemented by the attest client and within the firm's own systems and procedures may not all be present in each instance. In addition, threats may be sufficiently mitigated through the application of other safeguards not specifically identified herein.

**.24** *Examples of safeguards created by the profession, legislation, or regulation*

- a. Education and training requirements on independence and ethics rules for new professionals
- b. Continuing education requirements on independence and ethics
- c. Professional standards and monitoring and disciplinary processes
- d. External review of a firm's quality control system
- e. Legislation governing the independence requirements of the firm
- f. Competency and experience requirements for professional licensure

**.25** *Examples of safeguards implemented by the attest client that would operate in combination with other safeguards*

- a. The attest client has personnel with suitable skill, knowledge, and/or experience who make managerial decisions with respect to the delivery of nonattest services by the member to the attest client

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<sup>5</sup> Solely for the purpose of this conceptual framework, the following entities are considered to be public interest entities: (1) entities subject to Securities and Exchange Commission reporting requirements; (2) employee benefit and health and welfare plans subject to Employee Retirement Income Security Act audit requirements; (3) governmental retirement plans; (4) entities or programs (including for-profit entities) subject to Single Audit Act *OMB Circular A-133* requirements and entities or programs subject to similar program oversight; and (5) financial institutions, credit unions, and insurance companies. These entities are public interest entities because their audited financial statements are directly relied upon by significant numbers of stakeholders to make investment, credit, or similar decisions (for example, in the case of a publicly held company) or indirectly relied upon through regulatory oversight (for example, in the case of pension plans, banks, and insurance companies) and, therefore, the potential extent of harm to the public from an audit failure involving one of these entities would generally be significant.

- b. A tone at the top that emphasizes the attest client's commitment to fair financial reporting
- c. Policies and procedures that are designed to achieve fair financial reporting
- d. A governance structure, such as an active audit committee, that is designed to ensure appropriate decision making, oversight, and communications regarding a firm's services
- e. Policies that dictate the types of services that the entity can hire the audit firm to provide without causing the firm's independence to be considered impaired

**.26** *Examples of safeguards implemented by the firm*

- a. Firm leadership that stresses the importance of independence and the expectation that members of attest engagement teams will act in the public interest
- b. Policies and procedures that are designed to implement and monitor quality control in attest engagements
- c. Documented independence policies regarding the identification of threats to independence, the evaluation of the significance of those threats, and the identification and application of safeguards that can eliminate the threats or reduce them to an acceptable level
- d. Internal policies and procedures that are designed to monitor compliance with the firm's independence policies and procedures
- e. Policies and procedures that are designed to identify interests or relationships between the firm or its partners and professional staff and attest clients
- f. The use of different partners and engagement teams that have separate reporting lines in the delivery of permitted nonattest services to an attest client, particularly when the separation between reporting lines is significant
- g. Training on and timely communication of a firm's policies and procedures, and any changes to them, for all partners and professional staff
- h. Policies and procedures that are designed to monitor the firm or partner's reliance on revenue from a single client and, if necessary, cause action to be taken to address excessive reliance
- i. Designating someone from senior management as the person who is responsible for overseeing the adequate functioning of the firm's quality control system
- j. A means of informing partners and professional staff of attest clients and related entities from which they must be independent
- k. A disciplinary mechanism that is designed to promote compliance with policies and procedures
- l. Policies and procedures that are designed to empower staff to communicate to senior members of the firm any engagement issues that concern them without fear of retribution
- m. Policies and procedures relating to independence communications with audit committees or others charged with client governance
- n. Discussing independence issues with the audit committee or others responsible for the client's governance

- o.* Disclosures to the audit committee (or others responsible for the client's governance) regarding the nature of the services that are or will be provided and the extent of the fees charged or to be charged
- p.* The involvement of another professional accountant who (1) reviews the work that is done for an attest client or (2) otherwise advises the attest engagement team (This individual could be someone from outside the firm or someone from within the firm who is not otherwise associated with the attest engagement.)
- q.* Consultation on engagement issues with an interested third party, such as a committee of independent directors, a professional regulatory body, or another professional accountant
- r.* Rotation of senior personnel who are part of the attest engagement team
- s.* Policies and procedures that are designed to ensure that members of the attest engagement team do not make or assume responsibility for management decisions for the attest client
- t.* The involvement of another firm to perform part of the attest engagement
- u.* The involvement of another firm to reperform a nonattest service to the extent necessary to enable it to take responsibility for that service
- v.* The removal of an individual from an attest engagement team when that individual's financial interests or relationships pose a threat to independence
- w.* A consultation function that is staffed with experts in accounting, auditing, independence, and reporting matters who can help attest engagement teams (1) assess issues when guidance is unclear, or when the issues are highly technical or require a great deal of judgment and (2) resist undue pressure from a client when the engagement team disagrees with the client about such issues
- x.* Client acceptance and continuation policies that are designed to prevent association with clients that pose an unacceptable threat to the member's independence
- y.* Policies that preclude audit partners from being directly compensated for selling nonattest services to the audit client

[Issued April 2006, effective April 30, 2007, with earlier application encouraged, by the Professional Ethics Executive Committee.]

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## ET Section 101

### *Independence*

**.01 Rule 101—Independence** A member in public practice shall be independent in the performance of professional services as required by standards promulgated by bodies designated by Council.

[As adopted January 12, 1988.]

#### ***Interpretations under Rule 101—Independence***

*In performing an attest engagement, a member should consult the rules of his or her state board of accountancy, his or her state CPA society, the Public Company Accounting Oversight Board and the U.S. Securities and Exchange Commission (SEC) if the member's report will be filed with the SEC, the U.S. Department of Labor (DOL) if the member's report will be filed with the DOL, the Government Accountability Office (GAO) if law, regulation, agreement, policy or contract requires the member's report to be filed under GAO regulations, and any organization that issues or enforces standards of independence that would apply to the member's engagement. Such organizations may have independence requirements or rulings that differ from (e.g., may be more restrictive than) those of the AICPA.*

**.02 101-1—Interpretation of Rule 101** Independence shall be considered to be impaired if:

- A. During the **period of the professional engagement**\* a **covered member**
  1. Had or was committed to acquire any direct or material indirect financial interest in the **client**.
  2. Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the client and
    - (i) The covered member (individually or with others) had the authority to make investment decisions for the trust or estate; or
    - (ii) 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
    - (iii) 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.
  3. Had a **joint closely held investment** that was material to the covered member.
  4. Except as specifically permitted in interpretation 101-5 [ET section 101.07], had any **loan** to or from the client, any officer or director of the client, or any individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests.

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\* Terms shown in **boldface** type upon first usage in this interpretation are defined in ET section 92, *Definitions*. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]



- B. During the period of the professional engagement, a **partner** or professional employee of the **firm**, his or her **immediate family**, or any group of such persons acting together owned more than 5 percent of a client's outstanding equity securities or other ownership interests.
- C. During the period covered by the **financial statements** or during the period of the professional engagement, a firm, or partner or professional employee of the firm was simultaneously associated with the client as a(n)
  - 1. Director, officer, or employee, or in any capacity equivalent to that of a member of management;
  - 2. Promoter, underwriter, or voting trustee; or
  - 3. Trustee for any pension or profit-sharing trust of the client.

### **Transition Period for Certain Business and Employment Relationships**

A business or employment relationship with a client that impairs independence under interpretation 101-1.C [ET section 101.02], and that existed as of November 2001, will not be deemed to impair independence provided such relationship was permitted under rule 101 [ET section 101.01], and its interpretations and rulings as of November 2001, and the individual severed that relationship on or before May 31, 2002.

### **Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client**

An individual who was formerly (i) employed by a client or (ii) associated with a client as a(n) officer, director, promoter, underwriter, voting trustee, or trustee for a pension or profit-sharing trust of the client would impair his or her firm's independence if the individual—

- 1. Participated on the **attest engagement team** or was an **individual in a position to influence the attest engagement** for the client when the **attest engagement** covers any period that includes his or her former employment or association with that client; or
- 2. Was otherwise a covered member with respect to the client unless the individual first dissociates from the client by—
  - (a.) Terminating any relationships with the client described in interpretation 101-1.C [ET section 101.02];
  - (b.) Disposing of any direct or material indirect financial interest in the client;
  - (c.) Collecting or repaying any loans to or from the client, except for loans specifically permitted or grandfathered under interpretation 101-5 [ET section 101.07];
  - (d.) Ceasing to participate<sup>1</sup> in all employee benefit plans sponsored by the client, unless the client is legally required to allow the individual to participate in the plan (for example, COBRA) and the individual pays 100 percent of the cost of participation on a current basis; and

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<sup>1</sup> See Ethics Ruling No. 107, "Participation in Health and Welfare Plan of Client" [ET section 191.214–.215], for instances in which participation was the result of permitted employment of the individual's spouse or spousal equivalent.

- (e.) Liquidating or transferring all vested benefits in the client's defined benefit plans, defined contribution plans, deferred compensation plans, and other similar arrangements at the earliest date permitted under the plan. However, liquidation or transfer is not required if a penalty<sup>2</sup> significant to the benefits is imposed upon liquidation or transfer.

### **Application of the Independence Rules to a Covered Member's Immediate Family**

Except as stated in the following paragraph, a covered member's immediate family is subject to rule 101 [ET section 101.01], and its interpretations and rulings.

The exceptions are that independence would not be considered to be impaired solely as a result of the following:

1. An individual in a covered member's immediate family was employed by the client in a position other than a **key position**.
2. In connection with his or her employment, an individual in the immediate family of one of the following covered members participated in a retirement, savings, compensation, or similar plan that is a client, is sponsored by a client, or that invests in a client (provided such plan is normally offered to all employees in similar positions):
  - a. A partner or **manager** who provides ten or more hours of non-attest services to the client; or
  - b. Any partner in the **office** in which the lead attest engagement partner primarily practices in connection with the attest engagement.

For purposes of determining materiality under rule 101 [ET section 101.01] the financial interests of the covered member and his or her immediate family should be aggregated.

### **Application of the Independence Rules to Close Relatives**

Independence would be considered to be impaired if—

1. An individual participating on the attest engagement team has a **close relative** who had
  - a. A key position with the client, or
  - b. A financial interest in the client that
    - (i) Was material to the close relative and of which the individual has knowledge; or
    - (ii) Enabled the close relative to exercise **significant influence** over the client.
2. An individual in a position to influence the attest engagement or any partner in the office in which the lead attest engagement partner primarily practices in connection with the attest engagement has a close relative who had
  - a. A key position with the client; or
  - b. A financial interest in the client that
    - (i) Was material to the close relative and of which the individual or partner has knowledge; and
    - (ii) Enabled the close relative to exercise significant influence over the client.

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<sup>2</sup> A penalty includes an early withdrawal penalty levied under the tax law but excludes other income taxes that would be owed or market losses that may be incurred as a result of the liquidation or transfer.

### Grandfathered Employment Relationships

Employment relationships of a covered member's immediate family and close relatives with an existing attest client that impair independence under this interpretation and that existed as of November 2001, will not be deemed to impair independence provided such relationships were permitted under preexisting requirements of rule 101 [ET section 101.01], and its interpretations and rulings.

### Other Considerations<sup>§</sup>

It is impossible to enumerate all circumstances in which the appearance of independence might be questioned. In the absence of an independence interpretation or ruling under rule 101 [ET section 101.01] that addresses a particular circumstance, a member should evaluate whether that circumstance would lead a reasonable person aware of all the relevant facts to conclude that there is an unacceptable threat to the member's and the firm's independence. When making that evaluation, members should refer to the risk-based approach described in the Conceptual Framework for AICPA Independence Standards [see ET section 100.01]. If the threats to independence are not at an acceptable level, safeguards should be applied to eliminate the threats or reduce them to an acceptable level. In cases where threats to independence are not at an acceptable level, thereby requiring the application of safeguards, the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level should be documented.<sup>3</sup>

[Paragraph added by adoption of the Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, November 1991, effective January 1, 1992, with earlier application encouraged, by the Professional Ethics Executive Committee. Revised, effective February 28, 1998, by the Professional Ethics Executive Committee. Revised, November 2001, effective May 31, 2002, with earlier application encouraged, by the Professional Ethics Executive Committee. Revised, effective July 31, 2002, by the Professional Ethics Executive Committee. Revised, effective March 31, 2003, by the Professional Ethics Executive Committee. Revised, effective April 30, 2003, by the Professional Ethics Executive Committee. Revised, April 2006, effective April 30, 2007, with earlier application encouraged, by the Professional Ethics Executive Committee.]

[.03] [101-1] [Formerly paragraph .02 renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Formerly interpretation 101-1, renumbered as 101-4 and moved to paragraph .06, April 1992.]

**.04 101-2—Employment or association with attest clients.** A firm's independence will be considered to be impaired with respect to a client if a partner or professional employee leaves the firm and is subsequently employed by or associated with that client in a key position unless all the following conditions are met:

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<sup>§</sup> In April 2006, the Professional Ethics Executive Committee (PEEC) of the AICPA issued the *Conceptual Framework for AICPA Independence Standards (Conceptual Framework)* [ET section 100.01], which describes the risk-based approach to analyzing independence matters that is used by PEEC when it develops independence standards. Consequently, this interpretation has been revised in the "Other Considerations" section to reflect the issuance of the *Conceptual Framework*. Because the *Conceptual Framework* [ET section 100.01] is effective April 30, 2007, with earlier application encouraged, the revisions made in the "Other Considerations" section of this interpretation are also effective April 30, 2007, with earlier application encouraged.

<sup>3</sup> A failure to prepare the required documentation would be considered a violation of Rule 202, *Compliance With Standards* [ET section 202.01], of the AICPA Code of Professional Conduct. Independence would not be considered to be impaired provided the member can demonstrate that he or she did apply safeguards to eliminate unacceptable threats or reduce them to an acceptable level. [Footnote added, effective April 30, 2006, by the Professional Ethics Executive Committee.]

1. Amounts due to the former partner or professional employee for his or her previous interest in the firm and for unfunded, vested retirement benefits are not material to the firm, and the underlying formula used to calculate the payments remains fixed during the payout period. Retirement benefits may also be adjusted for inflation and interest may be paid on amounts due.
2. The former partner or professional employee is not in a position to influence the accounting firm's operations or financial policies.
3. The former partner or professional employee does not participate or appear to participate in, and is not associated with the firm, whether or not compensated for such participation or association, once employment or association with the client begins. An appearance of participation or association results from such actions as:
  - The individual provides consultation to the firm.
  - The firm provides the individual with an office and related amenities (for example, secretarial and telephone services).
  - The individual's name is included in the firm's office directory.
  - The individual's name is included as a member of the firm in other membership lists of business, professional, or civic organizations, unless the individual is clearly designated as retired.
4. The ongoing attest engagement team considers the appropriateness or necessity of modifying the engagement procedures to adjust for the risk that, by virtue of the former partner or professional employee's prior knowledge of the audit plan, audit effectiveness could be reduced.
5. The firm assesses whether existing attest engagement team members have the appropriate experience and stature to effectively deal with the former partner or professional employee and his or her work, when that person will have significant interaction with the attest engagement team.
6. The subsequent attest engagement is reviewed to determine whether the engagement team members maintained the appropriate level of skepticism when evaluating the representations and work of the former partner or professional employee, when the person joins the client in a key position within one year of disassociating from the firm and has significant interaction with the attest engagement team. The review should be performed by a professional with appropriate stature, expertise, and objectivity and should be tailored based on the position that the person assumed at the client, the position he or she held at the firm, the nature of the services he or she provided to the client, and other relevant facts and circumstances. Appropriate actions, as deemed necessary, should be taken based on the results of the review.

Responsible members within the firm should implement procedures for compliance with the preceding conditions when firm professionals are employed or associated with attest clients.

With respect to conditions 4, 5, and 6, the procedures adopted will depend on several factors, including whether the former partner or professional employee served as a member of the engagement team, the positions he or she held at the

firm and has accepted at the client, the length of time that has elapsed since the professional left the firm, and the circumstances of his or her departure.<sup>4</sup>

### **Considering Employment or Association With the Client**

When a member of the attest engagement team or an individual in a position to influence the attest engagement intends to seek or discuss potential employment or association with an attest client, or is in receipt of a specific offer of employment from an attest client, independence will be impaired with respect to the client unless the person promptly reports such consideration or offer to an appropriate person in the firm, and removes himself or herself from the engagement until the employment offer is rejected or employment is no longer being sought. When a covered member becomes aware that a member of the attest engagement team or an individual in a position to influence the attest engagement is considering employment or association with a client, the covered member should notify an appropriate person in the firm.

The appropriate person should consider what additional procedures may be necessary to provide reasonable assurance that any work performed for the client by that person was performed with objectivity and integrity as required under rule 102 [ET section 102.01]. Additional procedures, such as reperformance of work already done, will depend on the nature of the engagement and the individual involved.

[Replaces previous interpretation 101-2, *Retired Partners and Firm Independence*, August, 1989, effective August 31, 1989. Revised, effective December 31, 1998, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, effective April 30, 2003, by the Professional Ethics Executive Committee.]

**.05 101-3—Performance of nonattest services.** Before a member or his or her firm ("member") performs nonattest services (for example, tax or consulting services) for an attest client,<sup>5</sup> the member should determine that the requirements described in this interpretation have been met. In cases where the requirements 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.

### **Engagements Subject to Independence Rules of Certain Regulatory Bodies**

This interpretation requires compliance with independence regulations of authoritative regulatory bodies (such as the Securities and Exchange Commission [SEC], the General Accounting Office [GAO], the Department of Labor [DOL], and state boards of accountancy) where a member performs nonattest services for an attest client and is required to be independent of the client under

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<sup>4</sup> An inadvertent and isolated failure to meet conditions 4, 5, and 6 would not impair independence provided that the required procedures are performed promptly upon discovery of the failure to do so, and all other provisions of the interpretation are met. [Footnote added, effective April 30, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, April 2006.]

<sup>5</sup> A member who performs a compilation engagement for a client should modify the compilation report to indicate a lack of independence if the member does not meet all of the conditions set out in this interpretation when providing a nonattest service to that client (see Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements* [AR section 100.19]). [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, April 2006.]

the regulations of the applicable regulatory body. Accordingly, failure to comply with the nonattest services provisions contained in the independence rules of the applicable regulatory body that are more restrictive than the provisions of this interpretation would constitute a violation of this interpretation.

### **General Requirements for Performing Nonattest Services**

1. 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.
2. The client must agree to perform the following functions in connection with the engagement to perform nonattest services:
  - a. Make all management decisions and perform all management functions;
  - b. Designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;
  - c. Evaluate the adequacy and results of the services performed; and
  - d. Accept responsibility for the results of the services.

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 understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or re-perform the services.

In cases where 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.

3. Before performing nonattest services, the member should establish and document in writing<sup>6</sup> his or her understanding with the client (board of directors, audit committee, or management, as appropriate in the circumstances) regarding the following:
  - a. Objectives of the engagement
  - b. Services to be performed
  - c. Client's acceptance of its responsibilities
  - d. Member's responsibilities
  - e. Any limitations of the engagement

The documentation requirement does not apply to:

- a. Nonattest services performed prior to January 1, 2005.

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<sup>6</sup> A failure to prepare the required documentation would not impair independence, but would be considered a violation of Rule 202, *Compliance With Standards* [Rule 202.01], provided that the member did establish the understanding with the client. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote revised, January 2005, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, April 2006.]

- b. Nonattest services performed prior to the client becoming an attest client.<sup>7</sup>

General requirements 2 and 3 above 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.

### General Activities

The following are some general activities that would impair a member's independence:

- Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of a client or having the authority to do so
- Preparing source documents,<sup>8</sup> in electronic or other form, evidencing the occurrence of a transaction
- Having custody of client assets
- Supervising client employees in the performance of their normal recurring activities
- Determining which recommendations of the member should be implemented
- Reporting to the board of directors on behalf of management
- Serving as a client's stock transfer or escrow agent, registrar, general counsel or its equivalent
- Establishing or maintaining internal controls, including performing ongoing monitoring activities<sup>9</sup> for a client

### Specific Examples of Nonattest Services

The examples in the following table identify the effect that performance of certain nonattest services for an attest client can have on a member's independence. These examples presume that the general requirements in the previous section "General Requirements for Performing Nonattest Services" have been met and are not intended to be all-inclusive of the types of nonattest services performed by members.

<sup>7</sup> 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. [Footnote added, effective October 31, 2004, by the Professional Ethics Executive Committee. Footnote renumbered by the revision of interpretation 101-1, April 2006.]

<sup>8</sup> Source documents are the documents upon which evidence of an accounting transaction are 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. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered and revised, September 2003, by the Professional Ethics Executive Committee. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006.]

<sup>9</sup> Monitoring can be accomplished through ongoing activities, separate evaluations, or a combination of both. Ongoing monitoring activities are the procedures designed to assess the quality of internal control performance over time, and is built into the normal recurring activities of an entity; these activities include regular management and supervisory activities. Separate evaluations focus on the continued effectiveness of a client's internal control. A member's independence would not be impaired by the performance of separate evaluations of the effectiveness of a client's internal control, including separate evaluations of the client's ongoing monitoring activities. [Footnote added, effective July 31, 2007, by the Professional Ethics Executive Committee.]

**Impact on Independence of Performance of Nonattest Services**

<i>Type of Nonattest Service</i>	<i>Independence Would Not Be Impaired</i>	<i>Independence Would Be Impaired</i>
Bookkeeping	<ul style="list-style-type: none"> <li>• Record transactions for which management has determined or approved the appropriate account classification, or post coded transactions to a client's general ledger.</li> <li>• Prepare financial statements based on information in the trial balance.</li> <li>• Post client-approved entries to a client's trial balance.</li> <li>• Propose standard, adjusting, or correcting journal entries or other changes affecting the financial statements to the client provided the client reviews the entries and the member is satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements.</li> </ul>	<ul style="list-style-type: none"> <li>• Determine or change journal entries, account codings or classification for transactions, or other accounting records without obtaining client approval.</li> <li>• Authorize or approve transactions.</li> <li>• Prepare source documents.</li> <li>• Make changes to source documents without client approval.</li> </ul>
Non tax disbursement	<ul style="list-style-type: none"> <li>• Using payroll time records provided and approved by the client, generate unsigned checks, or process client's payroll.</li> <li>• Transmit client-approved payroll or other disbursement information to a financial institution provided the client has authorized the member to make the transmission and has made arrangements for the financial institution to limit the corresponding individual payments as to amount and payee. In addition, once transmitted, the client must authorize the financial institution to process the information.<sup>[10]</sup></li> </ul>	<ul style="list-style-type: none"> <li>• Accept responsibility to authorize payment of client funds, electronically or otherwise, except as specifically provided for with respect to electronic payroll tax payments.</li> <li>• Accept responsibility to sign or cosign client checks, even if only in emergency situations.</li> <li>• Maintain a client's bank account or otherwise have custody of a client's funds or make credit or banking decisions for the client.</li> <li>• Approve vendor invoices for payment</li> </ul>

*(continued)*

<sup>[10]</sup> [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September, 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote deleted by the Professional Ethics Executive Committee, February 2007. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.]



<i>Type of Nonattest Service</i>	<i>Independence Would Not Be Impaired</i>	<i>Independence Would Be Impaired</i>
Benefit plan administration <sup>11</sup>	<ul style="list-style-type: none"> <li>• Communicate summary plan data to plan trustee.</li> <li>• Advise client management regarding the application or impact of provisions of the plan document.</li> <li>• Process transactions (e.g., investment/benefit elections or increase/decrease contributions to the plan; data entry; participant confirmations; and processing of distributions and loans) initiated by plan participants through the member's electronic medium, such as an interactive voice response system or Internet connection or other media.</li> <li>• Prepare account valuations for plan participants using data collected through the member's electronic or other media.</li> <li>• Prepare and transmit participant statements to plan participants based on data collected through the member's electronic or other medium.</li> </ul>	<ul style="list-style-type: none"> <li>• Make policy decisions on behalf of client management.</li> <li>• When dealing with plan participants, interpret the plan document on behalf of management without first obtaining management's concurrence.</li> <li>• Make disbursements on behalf of the plan.</li> <li>• Have custody of assets of a plan.</li> <li>• Serve a plan as a fiduciary as defined by ERISA.</li> </ul>
Investment— advisory or management	<ul style="list-style-type: none"> <li>• Recommend the allocation of funds that a client should invest in various asset classes, depending upon the client's desired rate of return, risk tolerance, etc.</li> <li>• Perform recordkeeping and reporting of client's portfolio balances including providing a comparative analysis of the client's investments to third-party benchmarks.</li> <li>• Review the manner in which a client's portfolio is being managed by investment account managers, including determining whether the managers are (1) following the guidelines of the client's investment policy statement; (2) meeting the client's investment objectives; and (3) conforming to the client's stated investment styles.</li> <li>• Transmit a client's investment selection to a broker-dealer or equivalent provided the client has authorized the broker-dealer or equivalent to execute the transaction.</li> </ul>	<ul style="list-style-type: none"> <li>• Make investment decisions on behalf of client management or otherwise have discretionary authority over a client's investments.</li> <li>• Execute a transaction to buy or sell a client's investment.</li> <li>• Have custody of client assets, such as taking temporary possession of securities purchased by a client.</li> </ul>

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<sup>11</sup> When auditing plans subject to the Employee Retirement Income Security Act (ERISA), Department of Labor (DOL) regulations, which may be more restrictive, must be followed. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007.]

<i>Type of Nonattest Service</i>	<i>Independence Would Not Be Impaired</i>	<i>Independence Would Be Impaired</i>
Corporate finance— consulting or advisory	<ul style="list-style-type: none"> <li>• Assist in developing corporate strategies.</li> <li>• Assist in identifying or introducing the client to possible sources of capital that meet the client's specifications or criteria.</li> <li>• Assist in analyzing the effects of proposed transactions including providing advice to a client during negotiations with potential buyers, sellers, or capital sources.</li> <li>• Assist in drafting an offering document or memorandum.</li> <li>• Participate in transaction negotiations in an advisory capacity.</li> <li>• Be named as a financial adviser in a client's private placement memoranda or offering documents.</li> </ul>	<ul style="list-style-type: none"> <li>• Commit the client to the terms of a transaction or consummate a transaction on behalf of the client.</li> <li>• Act as a promoter, underwriter, broker-dealer, or guarantor of client securities, or distributor of private placement memoranda or offering documents.</li> <li>• Maintain custody of client securities.</li> </ul>
Executive or employee search	<ul style="list-style-type: none"> <li>• Recommend a position description or candidate specifications.</li> <li>• Solicit and perform screening of candidates and recommend qualified candidates to a client based on the client-approved criteria (e.g., required skills and experience).</li> <li>• Participate in employee hiring or compensation discussions in an advisory capacity.</li> </ul>	<ul style="list-style-type: none"> <li>• Commit the client to employee compensation or benefit arrangements.</li> <li>• Hire or terminate client employees.</li> </ul>
Business risk consulting	<ul style="list-style-type: none"> <li>• Provide assistance in assessing the client's business risks and control processes.</li> <li>• Recommend a plan for making improvements to a client's control processes and assist in implementing these improvements.</li> </ul>	<ul style="list-style-type: none"> <li>• Make or approve business risk decisions.</li> <li>• Present business risk considerations to the board or others on behalf of management.</li> </ul>
Information systems—design, installation or integration	<ul style="list-style-type: none"> <li>• Install or integrate a client's financial information system that was not designed or developed by the member (e.g., an off-the-shelf accounting package).</li> <li>• Assist in setting up the client's chart of accounts and financial statement format with respect to the client's financial information system.</li> <li>• Design, develop, install, or integrate a client's information system that is unrelated to the client's financial statements or accounting records.</li> <li>• Provide training and instruction to client employees on an information and control system.</li> </ul>	<ul style="list-style-type: none"> <li>• Design or develop a client's financial information system.</li> <li>• Make other than insignificant modifications to source code underlying a client's existing financial information system.</li> <li>• Supervise client personnel in the daily operation of a client's information system.</li> <li>• Operate a client's local area network (LAN) system.</li> </ul>

### Tax Compliance Services

Tax compliance services addressed by this interpretation are preparation of a tax return,<sup>12</sup> transmittal of a tax return and transmittal of any related tax payment to the taxing authority, signing and filing a tax return, and authorized representation of clients in administrative proceedings before a taxing authority.

Preparing a tax return and transmitting the tax return and related tax payment to a taxing authority, in paper or electronic form, would not impair a member's independence provided the member does not have custody or control<sup>13</sup> over the client's funds and the individual designated by the client to oversee the tax services:

- Reviews and approves the tax return and related tax payment; and,
- If required for filing, signs the tax return prior to the member transmitting the return to the taxing authority.

However, signing and filing a tax return on behalf of client management would impair independence, unless the member has the legal authority to do so and:

- a. The taxing authority has prescribed procedures in place for a client to permit a member to sign and file a tax return on behalf of the client (for example, Form 8879 or 8453), and such procedures meet, at the minimum, standards for electronic return originators and officers outlined in I.R.S. Form 8879; or
- b. An individual in client management who is authorized to sign and file the client's tax return provides the member with a signed statement that clearly identifies the return being filed and represents that:
  1. Such individual is authorized to sign and file the tax return;
  2. Such individual has reviewed the tax return, including accompanying schedules and statements, and it is true, correct and complete to the best of his or her knowledge and belief; and
  3. Such individual authorizes the member or another named individual in the member's firm to sign and file the tax return on behalf of the client.

Authorized representation of a client in administrative proceedings before a taxing authority would not impair a member's independence provided the member obtains client agreement prior to committing the client to a specific resolution with the taxing authority. However, representing a client in a court<sup>14</sup> to resolve a tax dispute would impair a member's independence.

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<sup>12</sup> For purposes of this interpretation, a tax return includes informational tax forms (for example, estimated tax vouchers, extension forms, and Forms 990, 5500, 1099, and W-2) filed with a taxing authority or other regulatory agencies. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007.]

<sup>13</sup> Making electronic tax payments under a taxing authority's specified criteria or remitting a check payable to the taxing authority and signed by the client would not be considered having custody or control over a client's funds. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007.]

<sup>14</sup> The term *court* encompasses a tax, district, or federal court of claims, and the equivalent state, local, or foreign forums. [Footnote added, effective July 31, 2007, by the Professional Ethics Executive Committee.]

## Transition

Independence would not be impaired as a result of the more restrictive requirements of the tax compliance services provisions provided such services are pursuant to engagements commenced prior to February 28, 2007, and completed prior to January 1, 2008, and the member complied with all applicable independence interpretations and rulings in effect on February 28, 2007.

## Appraisal, Valuation, and Actuarial Services

Independence would be impaired if a member performs an appraisal, valuation, or actuarial service for an attest client where the results of the service, individually or in the aggregate, would be material to the financial statements and the appraisal, valuation, or actuarial service involves a significant degree of subjectivity.

Valuations performed in connection with, for example, employee stock ownership plans, business combinations, or appraisals of assets or liabilities generally involve a significant degree of subjectivity. Accordingly, if these services produce results that are material to the financial statements, independence would be impaired.

An actuarial valuation of a client's pension or postemployment benefit liabilities generally produces reasonably consistent results because the valuation does not require a significant degree of subjectivity. Therefore, such services would not impair independence. In addition, appraisal, valuation, and actuarial services performed for nonfinancial statement purposes would not impair independence.<sup>15</sup> However, in performing such services, all other requirements of this interpretation should be met, including that all significant assumptions and matters of judgment are determined or approved by the client and the client is in a position to have an informed judgment on, and accepts responsibility for, the results of the service.

## Forensic Accounting Services

For purposes of this interpretation, forensic accounting services<sup>16</sup> are nonattest services that involve the application of special skills in accounting, auditing, finance, quantitative methods and certain areas of the law, and research, and investigative skills to collect, analyze, and evaluate evidential matter and to interpret and communicate findings and consist of:

- Litigation services; and
- Investigative services.

Litigation services recognize the role of the member as an expert or consultant and consist of providing assistance for actual or potential legal or regulatory proceedings before a trier of fact in connection with the resolution of disputes between parties. Litigation services consist of the following services:

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<sup>15</sup> Examples of such services may include appraisal, valuation, and actuarial services performed for tax planning or tax compliance, estate and gift taxation, and divorce proceedings. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, February and July 2007.]

<sup>16</sup> The definitions of the specific services identified in this interpretation are solely for purposes of this interpretation and are not intended to be used for any other purpose. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007.]

- a. Expert witness services<sup>17</sup> are those litigation services where a member is engaged to render an opinion before a trier of fact as to the matter(s) in dispute based on the member's expertise, rather than his or her direct knowledge of the disputed facts or events.

Expert witness services create the appearance that a member is advocating or promoting a client's position.<sup>18</sup> Accordingly, if a member conditionally or unconditionally agrees to provide expert witness testimony for a client,<sup>19</sup> independence would be considered to be impaired.

However, independence would not be considered impaired if a member provides expert witness services for a large group of plaintiffs or defendants that includes one or more attest clients of the firm provided that at the outset of the engagement: 1) the member's attest clients constitute less than 20 percent of (i) the members of the group (ii) the voting interests of the group, and (iii) the claim; (2) no attest client within the group is designated as the "lead" plaintiff or defendant of the group; and (3) no attest client has the sole decision-making power to select or approve the expert witness.

While testifying as a fact witness,<sup>20</sup> a member may be questioned by the trier of fact or counsel as to his or her opinions pertaining to matters within the member's area of expertise. Answering such questions would not impair the member's independence.

- b. Litigation consulting services are those litigation services where a member provides advice about the facts, issues, and strategy of a matter. The consultant does not testify as an expert witness before a trier of fact.

The performance of litigation consulting services would not impair independence provided the member complies with the general requirements set forth under this interpretation.<sup>21</sup> However, if the member subsequently agrees to serve as an expert witness, independence would be considered to be impaired.

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<sup>17</sup> In determining whether the member's services are considered to be expert witness services or fact witness testimony, members should refer to the Federal Rules of Evidence, Article VII, Opinions and Expert Testimony (Rules 701, 702, and 703), and other applicable laws, regulations, and rules. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007.]

<sup>18</sup> See advocacy threat as defined in the Conceptual Framework for AICPA Independence Standards (ET section 100.01). However, even though there is an appearance of advocacy, when providing expert witness services, a member must comply with Rule 102, *Integrity and Objectivity*, which requires that a member maintain objectivity and integrity and not subordinate his or her judgment to others. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007.]

<sup>19</sup> The client in this case refers to the party to the litigation on whose behalf the member is providing testimony and not to the law firm that engaged the member on the client's behalf. If the law firm that engaged the member on behalf of the client is also an attest client of the member, the member should consider the applicability of Interpretation 101-12, "Independence and Cooperative Arrangements with Clients." [Footnote added, effective July 31, 2007, by the Professional Ethics Executive Committee.]

<sup>20</sup> A fact witness is also referred to as a percipient witness or a sensory witness. Fact witness testimony is based on the member's direct knowledge of the facts or events in dispute. A fact witness may have obtained his or her direct knowledge of the facts or events in dispute from the performance of prior professional services for the client. As a fact witness, the member's role is to provide factual testimony to the trier of fact. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007.]

<sup>21</sup> For purposes of complying with general requirement 2, the client may designate its attorney to oversee the litigation consulting services. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007.]

- c. Other services are those litigation services where a member serves as a trier of fact, special master, court-appointed expert, or arbitrator (including serving on an arbitration panel), in a matter involving a client. These other services create the appearance that the member is not independent. Accordingly, if a member serves in such a role, independence would be considered to be impaired. However, independence would not be considered impaired if a member serves as a mediator or any similar role in a matter involving a client provided the member is not making any decisions on behalf of the parties, but rather is acting as a facilitator by assisting the parties in reaching their own agreement.<sup>22</sup>

Investigative services include all forensic services not involving actual or threatened litigation such as performing analyses or investigations that may require the same skills as used in litigation services. Such services would not impair independence provided the member complies with the general requirements set forth under this interpretation.

### **Transition**

Independence would not be impaired as a result of the more restrictive requirements of the forensic accounting services provisions, provided such services are pursuant to engagements commenced prior to February 28, 2007, and the member complied with all applicable independence interpretations and rulings in existence on February 28, 2007.

### **Internal Audit Assistance Services**

Internal audit services involve assisting the client in the performance of its internal audit activities, sometimes referred to as "internal audit outsourcing." In evaluating whether independence would be impaired with respect to an attest client, the nature of the service needs to be considered.

Assisting the client in performing financial and operational<sup>23</sup> internal audit activities would impair independence unless the member takes appropriate steps to ensure that the client understands its responsibility for<sup>24</sup> directing the internal audit function, including the management thereof. Accordingly, any outsourcing of the internal audit function to the member whereby the member in effect manages the internal audit activities of the client would impair independence.

In addition to the general requirements of this interpretation, the member should ensure that client management:

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<sup>22</sup> However, the member should consider the requirements of Interpretation 102-2, "Conflicts of Interests" [ET section 102.03]. [Footnote added, effective February 28, 2007, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2007.]

<sup>23</sup> For example, a member may assess whether performance is in compliance with management's policies and procedures, to identify opportunities for improvement, and to develop recommendations for improvement or further action for management consideration and decision making. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, February and July 2007.]

<sup>24</sup> [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote renumbered by the Professional Ethics Executive Committee, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, July 2007. Footnote deleted and subsequently renumbered by the Professional Ethics Executive Committee, July 2007.]

- Designates an<sup>[25]</sup> individual or individuals, who possess suitable skill, knowledge, and/or experience, preferably within senior management, to be responsible for the internal audit function;
- Determines the scope, risk, and frequency of internal audit activities, including those to be performed by the member providing internal audit assistance services;
- Evaluates the findings and results arising from the internal audit activities, including those performed by the member providing internal audit assistance services; and
- Evaluates the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures by, among other things, obtaining reports from the member.

The member should also be satisfied that the client's board of directors, audit committee, or other governing body is informed about the member's and management's respective roles and responsibilities in connection with the engagement. Such information should provide the client's governing body a basis for developing guidelines for management and the member to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

The member is responsible for performing the internal audit procedures in accordance with the terms of the engagement and reporting thereon. The performance of such procedures should be directed, reviewed, and supervised by the member. The report should include information that allows the individual responsible for the internal audit function to evaluate the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures. This report may include recommendations for improvements in systems, processes, and procedures. The member may assist the individual responsible for the internal audit function in performing preliminary audit risk assessments, preparing audit plans, and recommending audit priorities. However, the member should not undertake any responsibilities that are required, as described above, to be performed by the individual responsible for the internal audit function.

The following are examples of activities (in addition to those listed in the "General Activities" section of this interpretation) that, if performed as part of an internal audit assistance engagement, would impair independence:

- Performing ongoing monitoring activities or control activities (for example, reviewing loan originations as part of the client's approval process or reviewing customer credit information as part of the customer's sales authorization process) that affect the execution of transactions or ensure that transactions are properly executed, accounted for, or both, and performing routine activities in connection with the client's operating or production processes that are equivalent to those of an ongoing compliance or quality control function
- Determining which, if any, recommendations for improving the internal control system should be implemented
- Reporting to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function

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<sup>[25]</sup> [Footnote deleted by the Professional Ethics Executive Committee, January 2005. Footnote renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the Professional Ethics Executive Committee, February and July 2007.]

- Approving or being responsible for the overall internal audit work plan including the determination of the internal audit risk and scope, project priorities, and frequency of performance of audit procedures
- Being connected with the client as an employee or in any capacity equivalent to a member of client management (for example, being listed as an employee in client directories or other client publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the client's internal audit function, or using the client's letterhead or internal correspondence forms in communications)

The foregoing list is not intended to be all-inclusive.

Services involving an extension of the procedures that are generally of the type considered to be extensions of the member's audit scope applied in the audit of the client's financial statements, such as confirming of accounts receivable and analyzing fluctuations in account balances, are not considered internal audit assistance services and would not impair independence even if the extent of such testing exceeds that required by generally accepted auditing standards. In addition, engagements performed under the attestation standards would not be considered internal audit assistance services and therefore would not impair independence.

### Transition

Independence would not be impaired as a result of the more restrictive requirements of interpretation 101-3, provided the provision of any such nonattest services are pursuant to arrangements in existence on December 31, 2003, and are completed by December 31, 2004, and the member was in compliance with the preexisting requirements of this interpretation.

[Formerly paragraph .04, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, effective May 31, 1999, by the Professional Ethics Executive Committee. Revised, effective April 30, 2000, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, effective December 31, 2003 (except for the documentation requirement, which takes effect for any new engagements that begin after December 31, 2004), with earlier application permitted, by the Professional Ethics Executive Committee. Revised, effective October 31, 2004, by the Professional Ethics Executive Committee. Revised, effective January 27, 2005, by the Professional Ethics Executive Committee. Revised, effective February 28, 2007, by the Professional Ethics Executive Committee. Revised, effective July 31, 2007, by the Professional Ethics Executive Committee.]

**.06 101-4—Honorary directorships and trusteeships of not-for-profit organization.** Partners or professional employees of a firm (individual) may be asked to lend the prestige of their names to not-for-profit organizations that limit their activities to those of a charitable, religious, civic, or similar nature by being named as a director or a trustee. An individual who permits his or her name to be used in this manner would not be considered to impair independence under rule 101 [ET section 101.01] provided his or her position is clearly honorary, and he or she cannot vote or otherwise participate in board or management functions. If the individual is named in letterheads and externally circulated materials, he or she must be identified as an honorary director or honorary trustee. [Formerly paragraph .05, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Formerly interpretation 101-1. Revised, effective June 30, 1990, by the Professional Ethics Executive



Committee. Renumbered as interpretation 101-4 and moved from paragraph .03, April, 1992. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

**.07 101-5—Loans from financial institution clients and related terminology.** Interpretation 101-1.A.4 [ET section 101.02] provides that, except as permitted in this interpretation, independence shall be considered to be impaired if a **covered member**<sup>†</sup> has any **loan** to or from a **client**, any officer or director of the client, or any individual owning ten percent or more of the client's outstanding equity securities or other ownership interests. This interpretation describes the conditions a covered member (or his or her **immediate family**) must meet in order to apply an exception for a "Grandfathered Loan" or "Other Permitted Loan."

### **Grandfathered Loans**

Unsecured loans that are not material to the covered member's net worth, home mortgages,<sup>26</sup> and other secured loans<sup>26</sup> are grandfathered if:

- (1) they were obtained from a **financial institution** under that institution's **normal lending procedures, terms, and requirements**,
- (2) after becoming a covered member they are kept current as to all terms at all times and those terms do not change in any manner not provided for in the original loan agreement,<sup>27</sup> and
- (3) they were:
  - (a) obtained from the financial institution prior to its becoming a client requiring independence; or
  - (b) obtained from a financial institution for which independence was not required and were later sold to a client for which independence is required; or
  - (c) obtained prior to February 5, 2001 and met the requirements of previous provisions of Interpretation 101-5 [ET section 101.07] covering grandfathered loans; or
  - (d) obtained between February 5, 2001 and May 31, 2002, and the covered member was in compliance with the applicable independence requirements of the SEC during that period; or
  - (e) obtained after May 31, 2002 from a financial institution client requiring independence by a borrower prior to his or her becoming a covered member with respect to that client

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<sup>†</sup> Terms shown in **boldface** type upon first usage in this interpretation are defined in ET section 92, *Definitions*.

<sup>26</sup> The value of the collateral securing a home mortgage or other secured loan should equal or exceed the remaining balance of the grandfathered loan during the term of the loan. If the value of the collateral is less than the remaining balance of the grandfathered loan, the portion of the loan that exceeds the value of the collateral must not be material to the covered member's net worth. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007.]

<sup>27</sup> Changes in the terms of the loan include, but are not limited to, a new or extended maturity date, a new interest rate or formula, revised collateral, or revised or waived covenants. [Footnote added, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007.]

In determining when a loan was obtained, the date a loan commitment or line of credit is granted must be used, rather than the date a transaction closes or funds are obtained.

For purposes of applying the grandfathered loans provision when the covered member is a partner in a partnership:

- a loan to a limited partnership (or similar type of entity) or a general partnership would be ascribed to each covered member who is a partner in the partnership on the basis of their legal liability as a limited or general partner if:
  - the covered member's interest in the limited partnership, either individually or combined with the interest of one or more covered members, exceeds 50 percent of the total limited partnership interest; or
  - the covered member, either individually or together with one or more covered members, can control the general partnership.
- even if no amount of a partnership loan is ascribed to the covered member(s) identified above, independence is considered to be impaired if the partnership renegotiates the loan or enters into a new loan that is not one of the permitted loans described below.

### Other Permitted Loans

This interpretation permits only the following new loans and leases to be obtained from a financial institution client for which independence is required. These loans and leases must be obtained under the institution's normal lending procedures, terms, and requirements and must, at all times, be kept current as to all terms.

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

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.

[Revised, November 30, 1987, by the Professional Ethics Executive Committee. Formerly paragraph .06, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. References revised to reflect issuance of AICPA Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, November 1991, effective January 1, 1992 with earlier application encouraged, by the Professional Ethics Executive Committee. Revised, effective February 28, 1998 by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, November 2002, by the Professional Ethics Executive Committee. Revised, September 2003, by the Professional Ethics Executive Committee.]

**.08 101-6—The effect of actual or threatened litigation on independence.** In some circumstances, independence may be considered to

be impaired as a result of litigation or the expressed intention to commence litigation as discussed below.

#### *Litigation between client and member*

The relationship between the management of the client and a covered member must be characterized by complete candor and full disclosure regarding all aspects of the client's business operations. In addition, there must be an absence of bias on the part of the covered member so that he or she can exercise professional judgment on the financial reporting decisions made by the management. When the present management of a client company commences, or expresses an intention to commence, legal action against a covered member, the covered member and the client's management may be placed in adversarial positions in which the management's willingness to make complete disclosures and the covered member's objectivity may be affected by self-interest.

For the reasons outlined above, independence may be impaired whenever the covered member and the covered member's client or its management are in threatened or actual positions of material adverse interests by reason of threatened or actual litigation. Because of the complexity and diversity of the situations of adverse interests which may arise, however, it is difficult to prescribe precise points at which independence may be impaired. The following criteria are offered as guidelines:

1. The commencement of litigation by the present management alleging deficiencies in audit work for the client would be considered to impair independence.
2. The commencement of litigation by the covered member against the present management alleging management fraud or deceit would be considered to impair independence.
3. An expressed intention by the present management to commence litigation against the covered member alleging deficiencies in audit work for the client would be considered to impair independence if the auditor concludes that it is probable that such a claim will be filed.
4. Litigation not related to performance of an attest engagement for the client (whether threatened or actual) for an amount not material to the covered member's firm<sup>28</sup> or to the client company<sup>28</sup> would not generally be considered to affect the relationship in such a way as to impair independence. Such claims may arise, for example, out of disputes as to billings for services, results of tax or management services advice or similar matters.

#### *Litigation by security holders*

A covered member may also become involved in litigation ("primary litigation") in which the covered member and the client or its management are defendants. Such litigation may arise, for example, when one or more stockholders bring a stockholders' derivative action or a so-called "class action" against the client or its management, its officers, directors, underwriters and covered

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<sup>28</sup> Because of the complexities of litigation and the circumstances under which it may arise, it is not possible to prescribe meaningful criteria for measuring materiality; accordingly, the covered member should consider the nature of the controversy underlying the litigation and all other relevant factors in reaching a judgment. [Footnote renumbered and revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote subsequently renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007.]

members under the securities laws. Such primary litigation in itself would not alter fundamental relationships between the client or its management and the covered member and therefore would not be deemed to have an adverse impact on independence. These situations should be examined carefully, however, since the potential for adverse interests may exist if cross-claims are filed against the covered member alleging that the covered member is responsible for any deficiencies or if the covered member alleges fraud or deceit by the present management as a defense. In assessing the extent to which independence may be impaired under these conditions, the covered member should consider the following additional guidelines:

1. The existence of cross-claims filed by the client, its management, or any of its directors to protect a right to legal redress in the event of a future adverse decision in the primary litigation (or, in lieu of cross-claims, agreements to extend the statute of limitations) would not normally affect the relationship between client management and the covered member in such a way as to impair independence, unless there exists a significant risk that the cross-claim will result in a settlement or judgment in an amount material to the covered member's firm<sup>29</sup> or to the client.
2. The assertion of cross-claims against the covered member by underwriters would not generally impair independence if no such claims are asserted by the client or the present management.
3. If any of the persons who file cross-claims against the covered member are also officers or directors of other clients of the covered member, independence with respect to such other clients would not generally be considered to be impaired.

#### *Other third-party litigation*

Another type of third-party litigation against the covered member may be commenced by a lending institution, other creditor, security holder, or insurance company who alleges reliance on financial statements of the client with which the covered member is associated as a basis for extending credit or insurance coverage to the client. In some instances, an insurance company may commence litigation (under subrogation rights) against the covered member in the name of the client to recover losses reimbursed to the client. These types of litigation would not normally affect independence with respect to a client who is either not the plaintiff or is only the nominal plaintiff, since the relationship between the covered member and client management would not be affected. They should be examined carefully, however, since the potential for adverse interests may exist if the covered member alleges, in his defense, fraud, or deceit by the present management.

If the real party in interest in the litigation (e.g., the insurance company) is also a client of the covered member ("the plaintiff client"), independence with respect to the plaintiff client may be impaired if the litigation involves a significant risk of a settlement or judgment in an amount which would be material to the covered member's firm<sup>30</sup> or to the plaintiff client.

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<sup>29</sup> See footnote 28. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote subsequently renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007.]

<sup>30</sup> See footnote 28. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote subsequently renumbered by the revision of

*(continued)*

*Effects of impairment of independence*

If the covered member believes that the circumstances would lead a reasonable person having knowledge of the facts to conclude that the actual or intended litigation poses an unacceptable threat to independence, the covered member should either (a) disengage himself or herself, or (b) disclaim an opinion because of lack of independence. Such disengagement may take the form of resignation or cessation of any attest engagement then in progress pending resolution of the issue between the parties.

*Termination of impairment*

The conditions giving rise to a lack of independence are generally eliminated when a final resolution is reached and the matters at issue no longer affect the relationship between the covered member and client. The covered member should carefully review the conditions of such resolution to determine that all impairments to the covered member's objectivity have been removed.

[Formerly paragraph .07, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, effective September 30, 1995, by the Professional Ethics Executive Committee, by deletion of subhead and paragraph and reissuance as ethics ruling No. 100, *Actions Permitted When Independence is Impaired*, under rule 101. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

[.09] [101-7]—[Deleted] [Formerly paragraph .08, renumbered by adoption of the Code of Professional Conduct on January 12, 1988.]

**.10 101-8—Effect on independence of financial interests in non-clients having investor or investee relationships with a covered member's client.**

### Introduction

Financial interests in nonclients that are related in various ways to a client may impair independence. Situations in which the nonclient investor is a partnership are covered in other rulings [ET section 191.138–.139, .158–.159, and .162–.163].

### Terminology

The following specifically identified terms are used in this interpretation as indicated:

1. Client. The term client means the person or entity with whose financial statements a covered member is associated.
2. Significant Influence. The term significant influence is as defined in Financial Accounting Standards Board *Accounting Standards Codification* 323-10-15.
3. Investor. The term investor means (a) a parent, (b) a general partner, or (c) a natural person or corporation that has the ability to exercise significant influence.
4. Investee. The term investee means (a) a subsidiary or (b) an entity over which an investor has the ability to exercise significant influence.

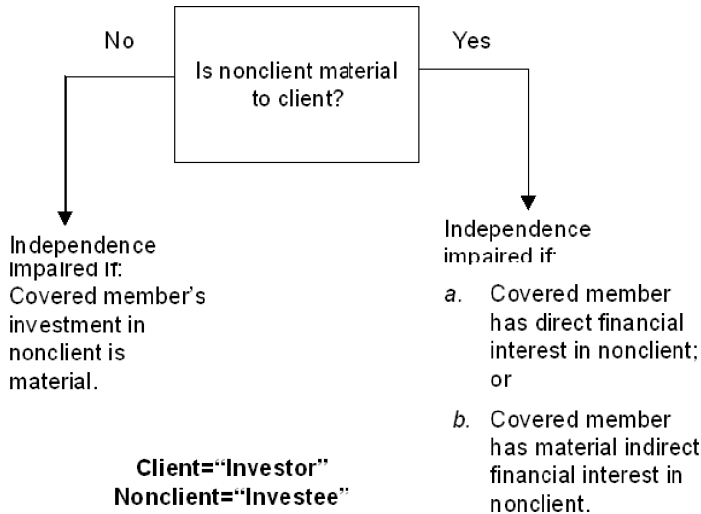
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*(footnote continued)*

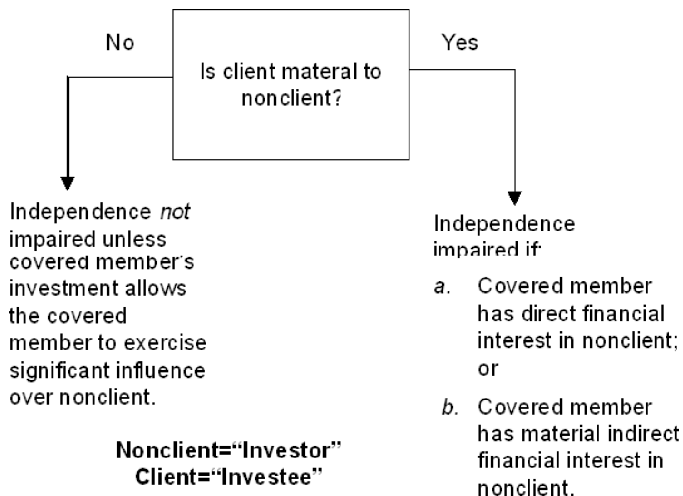
interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007.]

**Interpretation**

Where a nonclient investee is material to a client investor, any direct or material indirect financial interest of a covered member in the nonclient investee would be considered to impair independence with respect to the client investor. If the nonclient investee is immaterial to the client investor, a covered member's material investment in the nonclient investee would cause an impairment of independence.



Where a client investee is material to nonclient investor, any direct or material indirect financial interest of a covered member in the nonclient investor would be considered to impair independence with respect to the client investee. If the client investee is immaterial to the nonclient investor, and if a covered member's financial interest in the nonclient investor allows the covered member to exercise significant influence over the actions of the nonclient investor, independence would be considered to be impaired.



Other relationships, such as those involving brother-sister common control or client-nonclient joint ventures, may affect the appearance of independence. The covered member should make a reasonable inquiry to determine whether such relationships exist, and if they do, careful consideration should be given to whether the financial interests in question would lead a reasonable observer to conclude that the specified relationships pose an unacceptable threat to independence.

In general, in brother-sister common control situations, an immaterial financial interest of a covered member in the nonclient investee would not impair independence with respect to the client investee, provided the covered member could not exercise significant influence over the nonclient investor. However, if a covered member's financial interest in a nonclient investee is material, the covered member could be influenced by the nonclient investor, thereby impairing independence with respect to the client investee. In like manner, in a joint venture situation, an immaterial financial interest of a covered member in the nonclient investor would not impair the independence of the covered member with respect to the client investor, provided that the covered member could not exercise significant influence over the nonclient investor.

If a covered member does not and could not reasonably be expected to have knowledge of the financial interests or relationship described in this interpretation, independence would not be considered to be impaired under this interpretation.

[Revised, December 31, 1983, by the Professional Ethics Executive Committee. Formerly paragraph .09 renumbered by adoption of the Code of Professional Conduct on January 12, 1988. References changed to reflect the issuance of the AICPA Code of Professional Conduct on January 12, 1988. Replaces previous interpretation 101-8, *Effect on Independence of Financial Interests in Nonclients Having Investor or Investee Relationships With a Member's Client*, April 1991, effective April 30, 1991. Revised, December 31, 1991, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

[11] [101-9]—[Deleted]

**.12 101-10—The effect on independence of relationships with entities included in the governmental financial statements.**<sup>31</sup> For purposes of this Interpretation, a financial reporting entity's basic financial statements, issued in conformity with generally accepted accounting principles, include the government-wide financial statements (consisting of the entity's governmental activities, business-type activities, and discretely presented component units), the fund financial statements (consisting of major funds, nonmajor governmental and enterprise funds, internal service funds, blended component units, and fiduciary funds) and other entities disclosed in the notes to the basic financial statements. Entities that should be disclosed in the notes to the basic financial statements include, but are not limited to, related organizations, joint ventures,

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<sup>31</sup> Except for a financial reporting entity's basic financial statements, which is defined within the text of this Interpretation, certain terminology used throughout the Interpretation is specifically defined by the Governmental Accounting Standards Board. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote subsequently renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007.]

jointly governed organizations, and component units of another government with characteristics of a joint venture or jointly governed organization.

### **Auditor of Financial Reporting Entity**

A covered member issuing a report on the basic financial statements of the financial reporting entity must be independent of the financial reporting entity, as defined in paragraph 1 of this Interpretation. However, independence is not required with respect to any major or nonmajor fund, internal service fund, fiduciary fund, or component unit or other entities disclosed in the financial statements, where the primary auditor explicitly states reliance on other auditors reports thereon. In addition, independence is not required with respect to an entity disclosed in the notes to the basic financial statements, if the financial reporting entity is not financially accountable for the organization and the required disclosure does not include financial information. For example, a disclosure limited to the financial reporting entity's ability to appoint the governing board members would not require a member to be independent of that organization.

However, the covered member and his or her immediate family should not hold a key position with a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or other entity that should be disclosed in the notes to the basic financial statements.

### **Auditor of a Major Fund, Nonmajor Fund, Internal Service Fund, Fiduciary Fund, or Component Unit of the Financial Reporting Entity or Other Entity That Should Be Disclosed in the Notes to the Basic Financial Statements**

A covered member who is auditing the financial statements of a major fund, nonmajor fund, internal service fund, fiduciary fund, or component unit of the financial reporting entity or an entity that should be disclosed in the notes to the basic financial statements of the financial reporting entity, but is not auditing the primary government, should be independent with respect to those financial statements that the covered member is reporting upon. The covered member is not required to be independent of the primary government or other funds or component units of the reporting entity or entities that should be disclosed in the notes to the basic financial statements. However, the covered member and his or her immediate family should not hold a key position within the primary government. For purposes of this Interpretation, a covered member and immediate family member would not be considered employed by the primary government if the exceptions provided for in ET section 92.03 are met.<sup>[32-33]</sup>

[Formerly paragraph .11, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. References changed to reflect the issuance of the AICPA Code of Professional Conduct on January 12, 1988. Replaces previous interpretation 101-10, *The Effect on Independence of Relationships Proscribed by Rule 101 and its Interpretations With Nonclient Entities Included With a Member's Client in the Financial Statements of a Governmental Reporting Entity*, April 1991, effective April 30, 1991. Replaces previous interpretation 101-10, *The Effect on Independence of Relationships With Entities Included in the Governmental Financial Statements*, January 1996, effective January 31, 1996. Revised, July 2002, to reflect conforming changes necessary due to the revision

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<sup>[32-33]</sup> [Footnotes deleted by the Professional Ethics Executive Committee, March 2003. Footnotes renumbered by the revision of interpretation 101-2, April 2003. Footnotes subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnotes subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnotes subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnotes subsequently renumbered by the revision of interpretation 101-3, February and July 2007.]



of interpretation 101-1. Revised, effective March 31, 2003, by the Professional Ethics Executive Committee.]

**.13 101-11—Modified application of rule 101 for certain engagements to issue restricted-use reports under the Statements on Standards for Attestation Engagements.**

Rule 101: *Independence* [ET section 101.01], and its interpretations and rulings apply to all attest engagements. However, for purposes of performing engagements to issue reports under the Statements on Standards for Attestation Engagements (SSAEs) that are restricted to identified parties, only the following covered members, and their immediate families, are required to be independent with respect to the responsible party<sup>34</sup> in accordance with rule 101 [ET section 101.01]:

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

In addition, independence would be considered to be impaired if the firm had a financial relationship covered by interpretation 101-1.A [ET section 101.02] with the responsible party that was material to the firm.

In cases where the firm provides non-attest services to the responsible party that are proscribed under interpretation 101-3 [ET section 101.05] and that do not directly relate to the subject matter of the attest engagement, independence would not be considered to be impaired.

In circumstances where 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 [ET section 102.03] with regard to any relationships that may exist with the individual or entity that engages them to perform these services.

This interpretation does not apply to an engagement performed under the Statements on Auditing Standards or Statements on Standards for Accounting and Review Services, or to an examination or review engagement performed under the Statements on Standards for Attestation Engagements.

[Replaces previous interpretation 101-11, *Independence and Attest Engagements*, January 1996, effective January 31, 1996. Revised, effective November 30, 2001, by the Professional Ethics Executive Committee.]

**.14 101-12—Independence and cooperative arrangements with clients.** Independence will be considered to be impaired if, during the period of a professional engagement, a member or his or her firm had any cooperative arrangement with the client that was material to the member's firm or to the client.

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<sup>34</sup> As defined in the SSAEs. [Footnote renumbered, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote subsequently renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007.]

*Cooperative Arrangement*—A cooperative arrangement exists when a member's firm and a client jointly participate in a business activity. The following are examples, which are not all inclusive, of cooperative arrangements:

1. Prime/subcontractor arrangements to provide services or products to a third party
2. Joint ventures to develop or market products or services
3. Arrangements to combine one or more services or products of the firm with one or more services or products of the client and market the package with references to both parties
4. Distribution or marketing arrangements under which the firm acts as a distributor or marketer of the client's products or services, or the client acts as the distributor or marketer of the products or services of the firm

Nevertheless, joint participation with a client in a business activity does not ordinarily constitute a cooperative arrangement when all the following conditions are present:

- a. The participation of the firm and the participation of the client are governed by separate agreements, arrangements, or understandings.
- b. The firm assumes no responsibility for the activities or results of the client, and vice versa.
- c. Neither party has the authority to act as the representative or agent of the other party.

In addition, the member's firm should consider the requirements of rule 302 [ET section 302.01] and rule 503 [ET section 503.01].

[Effective November 30, 1993. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

#### [.15] [101-13]—[Deleted]

**.16 101-14—The effect of alternative practice structures on the applicability of independence rules.** Because of changes in the manner in which **members**<sup>‡</sup> are structuring their practices, the AICPA's professional ethics executive committee (PEEC) studied various alternatives to "traditional structures" to determine whether additional independence requirements are necessary to ensure the protection of the public interest.

In many "nontraditional structures," a substantial (the nonattest) portion of a member's practice is conducted under public or private ownership, and the attest portion of the practice is conducted through a separate firm owned and controlled by the member. All such structures must comply with applicable laws, regulations, and Rule 505, *Form of Organization and Name* [ET section 505.01]. In complying with laws, regulations, and rule 505 [ET section 505.01], many elements of quality control are required to ensure that the public interest is adequately protected. For example, all services performed by members and persons over whom they have control must comply with standards promulgated by AICPA Council-designated bodies, and, for all other firms providing attest services, enrollment is required in an AICPA-approved practice-monitoring program. Finally, and importantly, the members are responsible, financially and otherwise, for all the attest work performed. Considering the extent of such measures, PEEC believes that the additional independence rules set forth in this interpretation are sufficient to ensure that attest services can be performed

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<sup>‡</sup> Terms shown in **boldface** type upon first usage in this interpretation are defined in ET section 92, *Definitions*. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

with objectivity and, therefore, the additional rules satisfactorily protect the public interest.

Rule 505 [ET section 505.01] and the following independence rules for an alternative practice structure (APS) are intended to be conceptual and applicable to all structures where the "traditional firm" engaged in attest services is closely aligned with another organization, public or private, that performs other professional services. The following paragraph and the chart below provide an example of a structure in use at the time this interpretation was developed. Many of the references in this interpretation are to the example. PEEC intends that the concepts expressed herein be applied, in spirit and in substance, to variations of the example structure as they develop.

The example APS in this interpretation is one where an existing CPA practice ("Oldfirm") is sold by its owners to another (possibly public) entity ("PublicCo"). PublicCo has subsidiaries or divisions such as a bank, insurance company or broker-dealer, and it also has one or more professional service subsidiaries or divisions that offer to clients nonattest professional services (e.g., tax, personal financial planning, and management consulting). The owners and employees of Oldfirm become employees of one of PublicCo's subsidiaries or divisions and may provide those nonattest services. In addition, the owners of Oldfirm form a new CPA firm ("Newfirm") to provide attest services. CPAs, including the former owners of Oldfirm, own a majority of Newfirm (as to vote and financial interests). Attest services are performed by Newfirm and are supervised by its owners. The arrangement between Newfirm and PublicCo (or one of its subsidiaries or divisions) includes the lease of employees, office space and equipment; the performance of back-office functions such as billing and collections; and advertising. Newfirm pays a negotiated amount for these services.

### **APS Independence Rules for Covered Members**

The term **covered member** in an APS includes both employed and leased individuals. The **firm** in such definition would be Newfirm in the example APS. All covered members, including the firm, are subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety. For example, no covered member may have, among other things, a direct financial interest in or a loan to or from an attest client of Newfirm.

**Partners** of one Newfirm generally would not be considered partners of another Newfirm except in situations where those partners perform services for the other Newfirm or where there are significant shared economic interests between partners of more than one Newfirm. If, for example, partners of Newfirm 1 perform services in Newfirm 2, such owners would be considered to be partners of both Newfirms for purposes of applying the independence rules.

### **APS Independence Rules for Persons and Entities Other Than Covered Members**

As stated above, the independence rules normally extend only to those persons and entities included in the definition of covered member. This normally would include only the "traditional firm" (Newfirm in the example APS), those covered members who own or are employed or leased by Newfirm, and entities controlled by one or more of such persons. Because of the close alignment in many APSs between persons and entities included in covered member and other persons and entities, to ensure the protection of the public interest, PEEC believes it appropriate to require restrictions in addition to those required in a traditional firm structure. Those restrictions are divided into two groups:

1. *Direct Superiors*. Direct Superiors are defined to include those persons so closely associated with a partner or manager who is a covered member, that such persons can *directly control* the activities of such partner or manager.

For this purpose, a person who can *directly control* is the immediate superior of the partner or manager who has the power to direct the activities of that person so as to be able to directly or indirectly (e.g. through another entity over which the Direct Superior can exercise significant influence<sup>35</sup>) derive a benefit from that person's activities. Examples would be the person who has day-to-day responsibility for the activities of the partner or manager and is in a position to recommend promotions and compensation levels. This group of persons is, in the view of PEEC, so closely aligned through direct reporting relationships with such persons that their interests would seem to be inseparable. *Consequently, persons considered Direct Superiors, and entities within the APS over which such persons can exercise significant influence<sup>36</sup> are subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.*

**2. Indirect Superiors and Other PublicCo Entities.** Indirect Superiors are those persons who are one or more levels above persons included in Direct Superior. Generally, this would start with persons in an organization structure to whom Direct Superiors report and go up the line from there. PEEC believes that certain restrictions must be placed on Indirect Superiors, but also believes that such persons are sufficiently removed from partners and managers who are covered persons to permit a somewhat less restrictive standard. Indirect Superiors are not connected with partners and managers who are covered members through direct reporting relationships; there always is a level in between. The PEEC also believes that, for purposes of the following, the definition of Indirect Superior also includes the **immediate family** of the Indirect Superior.

PEEC carefully considered the risk that an Indirect Superior, through a Direct Superior, might attempt to influence the decisions made during the engagement for a Newfirm attest client. PEEC believes that this risk is reduced to a sufficiently low level by prohibiting certain relationships between Indirect Superiors and Newfirm attest clients and by applying a materiality concept with respect to financial relationships. If the financial relationship is not material to the Indirect Superior, PEEC believes that he or she would not be sufficiently

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<sup>35</sup> For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 323-10-15 to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

<sup>36</sup> For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in FASB ASC 323-10-15 to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

financially motivated to attempt such influence particularly with sufficient effort to overcome the presumed integrity, objectivity and strength of character of individuals involved in the engagement.

Similar standards also are appropriate for Other PublicCo Entities. These entities are defined to include PublicCo and all entities consolidated in the PublicCo financial statements that are not subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.

The rules for Indirect Superiors and Other PublicCo Entities are as follows:

- A. Indirect Superiors and Other PublicCo Entities may *not* have a relationship contemplated by interpretation 101-1.A [ET section 101.02] (e.g., investments, loans, etc.) with an attest client of Newfirm that is material. In making the test for materiality for financial relationships of an Indirect Superior, all the financial relationships with an attest client held by such person should be aggregated and, to determine materiality, assessed in relation to the person's net worth. In making the materiality test for financial relationships of Other PublicCo Entities, all the financial relationships with an attest client held by such entities should be aggregated and, to determine materiality, assessed in relation to the consolidated financial statements of PublicCo. In addition, any Other PublicCo Entity over which an Indirect Superior has direct responsibility cannot have a financial relationship with an attest client that is material in relation to the Other PublicCo Entity's financial statements.
- B. Further, financial relationships of Indirect Superiors or Other PublicCo Entities should not allow such persons or entities to exercise significant influence<sup>37</sup> over the attest client. In making the test for significant influence, financial relationships of all Indirect Superiors and Other PublicCo Entities should be aggregated.
- C. Neither Other PublicCo Entities nor any of their employees may be connected with an attest client of Newfirm as a promoter, underwriter, voting trustee, director or officer.
- D. Except as noted in C above, Indirect Superiors and Other PublicCo Entities may provide services to an attest client of Newfirm that would impair independence if performed by Newfirm. For example, trustee and asset custodial services in the ordinary course of business by a bank subsidiary of PublicCo would be acceptable as long as the bank was not subject to rule 101 [ET section 101.01] and its interpretations and rulings in their entirety.

### Other Matters

1. An example, using the chart below, of the application of the concept of Direct and Indirect Superiors would be as follows: The chief executive of the

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<sup>37</sup> For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in FASB ASC 323-10-15 to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

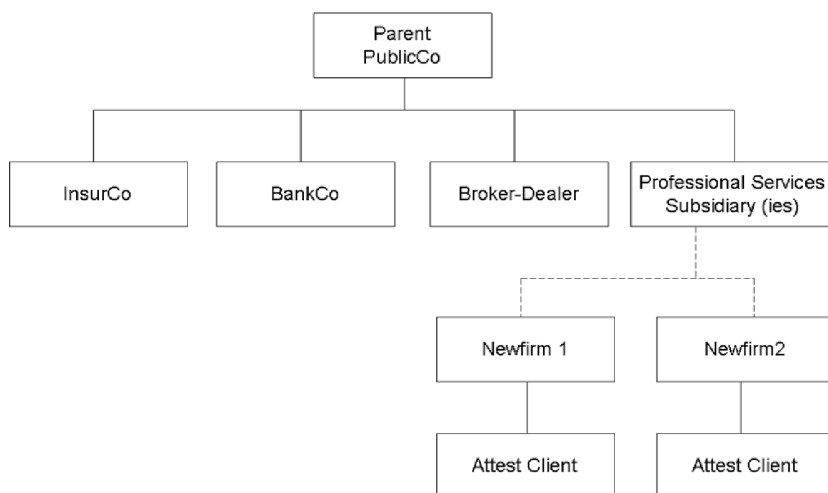
local office of the Professional Services Subsidiary (PSS), where the partners of Newfirm are employed, would be a Direct Superior. The chief executive of PSS itself would be an Indirect Superior, and there may be Indirect Superiors in between such as a regional chief executive of all PSS offices within a geographic area.

2. PEEC has concluded that Newfirm (and its partners and employees) may not perform an **attest engagement** for PublicCo or any of its subsidiaries or divisions.

3. PEEC has concluded that independence would be considered to be impaired with respect to an attest client of Newfirm if such attest client holds an investment in PublicCo that is material to the attest client or allows the attest client to exercise significant influence<sup>38</sup> over PublicCo.

4. When making referrals of services between Newfirm and any of the entities within PublicCo, a member should consider the provisions of Interpretation 102-2, *Conflicts of Interest* [ET section 102.03].

### Alternative Practice Structure (APS) Model



[Effective February 28, 1999; Revised, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

<sup>38</sup> For purposes of this Interpretation, significant influence means having the ability to exercise significant influence over the financial, operating or accounting policies of the entity, for example by (1) being connected with the entity as a promoter, underwriter, voting trustee, general partner or director, (2) being in a policy-making position such as chief executive officer, chief operating officer, chief financial officer or chief accounting officer, or (3) meeting the criteria in FASB ASC 323-10-15 to determine the ability of an investor to exercise such influence with respect to an entity. The foregoing examples are not necessarily all-inclusive. [Footnote added, November 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, September 2003. Footnote subsequently renumbered by the revision of interpretation 101-3, July 2004. Footnote subsequently renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007. Footnote revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

**.17 101-15—Financial relationships.****Financial Interests**

Interpretation 101-1 [ET section 101.02A.1] states that independence shall be considered to be impaired if, during the period of the professional engagement, a covered member had or was committed to acquire any direct or material indirect financial interest in the client. When reviewing this interpretation, the covered member should also refer to Interpretation 101-1 [ET section 101.02] for the application of rule 101 and its interpretations and rulings to the covered member's immediate family and close relatives.

This interpretation provides definitions of direct and indirect financial interests and further guidance on whether various types of financial interests should be considered to be direct or indirect financial interests and provides certain limited exceptions under which a covered member could hold a direct or material indirect financial interest in an attest client without being considered to have impaired his or her independence.

**Definitions**

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.

A **direct financial interest** is a financial interest:

1. Owned directly by an individual or entity (including those managed on a discretionary basis by others); or
2. Under the control<sup>39</sup> of an individual or entity (including those managed on a discretionary basis by others); or
3. Beneficially owned through an investment vehicle, estate, trust, or other intermediary when the beneficiary:
  - a. Controls the intermediary; or
  - b. Has the authority to supervise or participate in the intermediary's investment decisions.

An **indirect financial interest** is a financial interest beneficially owned through an investment vehicle, estate, trust, or other intermediary when 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** when 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.

**Unsolicited Financial Interests**

Independence would not be considered to be impaired if an unsolicited financial interest in a client is received, such as through gift or inheritance, and the financial interest is disposed of as soon as practicable, but no later than 30 days after the covered member has knowledge of and the right to dispose of the financial interest. In addition, when the covered member becomes aware

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<sup>39</sup> When used herein, the term *control* includes situations where the covered member, individually or acting together with his or her firm or with other partners or professional employees of his or her firm, has the ability to exercise such control. [Footnote renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007.]

that he or she will receive or has received a material direct or material indirect financial interest in a client requiring independence but does not have the right to dispose of the financial interest, independence would be considered to be impaired unless the covered member does not participate on the attest engagement team and disposes of the financial interest as soon as practicable but no later than 30 days after the right to dispose exists.

### **Mutual Funds**

The ownership of shares in a mutual fund is considered to be a direct financial interest in the mutual fund. The underlying investments of a mutual fund are considered to be indirect financial interests.

If the mutual fund is diversified,<sup>40</sup> a covered member's ownership of 5 percent or less of the outstanding shares of the mutual fund would not be considered to constitute a material indirect financial interest in the underlying investments.

If a covered member owns more than 5 percent of the outstanding shares of a diversified mutual fund, or if the mutual fund is not diversified, the covered member should evaluate the underlying investments of the mutual fund to determine whether the covered member holds a material indirect financial interest in any of the underlying investments.

For example, if a nondiversified mutual fund owns shares in attest client Company A, and

- The mutual fund's net assets are \$10,000,000;
- The covered member owns 1 percent of the outstanding shares of the mutual fund, having a value of \$100,000; and
- The mutual fund has 10 percent of its assets invested in Company A;

the indirect financial interest of the covered member in Company A is \$10,000 and this amount should be measured against the covered member's net worth (including the net worth of his or her immediate family) to determine if it is material.

### **Retirement, Savings, Compensation, or Similar Plans**

A covered member who participates in a retirement, savings, compensation, or similar plan is considered to have a direct financial interest in the plan.<sup>41</sup>

Investments held by a retirement, savings, compensation, or similar plan sponsored by a covered member's firm would be considered direct financial interests of the firm.

If a covered member controls a retirement, savings, compensation, or similar plan or has the ability to supervise or participate in the plan's investment decisions, the investments held by the plan would be considered direct financial

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<sup>40</sup> To determine if the mutual fund is diversified, the covered member should refer to (1) the mutual fund's prospectus to see if the prospectus discloses that the fund is *not* diversified or (2) Section 5(b)(1) of the Investment Company Act of 1940. [Footnote renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007.]

<sup>41</sup> A covered member who is an employee of a governmental organization that is required by law or regulation to audit a retirement plan sponsored by a governmental unit will be permitted to be a participant in the plan, provided the plan is offered to all employees in equivalent employment positions, and the covered member (1) is not associated with the plan in any capacity prohibited by interpretation 101-1.C; (2) has no influence or control over the investment strategy, benefits, or other management activities associated with the plan; and (3) is required to participate in the plan as a condition of employment. [Footnote renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007.]



interests of the covered member. Otherwise, the underlying plan investments would be considered indirect financial interests of the covered member.

Investments held in a defined benefit plan would not be considered financial interests of the covered member unless the covered member is a trustee of the plan or otherwise has the ability to supervise or participate in the plan's investment decisions because the benefits are not dependent upon investment performance.

The following examples illustrate these concepts:

1. If a covered member is a trustee of a retirement, savings, compensation, or similar plan or otherwise has the authority to supervise or participate in the plan's investment decisions, the underlying investments would be considered to be direct financial interests of the covered member.
2. If investments in a defined contribution plan are participant directed, whereby a covered member selects his or her underlying plan investments or selects from investment alternatives offered by the plan, the covered member would be considered to have a direct financial interest in those investments.
3. If investments in a defined contribution plan are not participant directed and the covered member has no authority to supervise or participate in the plan's investment decisions, the covered member would be considered to have an indirect financial interest in the underlying plan investments.

Also refer to ethics ruling No. 107, "Participation in Health and Welfare Plan Sponsored by Client" [ET section 191.214–.215], and Interpretation 101-1, *Interpretation of Rule 101* [ET section 101.02], subsections "Application of the Independence Rules to Covered Members Formerly Employed by a Client or Otherwise Associated With a Client," "Application of the Independence Rules to a Covered Member's Immediate Family," and "Application of the Independence Rules to Close Relatives."

### Section 529 Plans<sup>42</sup>

Section 529 plans are sponsored by states or higher education institutions, and may be prepaid tuition plans or savings plans. Both types of plans are established by an account owner for the benefit of a single beneficiary. The account owner may change the beneficiary at any time to another individual who is related to the previous beneficiary.

A covered member who is the account owner of a Section 529 prepaid tuition plan is considered to have a direct financial interest in the plan but not in the investments of the plan because the credits purchased represent an obligation of the state or educational institution to provide the education regardless of the investment performance of the plan or the cost of the education at the future date.

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<sup>42</sup> However, a covered member who is an employee of a governmental organization that is required by law or regulation to audit a Section 529 plan sponsored by a governmental unit will be permitted to be an account owner in the plan for a period not to exceed one year from the effective date of this Interpretation. [Footnote renumbered by the revision of interpretation 101-1, April 2006. Footnote subsequently renumbered by the revision of interpretation 101-3, February 2007 and July 2007.]

A covered member who is the account owner of a Section 529 savings plan is considered to have a direct financial interest in both the plan and the investments of the plan because he or she decides in which sponsor's Section 529 savings plan to invest and prior to making the investment has access to information about the plan's investments.

If a covered member invests in a Section 529 savings plan that does not hold financial interests in an attest client at the time of the investment, but the plan subsequently invests in an attest client, the covered member should (1) transfer the account to another sponsor's Section 529 savings plan or (2) transfer the account to another account owner who is not a covered member. However, when the transfer of the account will result in a penalty or tax that is significant to the account, the covered member may continue to own the account until the account can be transferred without significant penalty or tax, provided the covered member does not participate on the attest engagement team and is not in a position to influence the attest engagement.

A covered member who is a beneficiary of a Section 529 account is not considered to have a financial interest in the plan or the investments of the plan because he or she does not own the account or possess any of the underlying benefits of ownership and the beneficiary's only interest is to receive distributions from the account for qualified higher education expenses if and when they are authorized by the account owner.

Before becoming engaged to perform an attest engagement for a government or governmental entity that sponsors a Section 529 plan, covered members that are account owners of a Section 529 plan should consider the guidance in Interpretation 101-10, *The Effect on Independence of Relationships With Entities Included in the Governmental Financial Statements* [ET section 101.12].

### **Trust Investments**

When a covered member is a grantor of a trust, the trust and the underlying investments held by the trust are considered to be direct financial interests if the covered member retains the right to amend or revoke the trust, or otherwise has the authority to control the trust or to supervise or participate in the trust's investment decisions. However, where the covered member does not have the authority to amend or revoke the trust or to supervise or participate in the trust's investment decisions, he or she is not considered to have a financial interest in the trust or the underlying investments held by the trust.

When a covered member is a beneficiary of a trust, the trust is considered to be a direct financial interest of the covered member and the underlying investments held by the trust are considered to be indirect financial interests of the covered member. However, if the covered member controls the trust or supervises or participates in the investment decisions of the trust, the underlying investments held by the trust are considered to be direct financial interests of the covered member.

In a blind trust, the grantor is also the beneficiary, but does not supervise or participate in the trust's investment decisions during the term of the trust. However, the investments will ultimately revert to the grantor, and the grantor usually retains the right to amend or revoke the trust. Therefore, both the blind

trust and the underlying investments held in a blind trust are considered to be direct financial interests of the covered member.

See Interpretation 101-1 [ET section 101.02A.2] and ethics ruling No. 11 [ET section 191.021–.022] for additional guidance on trustee relationships.

### **Partnerships**

The ownership of a general or limited partnership interest is considered a direct financial interest in the partnership.

The financial interests held by a partnership are considered to be direct financial interests of a covered member that is a general partner because the covered member is in a position to control the partnership or to supervise or participate in the partnership's investment decisions.

The financial interests held by a limited partnership are considered to be indirect financial interests of a covered member who is a limited partner as long as the covered member does not control the partnership or supervise or participate in the partnership's investment decisions. However, if the covered member has the ability to replace the general partner or has the authority to supervise or participate in the partnership's investment decisions, the financial interests of the partnership would be considered to be direct financial interests of the covered member.

See Interpretation 101-1 [ET section 101.02A.3] for additional guidance on joint closely held investments and Interpretation 101-8 [ET section 101.10] for additional guidance on financial interests in nonclients having investor or investee relationships with a covered member.

### **Limited Liability Companies**

The ownership of an interest in a limited liability company (LLC) is considered a direct financial interest in the LLC.

In an LLC, members who are managers control the LLC and have the authority to supervise or participate in the LLC's investment decisions. Accordingly, if a covered member is a manager of the LLC, the financial interests of the LLC are considered to be direct financial interests of the covered member. If a covered member is a member but not a manager of the LLC, the covered member should look to the operating agreement of the LLC to determine whether he or she can control the LLC or has the authority to supervise or participate in the investment decisions of the LLC. If the covered member does not control the LLC, or have the authority to supervise or participate in the LLC's investment decisions, the financial interests held by the LLC would be considered to be indirect financial interests of the covered member.

### **Insurance Products**

An insurance policy obtained from a stock or mutual insurance company that does not offer the policy holder an investment option is not considered to be a financial interest. Accordingly, if a covered member owns an insurance policy issued by an attest client, independence is not considered to be impaired, provided the policy does not offer the policy holder an investment option and the policy was purchased under the insurance company's normal terms, procedures, and requirements. If a mutual insurance company begins the

demutualization process, covered members who hold an insurance policy from the company should refer to the guidance contained in the "Unsolicited Financial Interests" section of this Interpretation.

Some insurance policies offer an investment option whereby the policy owner may choose to invest part of the cash value in a variety of underlying investments. The underlying investments of this type of insurance policy are considered to be a financial interest, and the covered member should apply the guidance in this interpretation to determine whether the underlying investments are direct or indirect financial interests. For example, if the covered member has the ability to select the underlying investments or the authority to supervise or participate in the investment decisions and the cash value of the insurance policy is invested in a mutual fund, the mutual fund is considered to be a direct financial interest and the underlying investments of the mutual fund are considered to be indirect financial interests.

See Interpretation 101-1 [ET section 101.02A.3] for additional guidance on joint closely held investments and Interpretation 101-8 [ET section 101.10] for additional guidance on financial interests in nonclients having investor or investee relationships with a covered member.

[Effective December 31, 2005.]

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## ET Section 102

### *Integrity and Objectivity*

**.01 Rule 102—Integrity and objectivity** In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

[As adopted January 12, 1988.]

#### *Interpretations under Rule 102—Integrity and Objectivity*

**.02 102-1—Knowing misrepresentations in the preparation of financial statements or records** A member shall be considered to have knowingly misrepresented facts in violation of rule 102 [ET section 102.01] when he or she knowingly—

- a. Makes, or permits or directs another to make, materially false and misleading entries in an entity's financial statements or records; or
- b. Fails to correct an entity's financial statements or records that are materially false and misleading when he or she has the authority to record an entry; or
- c. Signs, or permits or directs another to sign, a document containing materially false and misleading information.

[Revised, effective May 31, 1999, by the Professional Ethics Executive Committee.]

**.03 102-2—Conflicts of interest** A conflict of interest may occur if a member performs a professional service for a client or employer and the member or his or her firm has a relationship with another person, entity, product, or service that could, in the member's professional judgment, be viewed by the client, employer, or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, the rule shall not operate to prohibit the performance of the professional service. When making the disclosure, the member should consider Rule 301, *Confidential Client Information* [ET section 301.01].

Certain professional engagements, such as audits, reviews, and other attest services, require independence. Independence impairments under rule 101 [ET section 101.01], its interpretations, and rulings cannot be eliminated by such disclosure and consent.

The following are examples, not all-inclusive, of situations that should cause a member to consider whether or not the client, employer, or other appropriate parties could view the relationship as impairing the member's objectivity:

- A member has been asked to perform litigation services for the plaintiff in connection with a lawsuit filed against a client of the member's firm.

- A member has provided tax or personal financial planning (PFP) services for a married couple who are undergoing a divorce, and the member has been asked to provide the services for both parties during the divorce proceedings.
- In connection with a PFP engagement, a member plans to suggest that the client invest in a business in which he or she has a financial interest.
- A member provides tax or PFP services for several members of a family who may have opposing interests.
- A member has a significant financial interest, is a member of management, or is in a position of influence in a company that is a major competitor of a client for which the member performs management consulting services.
- A member serves on a city's board of tax appeals, which considers matters involving several of the member's tax clients.
- A member has been approached to provide services in connection with the purchase of real estate from a client of the member's firm.
- A member refers a PFP or tax client to an insurance broker or other service provider, which refers clients to the member under an exclusive arrangement to do so.
- A member recommends or refers a client to a service bureau in which the member or partner(s) in the member's firm hold material financial interest(s).

The above examples are not intended to be all-inclusive.

[Replaces previous interpretation 102-2, *Conflicts of Interest*, August 1995, effective August 31, 1995.]

**.04 102-3—Obligations of a member to his or her employer's external accountant** Under rule 102 [ET section 102.01], a member must maintain objectivity and integrity in the performance of a professional service. In dealing with his or her employer's external accountant, a member must be candid and not knowingly misrepresent facts or knowingly fail to disclose material facts. This would include, for example, responding to specific inquiries for which his or her employer's external accountant requests written representation.

[Effective November 30, 1993.]

**.05 102-4—Subordination of judgment by a member** Rule 102 [ET section 102.01] prohibits a member from knowingly misrepresenting facts or subordinating his or her judgment when performing professional services. Under this rule, if a member and his or her supervisor have a disagreement or dispute relating to the preparation of financial statements or the recording of transactions, the member should take the following steps to ensure that the situation does not constitute a subordination of judgment:<sup>1</sup>

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<sup>1</sup> A member in the practice of public accounting should refer to the Statements on Auditing Standards. For example, see SAS No. 22, *Planning and Supervision* [AU section 311], which discusses what the auditor should do when there are differences of opinion concerning accounting and auditing standards.

1. The member should consider whether (a) the entry or the failure to record a transaction in the records, or (b) the financial statement presentation or the nature or omission of disclosure in the financial statements, as proposed by the supervisor, represents the use of an acceptable alternative and does not materially misrepresent the facts. If, after appropriate research or consultation, the member concludes that the matter has authoritative support and/or does not result in a material misrepresentation, the member need do nothing further.
2. If the member concludes that the financial statements or records could be materially misstated, the member should make his or her concerns known to the appropriate higher level(s) of management within the organization (for example, the supervisor's immediate superior, senior management, the audit committee or equivalent, the board of directors, the company's owners). The member should consider documenting his or her understanding of the facts, the accounting principles involved, the application of those principles to the facts, and the parties with whom these matters were discussed.
3. If, after discussing his or her concerns with the appropriate person(s) in the organization, the member concludes that appropriate action was not taken, he or she should consider his or her continuing relationship with the employer. The member also should consider any responsibility that may exist to communicate to third parties, such as regulatory authorities or the employer's (former employer's) external accountant. In this connection, the member may wish to consult with his or her legal counsel.
4. The member should at all times be cognizant of his or her obligations under interpretation 102-3 [ET section 102.04].

[Effective November 30, 1993.]

**.06 102-5—Applicability of rule 102 to members performing educational services** Educational services (for example, teaching full- or part-time at a university, teaching a continuing professional education course, or engaging in research and scholarship) are professional services as defined in ET section 92.11, and are therefore subject to rule 102 [ET section 102.01]. Rule 102 [ET section 102.01] provides that the member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others.

[Effective March 31, 1995.]

**.07 102-6—Professional services involving client advocacy** A member or a member's firm may be requested by a client—

1. To perform tax or consulting services engagements that involve acting as an advocate for the client.
2. To act as an advocate in support of the client's position on accounting or financial reporting issues, either within the firm or outside the firm with standard setters, regulators, or others.

Services provided or actions taken pursuant to such types of client requests are professional services [ET section 92.11] governed by the Code of Professional Conduct and shall be performed in compliance with Rule 201, *General Standards* [ET section 201.01], Rule 202, *Compliance With Standards* [ET section 202.01], and Rule 203, *Accounting Principles* [ET section 203.01], and



interpretations thereof, as applicable. Furthermore, in the performance of any professional service, a member shall comply with rule 102 [ET section 102.01], which requires maintaining objectivity and integrity and prohibits subordination of judgment to others. When performing professional services requiring independence, a member shall also comply with rule 101 [ET section 101.01] of the Code of Professional Conduct.

Moreover, there is a possibility that some requested professional services involving client advocacy may appear to stretch the bounds of performance standards, may go beyond sound and reasonable professional practice, or may compromise credibility, and thereby pose an unacceptable risk of impairing the reputation of the member and his or her firm with respect to independence, integrity, and objectivity. In such circumstances, the member and the member's firm should consider whether it is appropriate to perform the service.

[Effective August 31, 1995.]

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## ET Section 191

# *Ethics Rulings on Independence, Integrity, and Objectivity*

### [1.] Acceptance of a Gift

[.001–.002] [Deleted January 2006]

### 2. Association Membership

**.003** *Question*—Would independence be considered to be impaired if a member joined a trade association that is a client of the firm?

**.004** *Answer*—Independence would not be considered to be impaired provided the member did not serve as an officer, director, or in any capacity equivalent to that of a member of management.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

### [3.] Member as Signer or Cosigner of Checks

[.005–.006] [Deleted May 1999]

### [4.] Payroll Preparation Services

[.007–.008] [Deleted May 1999]

### [5.] Member as Bookkeeper

[.009–.010] [Deleted June 1991]

### [6.] Member's Spouse as Accountant of Client

[.011–.012] [Deleted November 2001]

### [7.] Member Providing Contract Services

[.013–.014] [Deleted May 1999]

### 8. Member Providing Advisory Services

**.015** *Question*—A member provides extensive advisory services for a client. In that connection, the member attends board meetings, interprets financial statements, forecasts and other analyses, counsels on potential expansion plans and on banking relationships. Would independence be considered to be impaired under these circumstances?

**.016** *Answer*—Independence would not be considered to be impaired because the member's role is advisory in nature.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## 9. Member as Representative of Creditor's Committee

**.017 Question**—A member performs the following functions for a creditors' committee in control of a debtor corporation which will continue to operate under its existing management subject to extension agreements:

- Signs or co-signs checks issued by the debtor corporation.
- Signs or co-signs purchase orders in excess of established minimum amounts.
- Exercises general supervision to insure compliance with budgetary controls and pricing formulas established by management, with the consent of the creditors, as part of an overall program aimed at the liquidation of deferred indebtedness.

Would independence be considered to be impaired with respect to the debtor corporation?

**.018 Answer**—Independence would be considered to be impaired if *any* partner or professional employee of the firm performed any of the functions described, since these are considered to be management functions.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## 10. Member as Legislator

**.019 Question**—A member is an elected legislator in a local government (a city). The city manager, who is responsible for all administrative functions, is also an elected official. Would independence be considered to be impaired with respect to the city?

**.020 Answer**—Independence would be considered to be impaired if *any* partner or professional employee of the firm served as an elected legislator for a city at the same time his or her firm was engaged to perform the city's attest engagement, even though the city manager is an elected official rather than an appointee of the legislature.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## 11. Member Designated to Serve as Executor or Trustee

**.021 Question**—A member has been designated to serve as an executor or trustee of the estate of an individual who owns the majority of a client's stock. Would independence be considered to be impaired with respect to the client?

**.022 Answer**—The mere designation of a *covered* member as executor or trustee would not be considered to impair independence, however, if a covered member actually served in such capacity, independence would be considered to be impaired.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## 12. Member as Trustee of Charitable Foundation

**.023 Question**—A charitable foundation is the sole beneficiary of the estate of the foundation's deceased organizer. If a member becomes a trustee of the foundation, would independence be considered to be impaired with respect to (1) the foundation or (2) the estate?

**.024 Answer**—If a *covered* member served as trustee of the foundation, independence would be considered to be impaired with respect to both the foundation and the estate.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## [13.] Member as Bank Stockholder

[.025–.026] [Deleted November 1993]

## 14. Member on Board of Federated Fund-Raising Organization

**.027 Question**—A member serves as a director or officer of a United Way or similar federated fund-raising organization (the organization). Certain local charities receive funds from the organization. Would independence be considered to be impaired with respect to such charities?

**.028 Answer**—Independence would be considered to be impaired if *any* partner or professional employee of the firm served as a director or officer of the organization and the organization exercised managerial control over the local charities. (See ethics ruling No. 93 [ET section 191.186–.187] under rule 101 [ET section 101.01] for additional guidance.)

[Replaces previous ruling No. 14, *Member on Board of Directors of United Fund*, April 1991. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## [15.] Retired Partner as Director

[.029–.030] [Deleted June 1991]

## 16. Member on Board of Directors of Nonprofit Social Club

**.031 Question**—Would independence be considered to be impaired if a member served on the board of directors of a nonprofit social club?

**.032 Answer**—Independence would be considered to be impaired if *any* partner or professional employee of the firm served on the board of directors since the board has ultimate responsibility for the club's affairs.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## 17. Member of Social Club

**.033 Question**—Would independence be considered to be impaired if a member belongs to a social club (for example, country club, tennis club) that requires him or her to acquire a pro rata share of the club's equity or debt securities?

**.034 Answer**—As long as membership in a club is essentially a social matter, a *covered* member's association with the club would not impair independence because such equity or debt ownership would not be considered to be a direct financial interest within the meaning of rule 101 [ET section 101.01]. Also see interpretation 101-1.C [ET section 101.02].

[Replaces previous ruling No. 17, *Member as Stockholder in Country Club*, February 1991. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## **[18.] Member as City Council Chairman**

[.035–.036] [Deleted June 1991]

## **19. Member on Deferred Compensation Committee**

**.037 Question**—Would independence be considered to be impaired if a member served on a committee that administers a client's deferred compensation program?

**.038 Answer**—Independence would be considered to be impaired if *any* partner or professional employee of the firm served on the committee since such service constitutes participation in the client's management functions. The partner or professional employee could however render consulting assistance without joining the committee.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## **20. Member Serving on Governmental Advisory Unit**

**.039 Question**—A member serves on a citizens' committee which is studying possible changes in the form of a county government that the firm audits. The member also serves on a committee appointed to study the financial status of a state. Would independence be considered to be impaired with respect to a county in that state?

**.040 Answer**—Independence would not be considered to be impaired with respect to the county through the member's service on either committee.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## **21. Member as Director and Auditor of an Entity's Profit Sharing and Retirement Trust**

**.041 Question**—A member serves in the dual capacity of director of an entity and auditor of the financial statements of that entity's profit sharing and retirement trust (the trust). Would independence be considered to be impaired with respect to the trust?

**.042 Answer**—Service as director of an entity constitutes participation in management functions that affect the entity's trust. Accordingly, independence would be considered to be impaired if *any* partner or professional of the firm served in such capacity.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

**[22.] Family Relationship, Brother**

[.043-.044] [Deleted June 1991]

**[23.] Family Relationship, Uncle by Marriage**

[.045-.046] [Deleted June 1991]

**[24.] Family Relationship, Father**

[.047-.048] [Deleted June 1991]

**[25.] Family Relationship, Son**

[.049-.050] [Deleted June 1991]

**[26.] Family Relationship, Son**

[.051-.052] [Deleted June 1991]

**[27.] Family Relationship, Spouse as Trustee**

[.053-.054] [Deleted June 1991]

**[28.] Cash Account With Brokerage Client**

[.055-.056] [Superseded by ethics ruling No. 59.]

**29. Member as Bondholder**

**.057 Question**—Would independence be considered to be impaired if a member owned an immaterial amount of a municipal authority's outstanding bonds?

**.058 Answer**—Ownership of a client's bonds constitute a loan to that client. Accordingly, if a *covered* member owned such bonds, independence would be considered to be impaired.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

**[30.] Financial Interest by Employee**

[.059-060] [Deleted July 1979]

**31. Performance of Services for Common Interest Realty Associations (CIRAs), Including Cooperatives, Condominium Associations, Planned Unit Developments, Homeowners Associations, and Timeshare Developments**

**.061 Question**—A member belongs to a common interest realty association (CIRA) as the result of the ownership or lease of real estate. Would independence be considered to be impaired with respect to the CIRA?

**.062 Answer**—Independence would be considered to be impaired if a *covered* member was a member of a CIRA unless all of the following conditions are met:

- a. The CIRA performs functions similar to local governments, such as public safety, road maintenance, and utilities.
- b. The covered member's annual assessment is not material to either the covered member or the CIRA's operating budgeted assessments.
- c. The liquidation of the CIRA or the sale of common assets would not result in a distribution to the covered member.
- d. The CIRA's creditors would not have recourse to the covered member's assets if the CIRA became insolvent.

Also see interpretation 101-1.C [ET section 101.02] for additional restrictions related to associations with a client.

If the member has a relationship with a real estate developer or management company that is associated with the CIRA, see interpretation 102-2 [ET section 102.03] for guidance.

[Revised, effective May 31, 1998, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

### **[32.] Mortgage Loan to Member's Corporation**

[.063–.064] [Deleted December 1991]

### **[33.] Member as Participant in Employee Benefit Plan**

[.065–.066] [Deleted May 1998]

### **[34.] Member as Auditor of Common Trust Funds**

[.067–.068] [Deleted February 1991]

### **[35.] Stockholder in Mutual Funds**

[.069–.070] [Deleted December 2005]

### **[36.] Participant in Investment Club**

[.071–.072] [Deleted December 2005]

### **[37.] Retired Partners as Co-Trustee**

[.073–.074] [Deleted November 1980]

## **38. Member as Co-Fiduciary With Client Bank**

**.075 Question**—A member serves with a client bank in a co-fiduciary capacity with respect to an estate or trust. Would independence be considered to be impaired with respect to the bank or the bank's trust department?

**.076 Answer**—Independence would not be considered to be impaired provided the assets in the estate or trust were not material to the total assets of the bank and/or the bank's trust department.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

**[39.] Member as Officially Appointed Stock Transfer Agent or Registrar**

[.077-.078] [Deleted May 1999]

**[40.] Controller Entering Public Practice**

[.079-.080] [Deleted June 1979]

**41. Financial Services Company Client Has Custody of a Member's Assets**

**.081 Question**—A financial services company client (for example, insurance company, investment adviser, broker-dealer, bank, or other depository institution) has custody of a member's assets (other than depository accounts), including retirement plan assets. Would independence be considered to be impaired?

**.082 Answer**—If a covered member's assets were held by a financial services company client, independence would not be considered to be impaired provided the services were rendered under the company's normal terms, procedures, and requirements and any of the covered member's assets subject to the risk of loss were immaterial to the covered member's net worth. Risk of loss may include losses arising from the bankruptcy of or defalcation by the client but would exclude losses due to a market decline in the value of the assets. When considering the materiality of assets subject to the risk of loss, the covered member should consider the following:

- Protection provided by state or federal regulators (for example, state insurance funds)
- Private insurance or other forms of protection (for example, the Securities Investor Protection Corporation) obtained by the financial services company to protect the assets
- Protection from creditors (for example, assets held in a pooled separate account)

For guidance dealing with depository accounts, see ethics ruling No. 70 [ET section 191.140 and .141].

[Replaces previous ruling No. 41, *Member as Auditor of Mutual Insurance Company*, November, 1990. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, effective March 31, 2003, by the Professional Ethics Executive Committee.]

**[42.] Member as Life Insurance Policy Holder**

[.083-.084] [Deleted April 1991]

**[43.] Member's Employee as Treasurer of a Client**

[.085-.086] [Deleted June 1991]

**[44.] Past Due Billings**

[.087-.088] [Superseded by ethics ruling No. 52.]



**[45.] Past Due Fees: Client in Bankruptcy**

[.089–.090] [Deleted November 1990]

**[46.] Member as General Counsel**

[.091–.092] [Superseded by ethics ruling No. 51.]

**[47.] Member as Auditor of Mutual Fund and Shareholder of Investment Advisor/Manager**

[.093–.094] [Deleted February 1991]

**48. Faculty Member as Auditor of a Student Fund**

**.095 Question**—A full or part-time faculty member employed by a university is asked to audit the financial statements of the Student Senate Fund. The university:

1. Acts as a collection agent for student fees and remits them to the Student Senate.
2. Requires that a university administrator approve and sign Student Senate checks.

Would independence be considered to be impaired under these circumstances?

**.096 Answer**—Independence would be considered to be impaired with respect to the Student Senate Fund if *any* partner or professional employee (individual) performed the functions described since the individual would be auditing several of the management functions performed by the university, the individual's employer.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

**[49.] Investor and Investee Companies**

[.097–.098] [Superseded by interpretation 101-8.]

**[50.] Family Relationship, Brother-in-Law**

[.099–.100] [Deleted June 1983]

**[51.] Member Providing Legal Services**

[.101–.102] [Deleted May 1999]

**52. Unpaid Fees**

**.103 Question**—A client of the member's firm has not paid fees for previously rendered professional services. Would independence be considered to be impaired for the current year?

**.104 Answer**—Independence is considered to be impaired if, when the report on the client's current year is issued, billed or unbilled fees, or a note receivable arising from such fees, remain unpaid for any professional services provided more than one year prior to the date of the report.

This ruling does not apply to fees outstanding from a client in bankruptcy. [Replaces previous ruling No. 52, *Past Due Fees*, November 1990. Revised, effective November 30, 1997, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

**[53.] Member as Auditor of Employee Benefit Plan and Sponsoring Company**

[.105–.106] [Deleted June 1991]

**[54.] Member Providing Appraisal, Valuation, or Actuarial Services**

[.107–.108] [Deleted May 1999]

**[55.] Independence During Systems Implementation**

[.109–.110] [Deleted May 1999]

**[56.] Executive Search**

[.111–.112] [Deleted May 1999]

**[57.] MAS Engagement to Evaluate Service Bureaus**

[.113–.114] [Deleted August 1995]

**[58.] Member as Lessor**

[.115–.116] [Deleted May 1998]

**[59.] Account With Brokerage Client**

[.117–.118] [Deleted November 1987]

**60. Employee Benefit Plans—Member’s Relationships Withbreak; Participating Employer**

**.119 Question**—A member has been asked to audit the financial statements of an employee benefit plan (“the plan”) that may have one or more participating employer(s). Would independence be considered to be impaired with respect to the plan if the member had financial or other relationships with a participating employer(s)?

**.120 Answer**—Independence would be considered to be impaired with respect to the plan if *any* partner or professional employee of the firm had significant influence over such employer, was in a key position with the employer, or was associated with the employer as a promoter, underwriter, or voting trustee.

When auditing plans subject to the Employee Retirement Income Security Act of 1974 (ERISA), Department of Labor (DOL) regulations must be followed.<sup>1</sup>

[Replaces previous ruling No. 60, *Employee Benefit Plans—Member’s Relationships With Participating Employer(s)*, November 1993. Revised, effective November 30, 2001, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

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<sup>1</sup> Currently, DOL regulations are more restrictive than the position taken in this ruling.

**[61.] Participation of Member's Spouse in Client's Stock Ownership Plans (Including an ESOP)**

[.121–.122] [Deleted May 1998]

**[62.] Member and Client Are Limited Partners in a Limited Partnership**

[.123–.124] [Deleted April 1991]

**[63.] Review of Prospective Financial Information—Member's Independence of Promoters**

[.125–.127] [Deleted August 1992]

**64. Member Serves on Board of Organization for Which Client Raises Funds**

**.128 Question**—A member serves on the board of directors of an organization. A fund-raising foundation functions solely to raise funds for that organization. Would independence be considered to be impaired with respect to the fund-raising foundation?

**.129 Answer**—Independence would be considered to be impaired with respect to the fund-raising foundation if *any* partner or professional employee of the firm served on the organization's board of directors. However, if the directorship were clearly honorary (in accordance with ET section 101.06, *Honorary directorships and trusteeships of not-for-profit organization*), independence would not be considered to be impaired.

[Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

**65. Use of the CPA Designation by Member Not in Public Practice**

**.130 Question**—A member who is not in public practice wishes to use his or her CPA designation in connection with financial statements and correspondence of the member's employer. The member also wants to use the CPA designation along with employment title on business cards. Is it permissible for the member to use the CPA designation in these manners?

**.131 Answer**—Yes. However, if the member uses the CPA designation in a manner to imply that he or she is independent of the employer, the member would be knowingly misrepresenting facts in violation of rule 102 [ET section 102.01]. Therefore, it is advisable that in any transmittal within which the member uses his or her CPA designation, he or she clearly indicate the employment title. In addition, if the member states affirmatively in any transmittal that a financial statement is presented in conformity with generally accepted accounting principles, the member is subject to rule 203 [ET section 203.01].

[Replaces previous ruling No. 65, *Use of the CPA Designation by Member Not in Public Practice*, February 1996, effective February 29, 1996.]

**[66.] Member's Retirement or Savings Plan Has Financial Interest in Client**

[.132–.133] [Deleted December 2005]

**67. Servicing of Loan**

**.134 Question**—Would the mere servicing of a loan by a client financial institution impair independence with respect to the client?

**.135 Answer**—No.

[Replaces previous ruling No. 67, *Servicing of Loan*, November 1993. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

**[68.] Blind Trust**

[.136–.137] [Deleted December 2005]

**69. Investment With a General Partner**

**.138 Question**—A private, closely held entity is the general partner and controls (as defined in Generally Accepted Accounting Principles) limited partnership A. The member has a material financial interest in limited partnership A. The member's firm has been asked to perform an attest engagement for a new limited partnership (B), which has the same general partner as limited partnership A. Would independence be considered to be impaired with respect to limited partnership B?

**.139 Answer**—Because the general partner has control over limited partnership A, the *covered* member would be considered to have a joint closely held investment with the general partner, who has significant influence over limited partnership B, the proposed client. Accordingly, independence would be considered to be impaired with respect to limited partnership B if the covered member had a material investment in limited partnership A.

[Replaces previous ruling No. 69, *Joint Investment With a Promoter and/or General Partner*, April 1991, effective April 30, 1991. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

**70. Member's Depository Relationship With Client Financial Institution**

**.140 Question**—A member maintains checking or savings accounts, certificates of deposit, or money market accounts at a client financial institution. Would these depository relationships impair independence?

**.141 Answer**—If an individual is a covered member, independence would not be considered to be impaired provided that—

- The checking accounts, savings accounts, certificates of deposit, or money market accounts were fully insured by the appropriate state or federal government deposit insurance agencies or by any other insurer; or
- The uninsured amounts, in the aggregate, were not material to the net worth of the covered member. (When insured amounts were considered material, independence would not be considered impaired provided the uninsured balance was reduced to an immaterial amount no later than 30 days from the date the uninsured amount becomes material.)

A firm's depository relationship would not impair its independence provided that the likelihood of the financial institution experiencing financial difficulties was considered to be remote.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, effective March 31, 2003, by the Professional Ethics Executive Committee.]

### 71. Use of Nonindependent CPA Firm on an Engagement

**.142 Question**—Firm A is not independent with respect to a client. Partners or professional employees of Firm A are participating on Firm B's attest engagement team for that client. Would Firm B's independence be considered to be impaired?

**.143 Answer**—Yes. The use by Firm B of partners or professional employees from Firm A as part of the attest engagement team would impair Firm B's independence with respect to that engagement.

However, use of the work of such individuals in a manner similar to internal auditors is permissible provided that there is compliance with the Statements on Auditing Standards. Applicable literature contained in the Statements on Auditing Standards should be consulted.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

### 72. Member on Advisory Board of Client

**.144 Question**—Would service on a client's advisory board impair independence?

**.145 Answer**—Independence would be considered to be impaired if *any* partner or professional employee of the firm served on the advisory board unless all the following criteria are met: (1) the responsibilities of the advisory board are in fact advisory in nature; (2) the advisory board has no authority to make nor does it appear to make management decisions on behalf of the client; and (3) the advisory board and those having authority to make management decisions (including the board of directors or its equivalent) are distinct groups with minimal, if any, common membership.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

### [73.] Meaning of the Period of a Professional Engagement

[.146–.147] [Deleted February 1998]

### 74. Audits, Reviews, or Compilations and a Lack of Independence

**.148 Question**—If a member or his or her firm is not independent with respect to a client, is it permissible to issue an audit, review, or compilation report for that client?

**.149 Answer**—A member or his or her firm may not issue an audit or review report if not independent of the client. A compilation report may be issued provided that the report specifically discloses the lack of independence without giving reasons for the impairment.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

### 75. Membership in Client Credit Union

**.150 Question**—Does membership in a client credit union impair independence?

**.151** *Answer*—A *covered* member's association with a client credit union would not impair independence provided all of the following criteria are met:

1. The covered member individually qualifies to join the credit union (other than by virtue of the professional services provided to the client).
2. Any loans from the credit union to the covered member meet the conditions specified in interpretation 101-1.A.4 [ET section 101.02] and are made under normal lending procedures, terms, and requirements (see interpretation 101-5 [ET section 101.07]).
3. Any deposits with the credit union meet the conditions specified in ruling No. 70 [ET section 191.140–.141] under rule 101 [ET section 101.01].

Partners and professional employees may be subject to additional restrictions as described in interpretation 101-1.B [ET section 101.02].

[Effective February 28, 1992, earlier application is encouraged. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

#### **[76.] Guarantee of Loan**

[.152–.153] [Deleted December 1991]

#### **[77.] Individual Considering or Accepting Employment With the Client**

[.154–.155] [Deleted April 2003]

#### **[78.] Service on Governmental Board**

[.156–.157] [Deleted August 1995]

#### **[79.] Member's Investment in a Partnership That Invests in Client**

[.158–.159] [Deleted December 2005]

#### **[80.] The Meaning of a Joint Closely Held Business Investment**

[.160–.161] [Deleted November 2001]

#### **81. Member's Investment in a Limited Partnership**

**.162** *Question*—A member is a limited partner in a limited partnership (LP), including a master limited partnership. A client is a general partner in the same LP. Is independence considered to be impaired with respect to (1) the LP, (2) the client, and (3) any subsidiaries of the LP?

**.163** *Answer*— **1.** A *covered* member's limited partnership interest in the LP is a direct financial interest in the LP that would impair independence under interpretation 101-1.A.1 [ET section 101.02].

2. The LP is an investee of the client because the client is a general partner in the LP. Therefore, under interpretation 101-8 [ET section 101.10], if the investment in the LP were material to the client, a *covered* member's financial interest in the LP would impair independence. However, if the client's financial interest in the LP were not material to the client, a *covered* member's immaterial financial interest in the LP would not impair independence.

3. If the *covered* member is a limited partner in the LP, the covered member is considered to have an indirect financial interest in all subsidiaries of the LP. If the indirect financial interest in the subsidiaries were material to the covered member, independence would be considered to be impaired with respect to those subsidiaries under interpretation 101-1.A.1 [ET section 101.02].

If the covered member or client general partner, individually or together can control the LP, the LP would be considered a joint closely held investment under ET section 92.16.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## 82. Campaign Treasurer

**.164 Question**—A member serves as the campaign treasurer of a mayoral candidate. Would independence be considered to be impaired with respect to (1) the political party with which the candidate is associated, (2) the municipality of which the candidate may become mayor, or (3) the campaign organization?

**.165 Answer**—Independence would not be considered to be impaired with respect to the political party or municipality. However, if *any* partner or professional employee of the firm served as campaign treasurer, independence would be considered to be impaired with respect to the campaign organization.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## [83.] Member on Board of Component Unit and Auditor of Oversight Entity

[.166–.167] [Deleted January 1996]

## [84.] Member on Board of Material Component Unit and Auditor of Another Material Component Unit

[.168–.169] [Deleted January 1996]

## 85. Bank Director

**.170 Question**—May a member in public practice serve as a director of a bank?

**.171 Answer**—Yes; however, before accepting a bank directorship, the member should carefully consider the implications of such service if the member has clients that are customers of the bank.

These implications fall into two categories:

- a. Confidential Client Information—Rule 301 [ET section 301.01] provides that a member in public practice shall not disclose any confidential client information without the specific consent of the client. This ethical requirement applies even though failure to disclose information may constitute a breach of the member's fiduciary responsibility as a director.
- b. Conflicts of Interest—Interpretation 102-2 [ET section 102.03] provides that a conflict of interest may occur if a member performs a professional service (including service as a director) and the member or his or her firm has a relationship with another entity that could, in the member's professional judgment, be viewed by appropriate parties as impairing the member's objectivity. If the member believes that the

professional service can be performed with objectivity and the relationship is disclosed to and consent is obtained from all appropriate parties, performance of the service shall not be prohibited.

In view of the above factors, it is generally not desirable for a member in public practice to accept a position as bank director where the member's clients are likely to engage in significant transactions with the bank. If a member is engaged in public practice, the member should avoid the high probability of a conflict of interest and the appearance that the member's fiduciary obligations and responsibilities to the bank may conflict with or interfere with the member's ability to serve the client's interest objectively and in complete confidence.

The general knowledge and experience of CPAs in public practice may be very helpful to a bank in formulating policy matters and making business decisions; however, in most instances, it would be more appropriate for the member as part of the member's public practice to serve as a consultant to the bank's board. Under such an arrangement, the member could limit activities to those which did not involve conflicts of interest or confidentiality problems.

### **[86.] Partially Secured Loans**

[.172–.173] [Deleted February 1998]

### **[87.] Loan Commitment or Line of Credit**

[.174–.175] [Deleted February 1998]

### **[88.] Loans to Partnership in Which Members Are Limited Partners**

[.176–.177] [Deleted February 1998]

### **[89.] Loan to Partnership in Which Members Are General Partners**

[.178–.179] [Deleted February 1998]

### **[90.] Credit Card Balances and Cash Advances**

[.180–.181] [Deleted February 1998]

## **91. Member Leasing Property to or From a Client**

**.182 Question**—Would independence be considered to be impaired if a member leased property to or from a client?

**.183 Answer**—Independence would not be considered to be impaired if the lease meets the criteria of an operating lease (as described in Generally Accepted Accounting Principles), the terms and conditions set forth in the lease agreement are comparable with other leases of a similar nature, and all amounts are paid in accordance with the terms of the lease.

Independence would be considered to be impaired if a *covered* member had a lease that meets the criteria of a capital lease (as described in Generally Accepted Accounting Principles) unless the lease is in compliance with interpretations 101-1.A.4 [ET section 101.02] and 101-5 [ET section 101.07], because the lease would be considered to be a loan to or from the client.

[Revised, effective May 31, 1998, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]



**92. Joint Interest in Vacation Home**

**.184 Question**—A member has a joint interest in a vacation home with a client (or one of the client's officers or directors, or any owner who has the ability to exercise significant influence over the client). Would the vacation home constitute a "joint closely held investment" as defined in ET section 92.16?

**.185 Answer**—Yes. The vacation home, even if solely intended for the personal use of the owners, would be considered a joint closely held investment as defined in ET section 92.16 if it meets the criteria described in the aforementioned definition.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

**93. Service on Board of Directors of Federated Fund-Raising Organization**

**.186 Question**—A member serves as a director or officer of a local United Way or similar organization that operates as a federated fund-raising organization from which local charities receive funds. Some of those charities are clients of the member's firm. Does the member have a conflict of interest under rule 102 [ET section 102.01]?

**.187 Answer**—Interpretation 102-2 [ET section 102.03] provides that a conflict of interest may occur if a member performs a professional service for a client and the member or his or her firm has a relationship with another entity that could, in the member's professional judgment, be viewed by the client or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity and the relationship is disclosed to and consent is obtained from the appropriate parties, performance of the service shall not be prohibited. (If the service being provided is an attest engagement, consult ethics ruling No. 14 [ET section 191.027-.028] under rule 101 [ET section 101.01]).

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

**94. Indemnification Clause in Engagement Letters**

**.188 Question**—A member or his or her firm proposes to include in engagement letters a clause that provides that the client would release, indemnify, defend, and hold the member (and his or her partners, heirs, executors, personal representatives, successors, and assigns) harmless from any liability and costs resulting from knowing misrepresentations by management. Would inclusion of such an indemnification clause in engagement letters impair independence?

**.189 Answer**—No.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

**95. Agreement With Attest Client to Use ADR Techniques**

**.190 Question**—Alternative dispute resolution (ADR) techniques are used to resolve disputes (in lieu of litigation) relating to past services, but are not used as a substitute for the exercise of professional judgment for current services. Would a predispute agreement to use ADR techniques between a member or his or her firm and a client cause independence to be impaired?

**.191 Answer**—No. Such an agreement would not cause independence to be impaired since the member (or the firm) and the client would not be in

threatened or actual positions of material adverse interests by reason of threatened or actual litigation.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## 96. Commencement of ADR Proceeding

**.192 Question**—Would the commencement of an alternative dispute resolution (ADR) proceeding impair independence?

**.193 Answer**—Except as stated in the next sentence, independence would not be considered to be impaired because many of the ADR techniques designed to facilitate negotiation and the actual conduct of those negotiations do not place the member or his or her firm and the client in threatened or actual positions of material adverse interests. Nevertheless, if a *covered* member and the client are in a position of material adverse interests because the ADR proceedings are sufficiently similar to litigation, ethics interpretation 101-6 [ET section 101.08] should be applied. Such a position would exist if binding arbitration were used.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## [97.] Performance of Certain Extended Audit Services

[.194–.195] [Deleted August 1996]

## 98. Member's Loan From a Nonclient Subsidiary or Parent of an Attest Client

**.196 Question**—A member has obtained a loan from a nonclient. The member's firm performs an attest engagement for the parent or a subsidiary of the nonclient. Does the loan from the nonclient subsidiary or parent impair independence?

**.197 Answer**—A *covered* member's loan that is not a "grandfathered" or "permitted" loan under interpretation 101-5 [ET section 101.07] from a nonclient subsidiary would impair independence with respect to the client parent. However, a loan from a nonclient parent would not impair independence with respect to the client subsidiary as long as the subsidiary is not material to its parent.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

## 99. Member Providing Services for Company Executives

**.198 Question**—A member has been approached by a company, for which he or she may or may not perform other professional services, to provide personal financial planning or tax services for its executives. The executives are aware of the company's relationship with the member, if any, and have also consented to the arrangement. The performance of the services could result in the member recommending to the executives actions that may be adverse to the company. What rules of conduct should the member consider before accepting and during the performance of the engagement?

**.199 Answer**—Before accepting and during the performance of the engagement, the member should consider the applicability of Rule 102, *Integrity and Objectivity* [ET section 102.01]. If the member believes that he or she can perform the personal financial planning or tax services with objectivity, the member would not be prohibited from accepting the engagement. The member

should also consider informing the company and the executives of possible results of the engagement. During the performance of the services, the member should consider his or her professional responsibility to the clients (that is, the company and the executives) under Rule 301, *Confidential Client Information* [ET section 301.01].

### 100. Actions Permitted When Independence Is Impaired

**.200 Question**—If a member or a member's firm (member) was independent when its report was initially issued, may the member re-sign the report or consent to its use at a later date when his or her independence is considered to be impaired?

**.201 Answer**—Yes. A member may re-sign the report or consent to its use at a later date when his or her independence is considered to be impaired, provided that no "post-audit work" is performed by the member during the period of impairment. The term "post-audit work," in this context, does not include inquiries of successor auditors, reading of subsequent financial statements, or such procedures as may be necessary to assess the effect of subsequently discovered facts on the financial statements covered by the member's previously issued report.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

### [101.] Client Advocacy and Expert Witness Services

[.202–.203] [Deleted July 2007]

### 102. Indemnification of a Client

**.204 Question**—As a condition to retaining a member or his or her firm to perform an attest engagement, a client or prospective client requests that the member (or the firm) enter into an agreement providing, among other things, that the member (or the firm) indemnify the client for damages, losses, or costs arising from lawsuits, claims, or settlements that relate, directly or indirectly, to client acts. Would entering into such an agreement impair independence?

**.205 Answer**—Yes. Such an agreement would impair independence under interpretation 101-1.A [ET section 101.02] and interpretation 101-1.C [ET section 101.02].

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

### 103. Attest Report on Internal Controls

**.206 Question**—If a member or his or her firm provides extended audit services for a client in compliance with interpretation 101-3 [ET section 101.05], would the firm be considered to be independent in the performance of an attestation engagement to report on the client's assertion regarding the effectiveness of its internal control over financial reporting?

**.207 Answer**—Independence would not be considered to be impaired with respect to the issuance of such a report if both of the following conditions are met:

1. Management has assumed responsibility to establish and maintain internal control.

2. Management does not rely on the firm's work as the primary basis for its assertion and accordingly has (a) evaluated the results of its ongoing monitoring procedures built into the normal recurring activities of the entity (including regular management and supervisory activities) and (b) evaluated the findings and results of the firm's work and other separate evaluations of controls, if any.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

#### **[104.] Operational Auditing Services**

[.208-.209] [Deleted September 2003]

#### **[105.] Frequency of Performance of Extended Audit Procedures**

[.210-.211] [Deleted September 2003]

### **106. Member Has Significant Influence Over an Entity That Has Significant Influence Over a Client**

**.212 Question**—Would independence be considered to be impaired if a member or his or her firm had significant influence, as defined in ET section 92.27, over an entity that has significant influence over a client?

**.213 Answer**—Independence would be considered to be impaired if *any* partner or professional of the firm had significant influence over an entity that has significant influence over a client. By having such influence over the non-client entity, the partner or professional employee would also be considered to have significant influence over the client.

See interpretation 101-8 [ET section 101.10] for further guidance.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

### **107. Participation in Health and Welfare Plan Sponsored by Client**

**.214 Question**—A member participates in or receives benefits from a health and welfare plan (the "plan") sponsored by a client. Would independence be considered to be impaired with respect to the client sponsor or the plan?

**.215 Answer**—A *covered* member's participation in a plan sponsored by a client would impair independence with respect to the client sponsor and the plan. However, if the covered member's participation in the plan, or benefits received thereunder, arises as a result of the permitted employment of the covered member's immediate family in accordance with interpretation 101-1 [ET section 101.02], independence would not be considered to be impaired provided that the plan is normally offered to all employees in equivalent employment positions.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, November 2002, by the Professional Ethics Executive Committee.]

#### **[108.] Participation of Member, Spouse or Dependent in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in, Client**

[.216-.217] [Deleted November 2001]

**[109.] Member's Investment in Financial Services Products That Invest in Clients**

[.218–.219] [Deleted December 2005]

**110. Member Is Connected With an Entity That Has a Loan to or From a Client**

**.220 Question**—A member is associated with an entity as an officer, director, or a shareholder who is able to exercise significant influence over an entity. That entity has a loan to or from a client of the member's firm. Would independence be considered to be impaired with respect to the client?

**.221 Answer**—If a *covered* member has control over the entity (as defined in Generally Accepted Accounting Principles) the existence of a loan to or from the client would impair independence unless the loan from the client is specifically permitted under interpretation 101-5 [ET section 101.07].

If *any* partner or professional employee of the firm is connected with the entity as an officer, director, or shareholder who is able to exercise significant influence over the entity, but is unable to control the entity, he or she should consider interpretation 102-2 [ET section 102.03]. Interpretation 102-2 provides that a conflict of interest may occur if a member performs a professional service for a client and the member or his or her firm has a relationship with another entity that could, in the member's professional judgment, be viewed by the client or other appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity, and the relationship is disclosed to and consent is obtained from such client and other appropriate parties, the rule shall not operate to prohibit the performance of the professional service.

When making the decision as to whether to perform a professional service and in making disclosure to the appropriate parties, the member should consider Rule 301, *Confidential Client Information* [ET section 301.01].

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

**111. Employee Benefit Plan Sponsored by Client**

**.222 Question**—A member or his or her firm provides asset management or investment services that may include having custody of assets, performing management functions, or making management decisions for an employee benefit plan (the plan) sponsored by a client. Would independence be considered to be impaired with respect to the plan and the client sponsor?

**.223 Answer**—The performance of investment management or custodial services for a plan would be considered to impair independence with respect to the plan. Independence would also be considered to be impaired with respect to the client sponsor of a defined benefit plan if the assets under management or in the custody of the member are material to the plan or the client sponsor.

Independence would not be considered to be impaired with respect to the client sponsor of a defined contribution plan provided the member does not make any management decisions or perform management functions on behalf of the client sponsor or have custody of the sponsor's assets.

[Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1.]

### **112. Use of a Third-Party Service Provider to Assist a Member in Providing Professional Services**

**.224 Question**—A member in public practice uses an entity that the member, individually or collectively with his or her firm or with members of his or her firm, does not control (as defined by accounting principles generally accepted in the United States) or an individual not employed by the member (a third-party service provider) to assist the member in providing professional services (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions) to clients. Does Rule 102, *Integrity and Objectivity* [ET section 102.01], require the member to disclose the use of the third-party service provider to the client?

**.225 Answer**—Yes. The concept of integrity set forth in Rule 102, *Integrity and Objectivity* [ET section 102.01] and Article III, *Integrity* [ET section 54] requires a member to be honest and candid. Clients might not have an expectation that a member would use a third-party service provider to assist the member in providing the professional services. Accordingly, before disclosing confidential client information to a third-party service provider, a member should inform the client, preferably in writing, that the member may use a third-party service provider. This disclosure does not relieve the member from his or her obligations under ethics ruling No. 1 [ET section 391.001–.002] under Rule 301, *Confidential Client Information* [ET section 301.01]. If the client objects to the member's use of a third-party service provider, the member should provide the professional services without using the third-party service provider or the member should decline the engagement.

A member is not required to inform the client when he or she uses a third-party service provider to provide administrative support services (for example, record storage, software application hosting, or authorized e-file tax transmittal services) to the member.

See ethics ruling No. 12 [ET section 291.023–.024] under Rule 201, *General Standards* [ET section 201.01], and Rule 202, *Compliance With Standards* [ET section 202.01]; and ethics ruling No. 1 [ET section 391.001–.002] under Rule 301, *Confidential Client Information* [ET section 301.01], for additional responsibilities of the member when using a third-party service provider.

### **113. Acceptance or Offering of Gifts or Entertainment**

**.226 Question**—Would objectivity or integrity be considered to be impaired if a member offers or accepts gifts or entertainment to or from a client (or an individual in a key position with a client or an individual owning 10 percent or more of the client's outstanding equity securities or other ownership interests), or a customer or vendor of the member's employer (or a representative of the customer or vendor)?

**.227 Answer**—Objectivity would be considered to be impaired unless the gift or entertainment is reasonable in the circumstances.

The member should exercise judgment in determining whether gifts or entertainment would be considered reasonable in the circumstances. Relevant facts and circumstances would include, but are not limited to:

- The nature of the gift or entertainment
- The occasion giving rise to the gift or entertainment
- The cost or value of the gift or entertainment
- The nature, frequency, and value of other gifts and entertainment offered or accepted
- Whether the entertainment was associated with the active conduct of business either directly before, during, or after the entertainment
- Whether other clients, customers, or vendors also participated in the entertainment
- The individuals from the client, customer, or vendor and the member's firm or employer who participated in the entertainment

In addition, a member would be presumed to lack integrity if he or she accepted or offered gifts or entertainment that he or she knew or was reckless in not knowing would violate the member, client, customer, or vendor's policies or applicable laws and regulations.

See ethics ruling No. 114, "Acceptance or Offering of Gifts and Entertainment to or From an Attest Client" [ET section 191.228–.229], under rule 101 [ET section 101.01], for guidance applicable to the offer or acceptance of gifts or entertainment to or from an attest client.

#### **114. Acceptance or Offering of Gifts and Entertainment to or From an Attest Client**

**.228 Question**—Would independence be considered to be impaired if a member or the member's firm offers or accepts gifts or entertainment to or from an attest client, an individual in a key position with an attest client, or an individual owning 10 percent or more of the attest client's outstanding equity securities or other ownership interests (collectively, an attest client)?

**.229 Answer**—Independence would be considered to be impaired if the member's firm or a member on the attest engagement team or in a position to influence the attest engagement accepts a gift from an attest client, unless the value is clearly insignificant to the recipient. Independence would not be considered to be impaired if a covered member accepts entertainment from an attest client, provided the entertainment is reasonable in the circumstances.

Independence would not be considered to be impaired if a covered member offers gifts or entertainment to an attest client, provided the gift or entertainment is reasonable in the circumstances.

See ethics ruling No. 113, "Acceptance or Offering of Gifts or Entertainment" [ET section 191.226–.227], under rule 102 [ET section 102.01], for criteria a member should consider in determining whether the gifts or entertainment would be considered reasonable in the circumstances.

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## ET Section 200

# GENERAL STANDARDS—ACCOUNTING PRINCIPLES

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### TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
201	General Standards	
	Rule 201—General standards .....	.01
	Interpretations under Rule 201—General Standards	
	201-1—Competence .....	.02
	[201-2]—[Deleted] .....	[.03]
	[201-3]—[Deleted] .....	[.04]
	[201-4]—[Deleted] .....	[.05]
202	Compliance With standards	
	Rule 202—Compliance with standards .....	.01
	Interpretation under Rule 202—Compliance With Standards [202-1]—[Deleted] .....	[.02]
203	Accounting Principles	
	Rule 203—Accounting principles .....	.01
	Interpretations under Rule 203— Accounting Principles	
	203-1—Departures from established accounting principles [Amended] .....	.02
	203-2—Status of FASB, GASB, and FASAB interpretations .....	.03
	[203-3]—[Deleted] .....	[.04]
	203-4—Responsibility of employees for the preparation of financial statements in conformity with GAAP .....	.05
291	Ethics Rulings on General and Technical Standards	
	[1.] Association of Name With Unaudited Statements When Member Is Not Independent [Deleted] .....	[.001-.002]
	[2.] Opinion by Member Not in Public Practice [Deleted] .....	[.003-.004]
	[3.] Controller, Preparation of Financial Statements [Deleted] .	[.005-.006]



<i>Section</i>		<i>Paragraph</i>
291	Ethics Rulings on General and Technical Standards—continued	
	[4.] Two-Year Opinion—Prior Year Previously Unaudited [Deleted] .....	[.007-.008]
	[5.] Interim Financial Statements [Deleted] .....	[.009-.010]
	[6.] Letterhead [Deleted] .....	[.011-.012]
	[7.] Non-CPA Partner [Transferred to section 591.379–.380 as ethics ruling No. 190 under section 591] .....	[.013-.014]
	8. Subcontractor Selection for Management Consulting Service Engagements .....	.015-.016
	9. Supervision of Technical Specialist on Management Consulting Services Engagements .....	.017-.018
	10. Submission of Financial Statements by a Member in Public Practice [Revised] .....	.019-.020
	11. Applicability of Rule 203 to Members Performing Litigation Support Services .....	.021-.022
	12. Applicability of General and Technical Standards When Using a Third-Party Service Provider .....	.023-.024

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## ET Section 201

### *General Standards*

**.01 Rule 201—General standards** A member shall comply with the following standards and with any interpretations thereof by bodies designated by Council.

- A. *Professional Competence.* Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.
- B. *Due Professional Care.* Exercise due professional care in the performance of professional services.
- C. *Planning and Supervision.* Adequately plan and supervise the performance of professional services.
- D. *Sufficient Relevant Data.* Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

[As adopted January 12, 1988.]

(See Appendix A.)

#### ***Interpretations under Rule 201—General Standards***

**.02 201-1—Competence** A member's agreement to perform professional services implies that the member has the necessary competence to complete those professional services according to professional standards, applying his or her knowledge and skill with reasonable care and diligence, but the member does not assume a responsibility for infallibility of knowledge or judgment.

Competence to perform professional services involves both the technical qualifications of the member and the member's staff and the ability to supervise and evaluate the quality of the work performed. Competence relates both to knowledge of the profession's standards, techniques and the technical subject matter involved, and to the capability to exercise sound judgment in applying such knowledge in the performance of professional services.

The member may have the knowledge required to complete the services in accordance with professional standards prior to performance. In some cases, however, additional research or consultation with others may be necessary during the performance of the professional services. This does not ordinarily represent a lack of competence, but rather is a normal part of the performance of professional services.

However, if a member is unable to gain sufficient competence through these means, the member should suggest, in fairness to the client and the public, the engagement of someone competent to perform the needed professional service, either independently or as an associate.

[.03] [201-2]—[Deleted]

[.04] [201-3]—[Deleted]

[.05] [201-4]—[Deleted]



## ET Section 202

### *Compliance With Standards*

**.01 Rule 202—Compliance with standards** A member who performs auditing, review, compilation, management consulting, tax, or other professional services shall comply with standards promulgated by bodies designated by Council.

[As adopted January 12, 1988.]

(See Appendix A.)

#### *Interpretation under Rule 202—Compliance With Standards*

[.02] [202-1]—[Deleted]

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## ET Section 203

### *Accounting Principles*

**.01 Rule 203—Accounting principles** A member shall not (1) express an opinion or state affirmatively that the financial statements or other financial data of any entity are presented in conformity with generally accepted accounting principles or (2) state that he or she is not aware of any material modifications that should be made to such statements or data in order for them to be in conformity with generally accepted accounting principles, if such statements or data contain any departure from an accounting principle promulgated by bodies designated by Council to establish such principles that has a material effect on the statements or data taken as a whole. If, however, the statements or data contain such a departure and the member can demonstrate that due to unusual circumstances the financial statements or data would otherwise have been misleading, the member can comply with the rule by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in a misleading statement.

[As adopted January 12, 1988.]

(See Appendix A.)

#### *Interpretations under Rule 203—Accounting Principles*

**.02 203-1—Departures from established accounting principles** Rule 203 [ET section 203.01] was adopted to require compliance with accounting principles promulgated by the body designated by Council to establish such principles. There is a strong presumption that adherence to officially established accounting principles would in nearly all instances result in financial statements that are not misleading.

However, in the establishment of accounting principles it is difficult to anticipate all of the circumstances to which such principles might be applied. This rule therefore recognizes that upon occasion there may be unusual circumstances where the literal application of pronouncements on accounting principles would have the effect of rendering financial statements misleading. In such cases, the proper accounting treatment is that which will render the financial statements not misleading.

The question of what constitutes unusual circumstances as referred to in rule 203 [ET section 203.01] is a matter of professional judgment involving the ability to support the position that adherence to a promulgated principle would be regarded generally by reasonable men as producing a misleading result.

Examples of events which may justify departures from a principle are new legislation or the evolution of a new form of business transaction. An unusual degree of materiality or the existence of conflicting industry practices are examples of circumstances which would not ordinarily be regarded as unusual in the context of rule 203 [ET section 203.01].

**.03 203-2—Status of FASB, GASB and FASAB interpretations** Council is authorized under rule 203 [ET section 203.01] to designate bodies to establish accounting principles. Council has designated the Financial Accounting Standards Board (FASB) as such a body and has resolved that FASB

*Accounting Standards Codification*<sup>TM</sup> (ASC) constitutes accounting principles as contemplated in rule 203 [ET section 203.01]. Council has also designated the Governmental Accounting Standards Board (GASB), with respect to Statements of Governmental Accounting Standards issued in July 1984 and thereafter, as the body to establish financial accounting principles for state and local governmental entities pursuant to rule 203 [ET section 203.01]. Council has also designated the Federal Accounting Standards Advisory Board (FASAB), with respect to Statements of Federal Accounting Standards adopted and issued in March 1993 and subsequently, as the body to establish accounting principles for federal government entities pursuant to rule 203 [ET section 203.01].

In determining the existence of a departure from an accounting principle as established in FASB ASC and encompassed by rule 203 [ET section 203.01], or the existence of a departure from an accounting principle established by a Statement of Governmental Accounting Standards or a Statement of Federal Accounting Standards encompassed by rule 203 [ET section 203.01], the division of professional ethics will construe such codification or statements, in the light of any interpretations thereof issued by FASB, GASB, or FASAB.

[As amended April 30, 2000. Revised June 2009.]

**[.04] [203-3]—[Deleted]**

**.05 203-4—Responsibility of employees for the preparation of financial statements in conformity with GAAP** Rule 203 [ET section 203.01] provides, in part, that a member shall not state affirmatively that financial statements or other financial data of an entity are presented in conformity with generally accepted accounting principles (GAAP) if such statements or data contain any departure from an accounting principle promulgated by a body designated by Council to establish such principles that has a material effect on the statements or data taken as a whole.

Rule 203 [ET section 203.01] applies to all members with respect to any affirmation that financial statements or other financial data are presented in conformity with GAAP. Representation regarding GAAP conformity included in a letter or other communication from a client entity to its auditor or others related to that entity's financial statements is subject to rule 203 [ET section 203.01] and may be considered an affirmative statement within the meaning of the rule with respect to members who signed the letter or other communication; for example, signing reports to regulatory authorities, creditors and auditors.

[Effective November 30, 1993.]

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## ET Section 291

### *Ethics Rulings on General and Technical Standards*

#### [1.] Association of Name With Unaudited Statements When Member Is Not Independent

[.001–.002] [Deleted September 1995]

#### [2.] Opinion by Member Not in Public Practice

[.003–.004] [Deleted December 1986]

#### [3.] Controller, Preparation of Financial Statements

[.005–.006] [Deleted May 1995]

#### [4.] Two-Year Opinion—Prior Year Previously Unaudited

[.007–.008] [Deleted May 1995]

#### [5.] Interim Financial Statements

[.009–.010] [Deleted October 1995]

#### [6.] Letterhead

[.011–.012] [Deleted September 1995]

#### [7.] Non-CPA Partner

[.013–.014] [Transferred to section 591.379-.380 as ethics ruling No. 190 under section 591, April 1995.]

### 8. Subcontractor Selection for Management Consulting Service Engagements

**.015 Question**—A member has been engaged to design and program a computer system. The engagement is well within the member's competence. The member plans to retain a contract programming organization as a subcontractor to provide additional qualified manpower. What procedures should the member consider in making the selection of a subcontractor?

**.016 Answer**—When selecting subcontractors the member has a responsibility to ensure that the subcontractors have the professional qualifications, technical skills and other resources required. Factors that can be helpful in evaluating a prospective subcontractor include business, financial and personal references from banks, from other CPAs, and from other customers of the subcontractor; the subcontractor's professional reputation and recognition; published materials (articles and books authored); and the member's personal evaluation of the subcontractor.



## 9. Supervision of Technical Specialist on Management Consulting Services Engagements

**.017 Question**—A member would like to add to the member's staff a systems analyst who specializes in developing computer systems. Must the member be able to perform all of the services that the specialist can perform in order to be able to supervise the specialist?

**.018 Answer**—The member must be qualified to supervise and evaluate the work of specialists in the member's employ. Although supervision does not require that the member be qualified to perform each of the specialist's tasks, the member should be able to define the tasks and evaluate the end product.

## 10. Submission of Financial Statements by a Member in Public Practice

**.019 Question**—A member in public practice is also a stockholder, partner, director, officer, or employee of an entity and in this capacity submits the entity's financial statements to third parties. What are the ethical considerations?

**.020 Answer**—If the member submits the financial statements in his or her capacity as a stockholder, partner, director, officer, or employee to a third party, the member should clearly communicate, preferably in writing, the relationship of the member to the entity and should not imply that the member is independent of the entity [ET section 191.130-.131]. In addition, if the communication states affirmatively that the financial statements are presented in conformity with generally accepted accounting principles, the member is subject to rule 203 [ET section 203.01] of the Code of Professional Conduct.

If the member prepares financial statements as a member in public practice and/or submits them using the member's public practitioner's letterhead or other identification, the member should comply with applicable standards, including any requirement to disclose a lack of independence.

[Revised, effective July 31, 2002, by the Professional Ethics Executive Committee.]

## 11. Applicability of Rule 203 to Members Performing Litigation Support Services

**.021 Question**—Does Rule 203, *Accounting Principles* [ET section 203.01], apply to members performing litigation support services?

**.022 Answer**—Yes.

## 12. Applicability of General and Technical Standards When Using a Third-Party Service Provider

**.023 Question**—What responsibility does a member in public practice have for complying with the general and technical standards under Rule 201, *General Standards* [ET section 201.01], and Rule 202, *Compliance With Standards* [ET section 202.01], when using an entity that the member, individually or collectively with his or her firm or with members of his or her firm, does not control (as defined by generally accepted accounting principles) or an individual not employed by the member (a third-party service provider) to assist the member in providing professional services (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions) to clients?

**.024 Answer**—Using a third-party service provider to assist the member in providing professional services to clients does not in any way relieve the member from his or her responsibilities to comply with the requirements of Rules 201 [ET section 201.01] and 202 [ET section 202.01]. Accordingly, the

member remains responsible for the adequate oversight of all services performed by the third-party service provider and for ensuring that all professional services are performed with professional competence and due professional care. In addition, the member must adequately plan and supervise the professional services provided by the third-party service provider, obtain sufficient relevant data to support his or her work product and comply with all technical standards applicable to the professional services.

This ruling does not extend the member's responsibility for planning and supervising the work of a third-party service provider beyond the requirements of applicable professional standards, which may vary depending upon the nature of the member's engagement.

See ethics ruling No. 112 [ET section 191.224–225] under Rule 102 [ET section 102.01], *Integrity and Objectivity*, and ethics ruling No. 1 [ET section 391.001–.002] under Rule 301, *Confidential Client Information* [ET section 301.01], for additional responsibilities of the member when using a third-party service provider.

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# ET Section 300

## RESPONSIBILITIES TO CLIENTS

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### TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
301	Confidential Client Information	
	Rule 301—Confidential client information .....	.01
	Interpretations under Rule 301—Confidential Client Information	
	[301-1]—[Deleted] .....	[.02]
	[301-2]—[Deleted] .....	[.03]
	301-3—Confidential information and the purchase, sale, or merger of a practice .....	.04
302	Contingent Fees	
	Rule 302—Contingent fees .....	.01
	Interpretation under Rule 302—Contingent Fees	
	302-1—Contingent fees in tax matters .....	.02
391	Ethics Rulings on Responsibilities to Clients	
	1. Use of a Third-Party Service Provider to Provide Professional Services to Clients or Administrative Support Services to the Member [Revised] .....	.001-.002
	2. Distribution of Client Information to Trade Associations ....	.003-.004
	3. Information to Successor Accountant About Tax Return Irregularities .....	.005-.006
	[4.] Prior Client Relationship [Deleted] .....	[.007-.008]
	[5.] Records Retention Agency [Deleted] .....	[.009-.010]
	6. Revealing Client Information to Competitors .....	.011-.012
	7. Revealing Names of Clients .....	.013-.014
	[8.] Fee as Percentage of Bond Issue [Deleted] .....	[.015-.016]
	[9.] Finder's Fee [Deleted] .....	[.017-.018]
	[10.] Fee as Expert Witness [Deleted] .....	[.019-.020]
	[11.] Fee Contingent on Mortgage Commitment [Deleted] ....	[.021-.022]
	[12.] Fee as Percentage of Tax Savings [Deleted] .....	[.023-.024]
	[13.] Contingent Fees to Fire Adjuster [Deleted] .....	[.025-.026]
	14. Use of Confidential Information on Management Consulting Service Engagements .....	.027-.028
	15. Earlier Similar Management Consulting Service Study With Negative Outcome .....	.029-.030

<i>Section</i>	<i>Paragraph</i>
391	Ethics Rulings on Responsibilities to Clients—continued
	16. Disclosure of Confidential Client Information ..... .031-.032
	17. Definition of the Receipt of a Contingent Fee or a Commission ..... .033-.034
	18. Bank Director ..... .035-.036
	19. Receipt of Contingent Fees or Commissions by Member's Spouse ..... .037-.038
	20. Disclosure of Confidential Client Information to Professional Liability Insurance Carrier ..... .039-.040
	21. Member Providing Services for Company Executives ..... .041-.042
	[22.] Member Removing Client Files From an Accounting Firm [Deleted] ..... [.043-.044]
	23. Disclosure of Confidential Client Information in Legal or Alternative Dispute Resolution Proceedings ..... .045-.046
	24. Investment Advisory Services ..... .047-.048
	25. Commission and Contingent Fee Arrangements With Nonattest Client ..... .049-.050

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## ET Section 301

### ***Confidential Client Information***

**.01 Rule 301—Confidential client information** A member in public practice shall not disclose any confidential client information without the specific consent of the client.

This rule shall not be construed (1) to relieve a member of his or her professional obligations under rules 202 [ET section 202.01] and 203 [ET section 203.01], (2) to affect in any way the member's obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a member's compliance with applicable laws and government regulations, (3) to prohibit review of a member's professional practice under AICPA or state CPA society or Board of Accountancy authorization, or (4) to preclude a member from initiating a complaint with, or responding to any inquiry made by, the professional ethics division or trial board of the Institute or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy.

Members of any of the bodies identified in (4) above and members involved with professional practice reviews identified in (3) above shall not use to their own advantage or disclose any member's confidential client information that comes to their attention in carrying out those activities. This prohibition shall not restrict members' exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above.

[As amended January 14, 1992.]

#### ***Interpretations under Rule 301—Confidential Client Information***

[.02] [301-1]—[Deleted]

[.03] [301-2]—[Deleted]

**.04 301-3—Confidential information and the purchase, sale, or merger of a practice** Rule 301 [ET section 301.01] prohibits a member in public practice from disclosing any confidential client information without the specific consent of the client. The rule provides that it shall not be construed to prohibit the review of a member's professional practice under AICPA or state CPA society authorization.

For purposes of rule 301 [ET section 301.01], a review of a member's professional practice is hereby authorized to include a review in conjunction with a prospective purchase, sale, or merger of all or part of a member's practice. The member must take appropriate precautions (for example, through a written confidentiality agreement) so that the prospective purchaser does not disclose any information obtained in the course of the review, since such information is deemed to be confidential client information.

Members reviewing a practice in connection with a prospective purchase or merger shall not use to their advantage nor disclose any member's confidential client information that comes to their attention.

[Effective February 28, 1990.]



## ET Section 302

### *Contingent Fees*

**.01 Rule 302—Contingent fees** A member in public practice shall not

- (1) Perform for a contingent fee any professional services for, or receive such a fee from a client for whom the member or the member's firm performs,
  - (a) an audit or review of a financial statement; or
  - (b) a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or
  - (c) an examination of prospective financial information;or
- (2) Prepare an original or amended tax return or claim for a tax refund for a contingent fee for any client.

The prohibition in (1) above applies during the period in which the member or the member's firm is engaged to perform any of the services listed above and the period covered by any historical financial statements involved in any such listed services.

Except as stated in the next sentence, 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. Solely for purposes of this rule, fees are not regarded as being contingent if fixed by courts or other public authorities, or, in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies.

A member's fees may vary depending, for example, on the complexity of services rendered.

[As adopted May 20, 1991.]

#### ***Interpretation under Rule 302—Contingent Fees***

**.02 302-1—Contingent fees in tax matters** This interpretation defines certain terms in rule 302 [ET section 302.01] and provides examples of the application of the rule.

#### **Definition of Terms**

- (a) Preparation of an original or amended tax return or claim for tax refund includes giving advice on events which have occurred at the time the advice is given if such advice is directly relevant to determining the existence, character, or amount of a schedule, entry, or other portion of a return or claim for refund.



- (b) A fee is considered determined based on the findings of governmental agencies if the member can demonstrate a reasonable expectation, at the time of a fee arrangement, of substantive consideration by an agency with respect to the member's client. Such an expectation is deemed not reasonable in the case of preparation of original tax returns.

### Examples

The following are examples, not all-inclusive, of circumstances where a contingent fee would be permitted:

1. Representing a client in an examination by a revenue agent of the client's federal or state income tax return.
2. Filing an amended federal or state income tax return claiming a tax refund based on a tax issue that is either the subject of a test case (involving a different taxpayer) or with respect to which the taxing authority is developing a position.
3. Filing an amended federal or state income tax return (or refund claim) claiming a tax refund in an amount greater than the threshold for review by the Joint Committee on Internal Revenue Taxation (\$1 million at March 1991) or state taxing authority.
4. Requesting a refund of either overpayments of interest or penalties charged to a client's account or deposits of taxes improperly accounted for by the federal or state taxing authority in circumstances where the taxing authority has established procedures for the substantive review of such refund requests.
5. Requesting, by means of "protest" or similar document, consideration by the state or local taxing authority of a reduction in the "assessed value" of property under an established taxing authority review process for hearing all taxpayer arguments relating to assessed value.
6. Representing a client in connection with obtaining a private letter ruling or influencing the drafting of a regulation or statute.

The following is an example of a circumstance where a contingent fee would not be permitted:

1. Preparing an amended federal or state income tax return for a client claiming a refund of taxes because a deduction was inadvertently omitted from the return originally filed. There is no question as to the propriety of the deduction; rather the claim is filed to correct an omission.
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## ET Section 391

### *Ethics Rulings on Responsibilities to Clients*

#### **1. Use of a Third-Party Service Provider to Provide Professional Services to Clients or Administrative Support Services to the Member**

**.001 Question**—A member in public practice uses an entity that the member, individually or collectively with his or her firm or with members of his or her firm, does not control (as defined by generally accepted accounting principles) or an individual not employed by the member (a "third-party service provider") to assist the member in providing professional services (for example, bookkeeping, tax return preparation, consulting, or attest services, including related clerical and data entry functions) to clients or for providing administrative support services to the member (for example, record storage, software application hosting, or authorized e-file tax transmittal services). Does Rule 301, *Confidential Client Information* [ET section 301.01], require the member to obtain the client's consent before disclosing confidential client information to the third-party service provider?

**.002 Answer**—No. Rule 301 [ET section 301.01] is not intended to prohibit a member in public practice from disclosing confidential client information to a third-party service provider used by the member for purposes of providing professional services to clients or for administrative support purposes. However, before using such a service provider, the member should enter into a contractual agreement with the third-party service provider to maintain the confidentiality of the information and be reasonably assured that the third-party service provider has appropriate procedures in place to prevent the unauthorized release of confidential information to others. The nature and extent of procedures necessary to obtain reasonable assurance depends on the facts and circumstances, including the extent of publicly available information on the third-party service provider's controls and procedures to safeguard confidential client information.

In the event the member does not enter into a confidentiality agreement with a third-party service provider, specific client consent should be obtained before the member discloses confidential client information to the third-party service provider.

See ethics ruling No. 112 [ET section 191.224–.225] under Rule 102, *Integrity and Objectivity* [ET section 102.01], and ethics ruling No. 12 [ET section 291.023–.024] under Rule 201, *General Standards* [ET section 201.01], and Rule 202, *Compliance With Standards* [ET section 202.01], for additional responsibilities of the member when using a third-party service provider.

[Revised, effective July 1, 2005, except for professional services performed pursuant to agreements in existence on June 30, 2005 that are completed by December 31, 2005, by the Professional Ethics Executive Committee.]

#### **2. Distribution of Client Information to Trade Associations**

**.003 Question**—A member's firm is requested by a trade association to supply profit and loss percentages taken from the reports of the accountants' clients. The association would distribute them to its members. May the firm comply with the request?

.004 *Answer*—Rule 301 [ET section 301.01] would not be violated if the firm has the clients' permission to distribute the figures.

### 3. Information to Successor Accountant About Tax Return Irregularities

.005 *Question*—A member withdrew from an engagement on discovering irregularities in his client's tax return. May he reveal to the successor accountant why the relationship was terminated?

.006 *Answer*—Rule 301 [ET section 301.01] is not intended to help an unscrupulous client cover up illegal acts or otherwise hide information by changing CPAs. If the member is contacted by the successor he should, at a minimum, suggest that the successor ask the client to permit the member to discuss all matters freely with the successor. The successor is then on notice of some conflict. Because of the serious legal implications, the member should seek legal advice as to his status and obligations in the matter.

### [4.] Prior Client Relationship

[.007–.008] [Deleted August 1989]

### [5.] Records Retention Agency

[.009–.010] [Deleted October 2004]

### 6. Revealing Client Information to Competitors

.011 *Question*—A municipality in a particular state enforces a personal property tax on business inventories, fixtures and equipment, and machinery by retaining a firm of CPAs to examine the books and records of the businesses to be sure the proper amount has been declared. In the course of its engagement, the CPA firm will examine sales, purchases, gross profit percentages, and inventories as well as fixed asset accounts. A member serving one of the companies involved objects to these procedures on the ground that information gathered from the books and records of his client could be inadvertently conveyed to competitors by employees of the CPA firm doing the audit. Is such an engagement ethically proper?

.012 *Answer*—It would be proper for a member's firm to perform such services. It should be emphasized to everyone concerned that rule 301 [ET section 301.01] prohibits members from revealing to others any confidential information obtained in their professional capacity.

### 7. Revealing Names of Clients

.013 *Question*—May a member in public practice disclose the name of a client for whom the member or the member's firm performed professional services?

.014 *Answer*—It is permissible under rule 301 [ET section 301.01] for a member to disclose the name of a client, whether publicly or privately owned, without the client's specific consent unless the disclosure of the client's name constitutes the release of confidential information. For example, if a member's practice is limited to bankruptcy matters, the disclosure of a client's name would suggest that the client may be experiencing financial difficulties, which could be confidential client information.

[Replaced previous ruling No. 7, *Revealing Names of Employer's Clients*, effective August 31, 1989.]

### [8.] Fee as Percentage of Bond Issue

[.015–.016] [Deleted June 1991]

**[9.] Finder's Fee**

[.017-.018] [Deleted June 1991]

**[10.] Fee as Expert Witness**

[.019-.020] [Deleted June 1991]

**[11.] Fee Contingent on Mortgage Commitment**

[.021-.022] [Deleted June 1991]

**[12.] Fee as Percentage of Tax Savings**

[.023-.024] [Deleted June 1991]

**[13.] Contingent Fees to Fire Adjuster**

[.025-.026] [Deleted June 1991]

**14. Use of Confidential Information on Management Consulting Service Engagements**

**.027 Question**—In the course of performing a feasibility study a nonclient outside source has provided pertinent information to the member's firm with the understanding that the source and the details of the information will not be disclosed. The information, which the firm believes is pertinent, directly affects its conclusions and recommendations. How may this information be utilized in connection with the feasibility study engagement and related conclusions and recommendations?

**.028 Answer**—Rule of conduct 301 [ET section 301.01] regarding confidential client information is not directly applicable to the circumstances described; however, Rule of conduct 501, *Acts Discreditable* [ET section 501.01], is applicable to situations involving confidential relationships with non-clients. For an engagement in which it appears likely that the development of pertinent information will have to come from outside non-client sources, and such information must remain confidential, the terms of the engagement with the client should specify that the confidences of outside non-client sources will not be divulged by the member's firm even when they might affect the outcome of the engagement. If the use of confidential outside sources is necessary and the terms of the engagement are silent regarding disclosure of source and details, the member should promptly seek the approval of the client to present his recommendations without making disclosures that include confidential information. If the client does not agree to this, the member should withdraw rather than breach a confidence or improperly limit the inclusion of information in his final recommendation.

**15. Earlier Similar Management Consulting Service Study With Negative Outcome**

**.029 Question**—A prospective client has asked a member's firm to study the desirability of his using a newly developed electronic ticketing system for his business. A recent study made for another client leads the member's firm to believe that the system would not be desirable for him. Must the firm state its reservations at the risk of disclosing information acquired while performing an assignment for a client competitor?

**.030 Answer**—Rule of conduct 301 [ET section 301.01] provides that a member shall not disclose any confidential information obtained in the course of a professional engagement except with the consent of the client. Knowledge and expertise which results in a special competence in a particular field can be

provided to a client without violating the confidence of another client. Reservations that the firm may have concerning the electronic ticketing system should be communicated to the prospective client provided the details of the other client's engagement are not disclosed. If, however, circumstances are such that the prospective client would clearly know the origin of the information on which the member's reservations are based, and such information is sensitive, the engagement should not be accepted without clearance with the first client.

## 16. Disclosure of Confidential Client Information

**.031 Question**—A member has prepared a married couple's joint tax returns for several years. The member was engaged by and has dealt exclusively with spouse A. Divorce proceedings are now under way and spouse B has approached the member with requests for confidential information relating to prior tax returns. Spouse A has directed the member not to comply with spouse B's requests. Would release of this information by the member to spouse B constitute a violation of rule 301 [ET section 301.01]?

**.032 Answer**—As defined by the Code of Professional Conduct, spouse B would be considered to be a client with respect to the prior tax returns in question. Therefore, release of the requested information to spouse B would not be prohibited by rule 301 [ET section 301.01]. The member should consider, however, reviewing the legal implications of such a disclosure with an attorney.

## 17. Definition of the Receipt of a Contingent Fee or a Commission

**.033 Question**—Rules 302 [ET section 302.01] and 503 [ET section 503.01] prohibit, among other acts, the receipt of contingent fees for the performance of certain services and the receipt of a commission for the referral of products or services under certain circumstances. When is a contingent fee or commission deemed to be received?

**.034 Answer**—A contingent fee or a commission is deemed to be received when the performance of the related services is complete and the fee or the commission is determined. For example, if in one year a member sells a life insurance policy to a client and the member's commission payments are determined to be a fixed percentage of future years' renewal premiums, the commission is deemed to be received in the year the policy is sold.

## 18. Bank Director

**.035 Question**—May a member in public practice serve as a director of a bank?

**.036 Answer**—Yes; however, before accepting a bank directorship, the member should carefully consider the implications of such service if the member has clients that are customers of the bank.

These implications fall into two categories:

- a. Confidential Client Information—Rule 301 [ET section 301.01] provides that a member in public practice shall not disclose any confidential client information without the specific consent of the client. This ethical requirement applies even though failure to disclose information may constitute a breach of the member's fiduciary responsibility as a director.
- b. Conflicts of Interest—Interpretation 102-2 [ET section 102.03] provides that a conflict of interest may occur if a member performs

a professional service (including service as a director) and the member or his or her firm has a relationship with another entity that could, in the member's professional judgment, be viewed by appropriate parties as impairing the member's objectivity. If the member believes that the professional service can be performed with objectivity and the relationship is disclosed to and consent is obtained from all appropriate parties, performance of the service shall not be prohibited.

In view of the above factors, it is generally not desirable for a member in public practice to accept a position as bank director where the member's clients are likely to engage in significant transactions with the bank. If a member is engaged in public practice, the member should avoid the high probability of a conflict of interest and the appearance that the member's fiduciary obligations and responsibilities to the bank may conflict with or interfere with the member's ability to serve the client's interest objectively and in complete confidence.

The general knowledge and experience of CPAs in public practice may be very helpful to a bank in formulating policy matters and making business decisions; however, in most instances, it would be more appropriate for the member as part of the member's public practice to serve as a consultant to the bank's board. Under such an arrangement, the member could limit activities to those which did not involve conflicts of interest or confidentiality problems.

## 19. Receipt of Contingent Fees or Commissions by Member's Spouse

**.037 Question**—May a member's spouse provide services to the member's attest client for a contingent fee or refer products or services for a commission to or from the member's attest client without causing the member to be in violation of rule 302 [ET section 302.01] or rule 503 [ET section 503.01]?

**.038 Answer**—Yes, if the activities of the member's spouse are separate from the member's practice and the member is not significantly involved in those activities. The member, however, should consider whether a conflict of interest may exist as described in rule 102 [ET section 102.01] and interpretation 102-2 [ET section 102.03].

## 20. Disclosure of Confidential Client Information to Professional Liability Insurance Carrier

**.039 Question**—A member has learned of a potential claim that may be filed against the member. The member's professional liability insurance policy requires that the carrier be promptly notified of actual or potential claims. If the member notifies the carrier and complies with its request for documents that would constitute confidential client information without the client's permission, would the member be in violation of rule 301 [ET section 301.01]?

**.040 Answer**—No. Rule 301 [ET section 301.01] is not intended to prohibit a member from releasing confidential client information to the member's liability insurance carrier solely to assist the defense against an actual or potential claim against the member.

## 21. Member Providing Services for Company Executives

**.041 Question**—A member has been approached by a company, for which he or she may or may not perform other professional services, to provide personal financial planning or tax services for its executives. The executives are aware of the company's relationship with the member, if any, and have also consented to the arrangement. The performance of the services could result in

the member recommending to the executives actions that may be adverse to the company. What rules of conduct should the member consider before accepting and during the performance of the engagement?

**.042 Answer**—Before accepting and during the performance of the engagement, the member should consider the applicability of Rule 102, *Integrity and Objectivity* [ET section 102.01]. If the member believes that he or she can perform the personal financial planning or tax services with objectivity, the member would not be prohibited from accepting the engagement. The member should also consider informing the company and the executives of possible results of the engagement. During the performance of the services, the member should consider his or her professional responsibility to the clients (that is, the company and the executives) under Rule 301, *Confidential Client Information* [ET section 301.01].

## **[22.] Member Removing Client Files From an Accounting Firm**

[.043–.044] [Deleted December 1998]

## **23. Disclosure of Confidential Client Information in Legal or Alternative Dispute Resolution Proceedings**

**.045 Question**—A member discloses confidential client information to the member's attorney or a court or in documents or proceedings in connection with an actual or threatened lawsuit or alternative dispute resolution proceedings relating to that client. Would the member be in violation of the rule 301 [ET section 301.01] of the Code of Professional Conduct?

**.046 Answer**—No. Rule 301 [ET section 301.01] is not included to prohibit a member from disclosing the information necessary to initiate, pursue or defend himself or herself in such proceedings.

This ruling is not intended to prohibit a member's compliance with applicable federal or state laws or regulations.

## **24. Investment Advisory Services**

**.047 Question**—A member or member's firm ("member") provides investment advisory services for an attest client for a fee based on a percentage of the client's investment portfolio. Would the member be considered to be in violation of rule 302, *Contingent Fees* [ET section 302.01]?

**.048 Answer**—Yes. However, the fee would not be contingent upon portfolio performance and, therefore, would not be in violation of rule 302 [ET section 302.01] if all of the following conditions are met:

1. The fee is determined as a specified percentage of the client's investment portfolio.
2. The dollar amount of the portfolio on which the fee is based is determined at the beginning of each quarterly period (or longer period of time as may be agreed upon) and is adjusted only for additions or withdrawals made by the client during the period.
3. The fee arrangement is not renewed with the client more frequently than on a quarterly basis.

When performing such services, the member should also consider Rule 101, *Independence* [ET section 101.01], especially interpretation 101-3 [ET section 101.05].

## 25. Commission and Contingent Fee Arrangements With Nonattest Client

**.049** *Question*—A member or member's firm (member) provides for a contingent fee investment advisory services, or refers for a commission products or services of a nonclient or a nonattest client, to the owners, officers, or employees of an attest client or to a nonattest client employee benefit plan sponsored by an attest client. Would the member be considered to be in violation of either rule 302 [ET section 302.01] or rule 503 [ET section 503.01]?

**.050** *Answer*—No. The member would not be in violation of either rule 302 [ET section 302.01] or rule 503 [ET section 503.01] provided that, with respect to rule 503 [ET section 503.01], the member discloses the commission to the owners, officers, or employees or to the employee benefit plan. The member should also consider the applicability of interpretation 102-2, *Conflicts of Interest* [ET section 102.03], and his or her professional responsibility to clients under Rule 301, *Confidential Client Information* [ET section 301.01].

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**ET Section 400**  
**RESPONSIBILITIES TO COLLEAGUES**

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*[Reserved.]*

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**ET Section 500****OTHER RESPONSIBILITIES AND PRACTICES**

## TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
501	Acts Discreditable	
	Rule 501—Acts discreditable .....	.01
	Interpretations under Rule 501—Acts Discreditable	
	501-1—Response to requests by clients and former clients for records [Revised] .....	.02
	501-2—Discrimination and harassment in employment practices [Revised] .....	.03
	501-3—Failure to follow standards and/or procedures or other requirements in governmental audits .....	.04
	501-4—Negligence in the preparation of financial statements or records [Revised] .....	.05
	501-5—Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies [Revised] .....	.06
	501-6—Solicitation or disclosure of CPA examination questions and answers [Revised] .....	.07
	501-7—Failure to file tax return or pay tax liability .....	.08
	501-8—Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies on indemnification and limitation of liability provisions in connection with audit and other attest services .....	.09
502	Advertising and Other Forms of Solicitation	
	Rule 502—Advertising and other forms of solicitation .....	.01
	Interpretations under Rule 502—Advertising and Other Forms of Solicitation	
	[502-1]—[Deleted] .....	[.02]
	502-2—False, misleading or deceptive acts in advertising or solicitation [Revised] .....	.03
	[502-3]—[Deleted] .....	[.04]
	[502-4]—[Deleted] .....	[.05]
	502-5—Engagements obtained through efforts of third parties .....	.06

<i>Section</i>	<i>Paragraph</i>
503	Commissions and Referral Fees
	Rule 503—Commissions and referral fees ..... .01
	Interpretation under Rule 503—Commissions and Referral Fees
	[503-1]—[Deleted] ..... [.02]
504	[Deleted]
505	Form of Organization and Name
	Rule 505—Form of organization and name ..... .01
	Interpretations under Rule 505—Form of Organization and Name
	[505-1]—[Deleted] ..... [.02]
	505-2—Application of rules of conduct to members who own a separate business [Revised] ..... .03
	505-3—Application of rule 505 to alternative practice structures ..... .04
591	Ethics Rulings on Other Responsibilities and Practices
	[1.] Retention of Records [Superseded by interpretation 501-1] ..... [.001-.002]
	2. Fees: Collection of Notes Issued in Payment ..... .003-.004
	3. Employment by Non-CPA Firm ..... .005-.006
	[4.] Association Employee [Deleted] ..... [.007-.008]
	[5.] Association as an Agent [Deleted] ..... [.009-.010]
	[6.] Associations, Speaking Engagements [Deleted] ..... [.011-.012]
	[7.] Trading Pool [Deleted] ..... [.013-.014]
	[8.] Change of Control of Client Company [Deleted] ..... [.015-.016]
	[9.] Charity Solicitation by Phone [Deleted] ..... [.017-.018]
	[10.] Church Bulletin [Deleted] ..... [.019-.020]
	[11.] Attorney, Clients [Deleted] ..... [.021-.022]
	[12.] Confirmation Requests [Deleted] ..... [.023-.024]
	[13.] Confirmation Stickers [Deleted] ..... [.025-.026]
	[14.] Estate Planning [Deleted] ..... [.027-.028]
	[15.] Golf Outing [Deleted] ..... [.029-.030]
	[16.] Letter on Behalf of Client [Deleted] ..... [.031-.032]
	[17.] Letterhead for Estate Practice [Deleted] ..... [.033-.034]
	[18.] Letterhead for Promotional Material [Deleted] ..... [.035-.036]
	[19.] Mailings to Accountants [Deleted] ..... [.037-.038]
	[20.] Trade Association Analysis [Deleted] ..... [.039-.040]
	[21.] Trade Association Survey [Deleted] ..... [.041-.042]
	[22.] Management Consultant [Deleted] ..... [.043-.044]

<i>Section</i>	<i>Paragraph</i>
591	Ethics Rulings on Other Responsibilities and Practices—continued
	[23.] Tax Work Obtained Through Bookkeeper [Deleted] . . . . . [045-046]
	[24.] Advertising on Tax Broadcast [Deleted] . . . . . [047-048]
	[25.] Alumni Magazine Announcement [Deleted] . . . . . [049-050]
	[26.] Brochure Showing Use of Equipment [Deleted] . . . . . [051-052]
	[27.] Client Publishing Article on Member’s Software Program [Deleted] . . . . . [053-054]
	[28.] Business Card on Newsletter [Deleted] . . . . . [055-056]
	[29.] Computer Print-Out [Deleted] . . . . . [057-058]
	[30.] Charitable Contribution [Deleted] . . . . . [059-060]
	[31.] Congratulatory Message [Deleted] . . . . . [061-062]
	[32.] Copyright for Wheel Computer and Tax Withholding Tables [Deleted] . . . . . [063-064]
	33. Course Instructor . . . . . 065-066
	[34.] Course Promotional Circular [Deleted] . . . . . [067-068]
	[35.] CPA-Author Credits [Deleted] . . . . . [069-070]
	[36.] CPA-Author of Book Review [Deleted] . . . . . [071-072]
	[37.] CPA-Authored Articles [Deleted] . . . . . [073-074]
	38. CPA Title, Controller of Bank . . . . . 075-076
	[39.] CPA Title Imprinted on Checks [Deleted] . . . . . [077-078]
	[40.] CPA Title in Campaign for School Board Membership [Deleted] . . . . . [079-080]
	[41.] CPA Title in Lecture Ad [Deleted] . . . . . [081-082]
	[42.] CPA Title in Political Endorsement [Deleted] . . . . . [083-084]
	[43.] CPA Designation in Speaker’s Qualifications [Deleted] . . . . . [085-086]
	[44.] CPA Designation of Speaker Named in Tax Forum Ad [Deleted] . . . . . [087-088]
	[45.] CPA Title on Agency Letterhead [Deleted] . . . . . [089-090]
	[46.] CPA Title on Employment Agency Letterhead [Deleted] . . . . . [091-092]
	[47.] Low-Income Taxpayers [Deleted] . . . . . [093-094]
	[48.] CPA Title on Public Official’s Match Folder [Deleted] . . . . . [095-096]
	[49.] CPA Designation on Research Reports [Deleted] . . . . . [097-098]
	[50.] Data Processing Program Ad in Technical Publications [Deleted] . . . . . [099-100]
	[51.] Directories in Elevator [Deleted] . . . . . [101-102]
	[52.] Directory, Alphabetical [Deleted] . . . . . [103-104]
	[53.] Directory, Chamber of Commerce Buyer’s Guide [Deleted] . . . . . [105-106]
	[54.] Directory, Trade Association [Deleted] . . . . . [107-108]
	[55.] Directory Listing, Bank Auditors [Deleted] . . . . . [109-110]

<i>Section</i>	<i>Paragraph</i>
591	Ethics Rulings on Other Responsibilities and Practices—continued
	[56.] Directory Listing, Change in Telephone Number Announcements [Deleted] ..... [111-112]
	[57.] Directory Listing, Fraternity [Deleted] ..... [113-114]
	[58.] Directory Listing, "Lawyer-CPA-Tax Attorney" [Deleted] ..... [115-116]
	[59.] Directory Listing, Membership Designation [Deleted] ... [117-118]
	[60.] Directory Listing, Multiple [Deleted] ..... [119-120]
	[61.] Directory Listings [Deleted] ..... [121-122]
	[62.] Directory Listing, Partners' Names [Deleted] ..... [123-124]
	[63.] Directory Listing, White Pages [Superseded] ..... [125-126]
	[64.] Directory, Trade Association [Deleted] ..... [127-128]
	[65.] Distribution of Firm Bulletin to Publisher [Deleted] ..... [129-130]
	[66.] Distribution of Firm Literature [Deleted] ..... [131-132]
	[67.] Firm Publications: Annual Financial Report [Deleted] ... [133-134]
	[68.] Employment Ads: "Situations Wanted" [Deleted] ..... [135-136]
	[69.] Firm Name in Staff Training Manual [Deleted] ..... [137-138]
	[70.] CPA Title on License Plates [Deleted] ..... [139-140]
	[71.] Firm Name on Bowling Shirts [Deleted] ..... [141-142]
	[72.] Firm Name on Desk Calendars [Deleted] ..... [143-144]
	[73.] Firm Name on EDP Publication [Deleted] ..... [145-146]
	[74.] Firm Name on Tax Booklet [Deleted] ..... [147-148]
	[75.] Greeting Cards to Clients [Deleted] ..... [149-150]
	[76.] Letterhead [Deleted] ..... [151-152]
	[77.] Letterhead: Academic Degrees [Deleted] ..... [153-154]
	78. Letterhead: Lawyer-CPA ..... 155-156
	[79.] Letterhead: Tax Specialization [Deleted] ..... [157-158]
	[80.] Management Letter [Deleted] ..... [159-160]
	[81.] Medicare Booklet [Deleted] ..... [161-162]
	[82.] Newsletter ..... [163-164]
	[83.] Nonpractitioner in Sales Brochure [Deleted] ..... [165-166]
	[84.] Paid for by Others, Member's Testimonial Letter [Deleted] ..... [167-168]
	[85.] Paid for by Others, Member's Testimonial Letter [Deleted] ..... [169-170]
	[86.] Paid for by Others, Name in Client Ad [Deleted] ..... [171-172]
	[87.] Paid for by Others, Radio Program Dedication [Deleted] ..... [173-174]
	[88.] Political Endorsement [Deleted] ..... [175-176]

<i>Section</i>	<i>Paragraph</i>
591	Ethics Rulings on Other Responsibilities and Practices—continued
	[89.] Postage Meter Machines [Deleted] ..... [177-178]
	[90.] Open House [Deleted] ..... [179-180]
	[91.] Press Release on Change in Staff [Superseded] ..... [181-182]
	[92.] Press Release on Change in Staff [Superseded] ..... [183-184]
	[93.] Press Release on Society Chapter Meeting [Deleted] ... [185-186]
	[94.] Professorship Named After CPA [Deleted] ..... [187-188]
	[95.] Qualifications as Attachment to Report [Deleted] ..... [189-190]
	[96.] Resume for Lender’s Information [Deleted] ..... [191-192]
	[97.] Seminar Announcement [Deleted] ..... [193-194]
	[98.] Signs on Office Premises [Deleted] ..... [195-196]
	[99.] Signs on Office Premises [Deleted] ..... [197-198]
	[100.] Specialization on Business Card [Deleted] ..... [199-200]
	[101.] Specialization, Acquisitions & Mergers [Deleted] .... [201-202]
	[102.] Specialization: “Tax Accountant” Designation by Nonpractitioner [Deleted] ..... [203-204]
	[103.] Recruiting Ad in Employment Guide or Career Opportunity Guide [Deleted] ..... [205-206]
	[104.] Staff Recruiting in University Publication [Deleted] .... [207-208]
	[105.] Announcement Card: Elected to Vice Presidency [Deleted] ..... [209-210]
	[106.] Information Under Telephone Directory Heading [Deleted] ..... [211-212]
	[107.] Member as Consultant for Client’s Customers [Deleted] ..... [213-214]
	108. Member Interviewed by the Press ..... 215-216
	[109.] Compensation From Nonpractitioners [Deleted] ..... [217-218]
	[110.] Computer Service Franchise [Deleted] ..... [219-220]
	[111.] Purchase of Bookkeeping Practice [Deleted] ..... [221-222]
	[112.] Referral [Deleted] ..... [223-224]
	[113.] Member’s Spouse as Insurance Agent [Deleted] ..... [225-226]
	[114.] Member’s Firm Paying Employee Bonuses [Deleted]... [227-228]
	[115.] Actuary [Deleted] ..... [229-230]
	[116.] Bank Director [Deleted] ..... [231-232]
	117. Consumer Credit Company Director ..... 233-234
	[118.] Employment Agency [Deleted] ..... [235-236]
	[119.] Finance Company [Deleted] ..... [237-238]
	[120.] Insurance Broker [Deleted] ..... [239-240]
	[121.] Insurance Salesman [Deleted] ..... [241-242]
	[122.] Investment Advisor [Deleted] ..... [243-244]



<i>Section</i>	<i>Paragraph</i>
591	Ethics Rulings on Other Responsibilities and Practices—continued
	[123.] Loan Broker [Deleted] ..... [.245-.246]
	[124.] Mutual Fund Salesman [Deleted] ..... [.247-.248]
	[125.] Private Investor in Business and Real Estate [Deleted] ..... [.249-.250]
	[126.] Real Estate Broker [Deleted] ..... [.251-.252]
	[127.] State Controller [Deleted] ..... [.253-.254]
	[128.] State Secretary of Revenue [Deleted] ..... [.255-.256]
	[129.] Travel Agency [Deleted] ..... [.257-.258]
	[130.] Collection Agent [Deleted] ..... [.259-.260]
	[131.] Bookkeeping Service as Feeder [Deleted] ..... [.261-.262]
	[132.] Tax Practice: Conflict of Interest [Deleted] ..... [.263-.264]
	[133.] Member Employed by Incorporated Law Firm [Deleted] ..... [.265-.266]
	134. Association of Accountants Not Partners ..... .267-.268
	135. Association of Firms Not Partners ..... .269-.270
	136. Audit with Former Partner ..... .271-.272
	137. Nonproprietary Partners ..... .273-.274
	138. Partner Having Separate Proprietorship ..... .275-.276
	[139.] Partnership with Non-CPA [Deleted] ..... [.277-.278]
	140. Political Election ..... .279-.280
	141. Responsibility for Non-CPA Partner ..... .281-.282
	[142.] Retired Partners [Deleted] ..... [.283-.284]
	[143.] Partnership With Non-CPA [Deleted] ..... [.285-.286]
	144. Title: Partnership Roster ..... .287-.288
	145. Firm Name of Merged Partnerships ..... .289-.290
	[146.] Membership Designation [Deleted] ..... [.291-.292]
	[147.] Firm Designation [Deleted] ..... [.293-.294]
	[148.] Firm Designation [Deleted] ..... [.295-.296]
	[149.] Data Processing: Accounting and Bookkeeping Assistance [Deleted] ..... [.297-.298]
	[150.] Data Processing: Billing Service [Deleted] ..... [.299-.300]
	[151.] Data Processing: Computer Center [Deleted] ..... [.301-.302]
	[152.] Data Processing: Computer Center [Deleted] ..... [.303-.304]
	[153.] Data Processing: Computer Center [Deleted] ..... [.305-.306]
	[154.] Data Processing: Computer Center, Service Bureau as Client [Deleted] ..... [.307-.308]
	[155.] Data Processing: Computer Corporation [Deleted] ... [.309-.310]

<i>Section</i>	<i>Paragraph</i>
591	Ethics Rulings on Other Responsibilities and Practices—continued
	[156.] Data Processing: Consultant to Service Bureaus [Deleted] ..... [311-312]
	[157.] Data Processing: Employee Not in Practice [Deleted] ..... [313-314]
	[158.] Operation of Separate Data Processing Business by a Public Practitioner [Deleted] ..... [315-316]
	[159.] Data Processing: Fees Paid to Other CPAs [Deleted] ..... [317-318]
	[160.] Data Processing: Forwarding Fees [Deleted] ..... [319-320]
	[161.] Time-Sharing Computer Programs Developed by Member’s Firm [Deleted] ..... [321-322]
	[162.] CPA Designation on Professional Organization Letterhead [Superseded] ..... [323-324]
	[163.] Distribution of Firm Publications to News Media [Deleted] ..... [325-326]
	[164.] Nonclients on Firm Publication Mailing List [Deleted] ..... [327-328]
	[165.] Sale of Firm Publications [Deleted] ..... [329-330]
	[166.] Announcement of Member’s Withdrawal from Firm [Deleted] ..... [331-332]
	[167.] Member Receiving Payment for Referral of Client to Others [Deleted] ..... [333-334]
	[168.] Audit Guides Issued by Governmental Agencies [Superseded by interpretation 501-31] ..... [335-336]
	[169.] Firm Publications, Distribution to Client’s Board of Directors [Deleted] ..... [337-338]
	[170.] Sponsor’s Announcement of Member’s Participation in Educational Seminar [Deleted] ..... [339-340]
	[171.] CPA Designation on Professional Organization or Corporation Letterhead [Deleted] ..... [341-342]
	[172.] Outside Review of Firm Publication [Deleted] ..... [343-344]
	[173.] Use of Credit Cards for Payment of Professional Services [Deleted] ..... [345-346]
	[174.] Directory Listing, White Pages [Deleted] ..... [347-348]
	[175.] Bank Director [Replaced by ruling No. 85 under rule of conduct 102 and ruling No. 18 under rule of conduct 301] ..... [349-350]
	176. Member’s Association With Newsletters and Publications [Revised] ..... 351-352
	177. Data Processing: Billing Services ..... 353-354
	[178.] Location of Separate Business [Deleted] ..... [355-356]

<i>Section</i>	<i>Paragraph</i>
591	Ethics Rulings on Other Responsibilities and Practices—continued
	179. Practice of Public Accounting Under Name of Association or Group ..... .357-.358
	[180.] Side Business Which Offers Services of a Type Performed by CPAs [Deleted] ..... [.359-.360]
	[181.] Sale of a Practice—Purchase of Accounts [Deleted] ..... [.361-.362]
	[182.] Termination of Engagement Prior to Completion [Deleted] ..... [.363-.364]
	183. Use of the AICPA Personal Financial Specialist Designation ..... .365-.366
	184. Definition of the Receipt of a Contingent Fee or a Commission ..... .367-.368
	185. Sale of Products to Clients ..... .369-370
	186. Billing for Subcontractor’s Services ..... .371-.372
	187. Receipt of Contingent Fees or Commissions by Member’s Spouse ..... .373-.374
	188. Referral of Products of Others ..... .375-.376
	189. Requests for Records Pursuant to Interpretation 501-1 [Revised] ..... .377-.378
	190. Non-CPA Partner ..... .379-.380
	191. Member Removing Client Files From an Accounting Firm [Revised] ..... .381-.382
	192. Commission and Contingent Fee Arrangements With Nonattest Client ..... .383-.384

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## ET Section 501

### *Acts Discreditable*

**.01 Rule 501—Acts discreditable** A member shall not commit an act discreditable to the profession.

[As adopted January 12, 1988.]

#### ***Interpretations under Rule 501—Acts Discreditable***

##### **.02 501-1—Response to requests by clients and former clients for records**

###### **Terminology**

The following terms are defined below solely for use with this interpretation:

- *Client provided records* are accounting or other records belonging to the client that were provided to the member by or on behalf of the client.
- *Client records prepared by the member* are accounting or other records (for example, tax returns, general ledgers, subsidiary journals, and supporting schedules such as detailed employee payroll records and depreciation schedules) that the member was engaged to prepare for the client.
- *Supporting records* are information not reflected in the client's books and records that are otherwise not available to the client with the result that the client's financial information is incomplete. For example, supporting records include adjusting, closing, combining, or consolidating journal entries (including computations supporting such entries) that are produced by the member during an engagement (for example, an audit).
- *Member's working papers* include, but are not limited to, audit programs, analytical review schedules, and statistical sampling results, analyses, and schedules prepared by the client at the request of the member.

###### **Interpretation**

When a client or former client (client) makes a request for client-provided records, client records prepared by the member, or supporting records that are in the custody or control of the member or the member's firm (member) that have not previously been provided to the client, the member should respond to the client's request as follows:<sup>1</sup>

- *Client provided records* in the member's custody or control should be returned to the client.
- *Client records prepared by the member* should be provided to the client, except that client records prepared by the member may be withheld if

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<sup>1</sup> The member is under no obligation to retain records for periods that exceed applicable professional standards, state and federal statutes and regulations, and contractual agreements relating to the service performed.

the preparation of such records is not complete or there are fees due the member for the engagement to prepare those records.

- *Supporting records* relating to a completed and issued work product should be provided to the client, except that such supporting records may be withheld if there are fees due to the member for the specific work product.

Once the member has complied with these requirements, he or she is under no ethical obligation to comply with any subsequent requests to again provide such records or copies of such records. However, if subsequent to complying with a request, a client experiences a loss of records due to a natural disaster or an act of war, the member should comply with an additional request to provide such records.

Member's working papers are the member's property and need not be provided to the client under provisions of this interpretation; however, such requirements may be imposed by state and federal statutes and regulations, and contractual agreements.

In connection with any request for client-provided records, client records prepared by the member, or supporting records, the member may:

- Charge the client a reasonable fee for the time and expense incurred to retrieve and copy such records and require that such fee be paid prior to the time such records are provided to the client;
- Provide the requested records in any format usable by the client<sup>2</sup>; and
- Make and retain copies of any records returned or provided to the client.

Where a member is required to return or provide records to the client, the member should comply with the client's request as soon as practicable but, absent extenuating circumstances, no later than 45 days after the request is made. The fact that the statutes of the state in which the member practices grants the member a lien on certain records in his or her custody or control does not relieve the member of his or her obligation to comply with this interpretation. In addition, certain states have laws and regulations that impose obligations on the member greater than the provisions of this interpretation and should be complied with.

[Revised, effective April 30, 2000, by the Professional Ethics Executive Committee. Revised, effective April 30, 2006, by the Professional Ethics Executive Committee.]

**.03 501-2—Discrimination and harassment in employment practices** Whenever a member is finally determined by a court of competent jurisdiction to have violated any of the antidiscrimination laws of the United States or any state or municipality thereof, including those related to sexual and other forms of harassment, or has waived or lost his/her right of appeal after a hearing by an administrative agency, the member will be presumed to have committed an act discreditable to the profession in violation of rule 501 [ET section 501.01].

[Revised, effective November 30, 1997, by the Professional Ethics Executive Committee.]

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<sup>2</sup> The member is not required to convert records that are not in electronic format to electronic format. However if the client requests records in a specific format and the member was engaged to prepare the records in that format, the client's request should be honored.

**.04 501-3—Failure to follow standards and/or procedures or other requirements in governmental audits** Engagements for audits of government grants, government units or other recipients of government monies typically require that such audits be in compliance with government audit standards, guides, procedures, statutes, rules, and regulations, in addition to generally accepted auditing standards. If a member has accepted such an engagement and undertakes an obligation to follow specified government audit standards, guides, procedures, statutes, rules and regulations, in addition to generally accepted auditing standards, he is obligated to follow such requirements. Failure to do so is an act discreditable to the profession in violation of rule 501 [ET section 501.01], unless the member discloses in his report the fact that such requirements were not followed and the reasons therefor.

**.05 501-4—Negligence in the preparation of financial statements or records** A member shall be considered to have committed an act discreditable to the profession in violation of rule 501 [ET section 501.01] when, by virtue of his or her negligence, such member—

- a. Makes, or permits or directs another to make, materially false and misleading entries in the financial statements or records of an entity; or
- b. Fails to correct an entity's financial statements that are materially false and misleading when the member has the authority to record an entry; or
- c. Signs, or permits or directs another to sign, a document containing materially false and misleading information.

[Revised, effective May 31, 1999, by the Professional Ethics Executive Committee.]

**.06 501-5—Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies** Many governmental bodies, commissions or other regulatory agencies have established requirements such as audit standards, guides, rules, and regulations that members are required to follow in the preparation of financial statements or related information, or in performing attest or similar services for entities subject to their jurisdiction. For example, the Securities and Exchange Commission, Federal Communications Commission, state insurance commissions, and other regulatory agencies, such as the Public Company Accounting Oversight Board, have established such requirements.

If a member prepares financial statements or related information (for example, management's discussion and analysis) for purposes of reporting to such bodies, commissions, or regulatory agencies, the member should follow the requirements of such organizations in addition to generally accepted accounting principles. If a member agrees to perform an attest or similar service for the purpose of reporting to such bodies, commissions, or regulatory agencies, the member should follow such requirements, in addition to generally accepted auditing standards (where applicable). A material departure from such requirements is an act discreditable to the profession, unless the member discloses in the financial statements or his or her report, as applicable, that such requirements were not followed and the reasons therefore.

[Effective August 31, 1989. Revised, effective October 31, 2000, by the Professional Ethics Executive Committee. Revised, effective April 30, 2004, by the Professional Ethics Executive Committee.]

**.07 501-6—Solicitation or disclosure of CPA examination questions and answers** A member who solicits or knowingly discloses the May 1996

or later Uniform CPA Examination question(s) and/or answer(s) without the written authorization of the AICPA shall be considered to have committed an act discreditable to the profession in violation of rule 501 [ET section 501.01].

[Effective January 31, 1996. Revised May 1996, by the Professional Ethics Executive Committee.]

**.08 501-7—Failure to file tax return or pay tax liability** A member who fails to comply with applicable federal, state, or local laws or regulations regarding the timely filing of his or her personal tax returns or tax returns of the member's firm, or the timely remittance of all payroll and other taxes collected on behalf of others, may be considered to have committed an act discreditable to the profession in violation of rule 501 [ET section 501.01].

[Effective May 31, 1999.]

**.09 501-8—Failure to follow requirements of governmental bodies, commissions, or other regulatory agencies on indemnification and limitation of liability provisions in connection with audit and other attest services** Certain governmental bodies, commissions, or other regulatory agencies (collectively, *regulators*) have established requirements through laws, regulations, or published interpretations that prohibit entities subject to their regulation (*regulated entity*) from including certain types of indemnification and limitation of liability provisions in agreements for the performance of audit or other attest services that are required by such regulators or that provide that the existence of such provisions causes a member to be disqualified from providing such services to these entities. For example, federal banking regulators, state insurance commissions, and the Securities and Exchange Commission have established such requirements.

If a member enters into, or directs or knowingly permits another individual to enter into, a contract for the performance of audit or other attest services that are subject to the requirements of these regulators, the member should not include, or knowingly permit or direct another individual to include, an indemnification or limitation of liability provision that would cause the regulated entity or a member to be in violation of such requirements or that would cause a member to be disqualified from providing such services to the regulated entity. A member who enters into, or directs or knowingly permits another individual to enter into, such an agreement for the performance of audit or other attest services that would cause the regulated entity or a member to be in violation of such requirements, or that would cause a member to be disqualified from providing such services to the regulated entity, would be considered to have committed an act discreditable to the profession.

Members should also consult Ethics Ruling No. 94, "Indemnification Clause in Engagement Letters," of ET section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* (ET sec. 191 par. .188–.189) and Ethics Ruling No. 102, "Indemnification of a Client," of ET section 191, (ET sec. 191 par. .204–.205) under Rule 101, *Independence* for guidance related to use of indemnification clauses in engagement letters and the impact on a member's independence.

[Effective July 31, 2008.]

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## ET Section 502

# *Advertising and Other Forms of Solicitation*

**.01 Rule 502—Advertising and other forms of solicitation** A member in public practice shall not seek to obtain clients by advertising or other forms of solicitation in a manner that is false, misleading, or deceptive. Solicitation by the use of coercion, over-reaching, or harassing conduct is prohibited.

[As adopted January 12, 1988.]

### ***Interpretations under Rule 502—Advertising and Other Forms of Solicitation***

[.02] [502-1]—[Deleted]

**.03 502-2—False, misleading or deceptive acts in advertising or solicitation** Advertising or other forms of solicitation that are false, misleading, or deceptive are not in the public interest and are prohibited. Such activities include those that—

1. Create false or unjustified expectations of favorable results.
2. Imply the ability to influence any court, tribunal, regulatory agency, or similar body or official.
3. Contain a representation that specific professional services in current or future periods will be performed for a stated fee, estimated fee or fee range when it was likely at the time of the representation that such fees would be substantially increased and the prospective client was not advised of that likelihood.
4. Contain any other representations that would be likely to cause a reasonable person to misunderstand or be deceived.

[Revised, November 30, 1990, by the Professional Ethics Executive Committee.]

[.04] [502-3]—[Deleted]

[.05] [502-4]—[Deleted]

**.06 502-5—Engagements obtained through efforts of third parties** Members are often asked to render professional services to clients or customers of third parties. Such third parties may have obtained such clients or customers as the result of their advertising and solicitation efforts.

Members are permitted to enter into such engagements. The member has the responsibility to ascertain that all promotional efforts are within the bounds of the Rules of Conduct. Such action is required because the members will receive the benefits of such efforts by third parties, and members must not do through others what they are prohibited from doing themselves by the Rules of Conduct.





## ET Section 503

### *Commissions and Referral Fees*

#### **.01 Rule 503—Commissions and referral fees**

##### *A. Prohibited commissions*

A member in public practice shall not for a commission recommend or refer to a client any product or service, or for a commission recommend or refer any product or service to be supplied by a client, or receive a commission, when the member or the member's firm also performs for that client

- (a) an audit or review of a financial statement; or
- (b) a compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or
- (c) an examination of prospective financial information.

This prohibition applies during the period in which the member is engaged to perform any of the services listed above and the period covered by any historical financial statements involved in such listed services.

##### *B. Disclosure of permitted commissions*

A member in public practice who is not prohibited by this rule from performing services for or receiving a commission and who is paid or expects to be paid a commission shall disclose that fact to any person or entity to whom the member recommends or refers a product or service to which the commission relates.

##### *C. Referral fees*

Any member who accepts a referral fee for recommending or referring any service of a CPA to any person or entity or who pays a referral fee to obtain a client shall disclose such acceptance or payment to the client.

[As adopted May 23, 1990, effective August 9, 1990.]

#### ***Interpretation under Rule 503—Commissions and Referral Fees***

[.02] [503-1]—[Deleted]

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## ET Section 505

### *Form of Organization and Name*

**.01 Rule 505—Form of organization and name** A member may practice public accounting only in a form of organization permitted by law or regulation whose characteristics conform to resolutions of Council.

A member shall not practice public accounting under a firm name that is misleading. Names of one or more past owners may be included in the firm name of a successor organization.

A firm may not designate itself as "Members of the American Institute of Certified Public Accountants" unless all of its CPA owners are members of the Institute.

[As amended January 14, 1992 and October 28, 1997. Revised May 15, 2000.]

(See Appendix B.)

#### *Interpretations under Rule 505—Form of Organization and Name*

##### [.02] [505-1]—[Deleted]

**.03 505-2—Application of rules of conduct to members who own a separate business** A member in the practice of public accounting may own an interest in a separate business that performs for clients any of the professional services of accounting, tax, personal financial planning, litigation support services, and those services for which standards are promulgated by bodies designated by Council (see ET section 92.25). If the member, individually or collectively with his or her firm or with members of his or her firm controls the separate business (as defined by generally accepted accounting principles [GAAP]), the entity and all its owners (including the member) and employees must comply with all of the provisions of the Code of Professional Conduct. For example, in applying Rule 503, *Commissions and Referral Fees* [ET section 503.01], if one or more members individually or collectively can control the separate business, such business would be subject to rule 503 [ET section 503.01], its interpretations and rulings. With respect to an attest client, rule 101 [ET section 101.01] and all its interpretations and rulings would apply to the separate business, its owners and employees.

If the member, individually or collectively with his or her firm or with members of his or her firm, does not control the separate business, the provisions of the Code would apply to the member for his or her actions but not apply to the entity, its other owners and employees. For example, the entity could enter into a contingent fee arrangement with an attest client of the member or accept commissions for the referral of products or services to such attest client.

[Replaces previous interpretation 505-2, with the same title, March 1993, effective March 31, 1993. Revised, effective December 31, 1998, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, effective April 30, 2003, by the Professional Ethics Executive Committee.]

**.04 505-3—Application of rule 505 to alternative practice structures** Rule 505, *Form of Organization and Name* [ET section 505.01], states, "A member may practice public accounting only in a form of organization permitted by law or regulation whose characteristics conform resolutions of

Council." The Council Resolution (the Resolution) requires, among other things, that a majority of the financial interests in a firm engaged in attest services (as defined therein) be owned by CPAs. In the context of alternative practice structures (APS) in which (1) the majority of the financial interests in the attest firm is owned by CPAs and (2) all or substantially all of the revenues are paid to another entity in return for services and the lease of employees, equipment, and office space, questions have arisen as to the applicability of rule 505 [ET section 505.01].

The overriding focus of the Resolution is that CPAs remain responsible, financially and otherwise, for the attest work performed to protect the public interest. The Resolution contains many requirements that were developed to ensure that responsibility. In addition to the provisions of the Resolution, other requirements of the Code of Professional Conduct and bylaws ensure that responsibility:

- a. Compliance with all aspects of applicable state law or regulation
- b. Enrollment in an AICPA-approved practice monitoring program
- c. Compliance with the independence rules prescribed by Rule 101, *Independence* [ET section 101.01]
- d. Compliance with applicable standards promulgated by Council-designated bodies (Rule 202, *Compliance With Standards* [ET section 202.01]) and all other provisions of the Code, including ET section 91, *Applicability*

Taken in the context of all the above-mentioned safeguards of the public interest, if the CPAs who own the attest firm remain financially responsible, under applicable law or regulation, the member is considered to be in compliance with the financial interests provision of the Resolution.

[Effective December 31, 1998. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, June 2009.]

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## ET Section 591

# *Ethics Rulings on Other Responsibilities and Practices*

### [1.] Retention of Records

[.001–.002] [Superseded by interpretation 501-1.]

### 2. Fees: Collection of Notes Issued in Payment

.003 *Question*—A member's firm made arrangements with a bank to collect notes issued by a client in payment of fees due, and so advised the delinquent client. Is this procedure ethical?

.004 *Answer*—The procedure followed does not violate any provision of the Code.

### 3. Employment by Non-CPA Firm

.005 *Question*—A member is considering employment with a public accounting firm made up of one or more non-CPA practitioners. If he is employed by such a firm, what are his responsibilities under the Rules of Conduct?

.006 *Answer*—A member so employed must comply with all the Rules of Conduct. If he becomes a partner in such a firm, he will then in addition be held responsible for compliance with the Rules of Conduct by all persons associated with him.

### [4.] Association Employee

[.007–.008] [Deleted March 1978]

### [5.] Association as an Agent

[.009–.010] [Deleted March 1978]

### [6.] Associations, Speaking Engagements

[.011–.012] [Deleted March 1978]

### [7.] Trading Pool

[.013–.014] [Deleted March 1978]

### [8.] Change of Control of Client Company

[.015–.016] [Deleted September 1981]

### [9.] Charity Solicitation by Phone

[.017–.018] [Deleted March 1978]

**[10.] Church Bulletin**

[.019-.020] [Deleted March 1978]

**[11.] Attorney, Clients**

[.021-.022] [Deleted March 1978]

**[12.] Confirmation Requests**

[.023-.024] [Deleted March 1978]

**[13.] Confirmation Stickers**

[.025-.026] [Deleted March 1978]

**[14.] Estate Planning**

[.027-.028] [Deleted March 1978]

**[15.] Golf Outing**

[.029-.030] [Deleted March 1978]

**[16.] Letter on Behalf of Client**

[.031-.032] [Deleted March 1978]

**[17.] Letterhead for Estate Practice**

[.033-.034] [Deleted March 1978]

**[18.] Letterhead for Promotional Material**

[.035-.036] [Deleted March 1978]

**[19.] Mailings to Accountants**

[.037-.038] [Deleted March 1978]

**[20.] Trade Association Analysis**

[.039-.040] [Deleted September 1981]

**[21.] Trade Association Survey**

[.041-.042] [Deleted September 1981]

**[22.] Management Consultant**

[.043-.044] [Deleted March 1978]

**[23.] Tax Work Obtained Through Bookkeeper**

[.045-.046] [Deleted March 1978]

**[24.] Advertising on Tax Broadcast**

[.047-.048] [Deleted March 1978]

**[25.] Alumni Magazine Announcement**

[.049-.050] [Deleted March 1978]

**[26.] Brochure Showing Use of Equipment**

[.051-.052] [Deleted March 1978]

**[27.] Client Publishing Article on Member's Software Program**

[.053-.054] [Deleted March 1978]

**[28.] Business Card on Newsletter**

[.055-.056] [Deleted March 1978]

**[29.] Computer Print-Out**

[.057-.058] [Deleted March 1978]

**[30.] Charitable Contribution**

[.059-.060] [Deleted March 1978]

**[31.] Congratulatory Message**

[.061-.062] [Deleted March 1978]

**[32.] Copyright for Wheel Computer and Tax Withholding Tables**

[.063-.064] [Deleted March 1978]

**33. Course Instructor**

**.065 Question**—What responsibility does a member have for the information included in advertising material used to promote a course which he has been asked to conduct?

**.066 Answer**—It is of value to prospective students to know the instructor's background—such as degrees he holds, professional society affiliations, and the name of his firm. The member has the responsibility to ascertain that all promotional efforts are within the bounds of rule 502 [ET section 502.01].

**[34.] Course Promotional Circular**

[.067-.068] [Deleted March 1978]

**[35.] CPA-Author Credits**

[.069-.070] [Deleted March 1978]

**[36.] CPA-Author of Book Review**

[.071-.072] [Deleted March 1978]

**[37.] CPA-Authored Articles**

[.073-.074] [Deleted March 1978]

**38. CPA Title, Controller of Bank**

**.075 Question**—A member not in public practice is controller of a bank. May the member permit the bank to use his CPA title on bank stationery and in paid advertisements listing the officers and directors of the bank?

**.076 Answer**—The use of the CPA title on bank stationery by a member not in public practice is proper. It would also be proper for the CPA title of the member to appear in paid advertisements of the bank that list the officers and directors.

**[39.] CPA Title Imprinted on Checks**

[.077-.078] [Deleted March 1978]



- [40.] **CPA Title in Campaign for School Board Membership**  
[.079-.080] [Deleted March 1978]
- [41.] **CPA Title in Lecture Ad**  
[.081-.082] [Deleted March 1978]
- [42.] **CPA Title in Political Endorsement**  
[.083-.084] [Deleted March 1978]
- [43.] **CPA Designation in Speaker's Qualifications**  
[.085-.086] [Deleted March 1978]
- [44.] **CPA Designation of Speaker Named in Tax Forum Ad**  
[.087-.088] [Deleted March 1978]
- [45.] **CPA Title on Agency Letterhead**  
[.089-.090] [Superseded August 1975]
- [46.] **CPA Title on Employment Agency Letterhead**  
[.091-.092] [Deleted March 1978]
- [47.] **Low-Income Taxpayers**  
[.093-.094] [Deleted March 1978]
- [48.] **CPA Title on Public Official's Match Folder**  
[.095-.096] [Deleted March 1978]
- [49.] **CPA Designation on Research Reports**  
[.097-.098] [Deleted March 1978]
- [50.] **Data Processing Program Ad in Technical Publications**  
[.099-.100] [Deleted March 1978]
- [51.] **Directories in Elevator**  
[.101-.102] [Deleted March 1978]
- [52.] **Directory, Alphabetical**  
[.103-.104] [Deleted March 1978]
- [53.] **Directory, Chamber of Commerce Buyer's Guide**  
[.105-.106] [Deleted March 1978]
- [54.] **Directory, Trade Association**  
[.107-.108] [Deleted March 1978]
- [55.] **Directory Listing, Bank Auditors**  
[.109-.110] [Deleted March 1978]
- [56.] **Directory Listing, Change in Telephone Number Announcements**  
[.111-.112] [Deleted March 1978]

- [57.] **Directory Listing, Fraternity**  
[.113-.114] [Deleted March 1978]
- [58.] **Directory Listing, "Lawyer-CPA-Tax Attorney"**  
[.115-.116] [Deleted March 1978]
- [59.] **Directory Listing, Membership Designation**  
[.117-.118] [Deleted March 1978]
- [60.] **Directory Listing, Multiple**  
[.119-.120] [Deleted March 1978]
- [61.] **Directory Listings**  
[.121-.122] [Deleted March 1978]
- [62.] **Directory Listing, Partners' Names**  
[.123-.124] [Deleted March 1978]
- [63.] **Directory Listing, White Pages**  
[.125-.126] [Superseded February 1976]
- [64.] **Directory, Trade Association**  
[.127-.128] [Deleted March 1978]
- [65.] **Distribution of Firm Bulletin to Publisher**  
[.129-.130] [Deleted March 1978]
- [66.] **Distribution of Firm Literature**  
[.131-.132] [Deleted March 1978]
- [67.] **Firm Publications: Annual Financial Report**  
[.133-.134] [Deleted March 1978]
- [68.] **Employment Ads: "Situations Wanted"**  
[.135-.136] [Deleted March 1978]
- [69.] **Firm Name in Staff Training Manual**  
[.137-.138] [Deleted March 1978]
- [70.] **CPA Title on License Plates**  
[.139-.140] [Deleted March 1978]
- [71.] **Firm Name on Bowling Shirts**  
[.141-.142] [Deleted March 1978]
- [72.] **Firm Name on Desk Calendars**  
[.143-.144] [Deleted March 1978]
- [73.] **Firm Name on EDP Publication**  
[.145-.146] [Deleted March 1978]

**[74.] Firm Name on Tax Booklet**

[.147-.148] [Deleted September 1981]

**[75.] Greeting Cards to Clients**

[.149-.150] [Deleted March 1978]

**[76.] Letterhead**

[.151-.152] [Deleted March 1978]

**[77.] Letterhead: Academic Degrees**

[.153-.154] [Deleted March 1978]

**78. Letterhead: Lawyer-CPA**

**.155 Question**—May a member who is also admitted to the Bar represent himself on his letterhead as both an attorney and a CPA, or should he use separate letterheads in the conduct of the two practices?

**.156 Answer**—The Code does not prohibit the simultaneous practice of accounting and law by a member licensed in both professions. Either a single or separate letterheads may be used, provided the information with respect to the CPA designation complies with rule 502 [ET section 502.01]. However, the member should also consult the rules of the applicable Bar Association.

**[79.] Letterhead: Tax Specialization**

[.157-.158] [Deleted March 1978]

**[80.] Management Letter**

[.159-.160] [Deleted March 1978]

**[81.] Medicare Booklet**

[.161-.162] [Deleted March 1978]

**[82.] Newsletter**

[.163-.164] [Deleted November 1997]

**[83.] Nonpractitioner in Sales Brochure**

[.165-.166] [Deleted March 1978]

**[84.] Paid for by Others, Member's Testimonial Letter**

[.167-.168] [Deleted March 1978]

**[85.] Paid for by Others, Member's Testimonial Letter**

[.169-.170] [Deleted March 1978]

**[86.] Paid for by Others, Name in Client Ad**

[.171-.172] [Deleted August 1989]

**[87.] Paid for by Others, Radio Program Dedication**

[.173-.174] [Deleted March 1978]

**[88.] Political Endorsement**

[.175-.176] [Deleted March 1978]

**[89.] Postage Meter Machines**

[.177-.178] [Deleted March 1978]

**[90.] Open House**

[.179-.180] [Deleted March 1978]

**[91.] Press Release on Change in Staff**

[.181-.182] [Superseded March 1975]

**[92.] Press Release on Change in Staff**

[.183-.184] [Superseded March 1975]

**[93.] Press Release on Society Chapter Meeting**

[.185-.186] [Deleted March 1978]

**[94.] Professorship Named After CPA**

[.187-.188] [Deleted March 1978]

**[95.] Qualifications as Attachment to Report**

[.189-.190] [Deleted March 1978]

**[96.] Resume for Lender's Information**

[.191-.192] [Deleted March 1978]

**[97.] Seminar Announcement**

[.193-.194] [Deleted March 1978]

**[98.] Signs on Office Premises**

[.195-.196] [Deleted March 1978]

**[99.] Signs on Office Premises**

[.197-.198] [Deleted March 1978]

**[100.] Specialization on Business Card**

[.199-.200] [Deleted March 1978]

**[101.] Specialization, Acquisitions & Mergers**

[.201-.202] [Deleted June 1982]

**[102.] Specialization: "Tax Accountant" Designation by Nonpractitioner**

[.203--.204] [Deleted March 1978]

**[103.] Recruiting Ad in Employment Guide or Career Opportunity Guide**

[.205--.206] [Deleted March 1978]

**[104.] Staff Recruiting in University Publication**

[.207--.208] [Deleted March 1978]

**[105.] Announcement Card: Elected to Vice Presidency**

[.209--.210] [Deleted March 1978]

**[106.] Information Under Telephone Directory Heading**

[.211--.212] [Deleted March 1978]

**[107.] Member as Consultant for Client's Customers**

[.213--.214] [Deleted March 1978]

**108. Member Interviewed by the Press**

**.215 Question**—What ethical standards should a member observe when he is interviewed by the press?

**.216 Answer**—When interviewed by a writer or reporter, the member should observe the limitations imposed on him by the Rules of Conduct. The member may not provide the press with any information for publication that he could not publish himself.

**[109.] Compensation From Nonpractitioners**

[.217--.218] [Deleted June 1991]

**[110.] Computer Service Franchise**

[.219--.220] [Deleted June 1991]

**[111.] Purchase of Bookkeeping Practice**

[.221--.222] [Deleted June 1991]

**[112.] Referral**

[.223--.224] [Deleted June 1991]

**[113.] Member's Spouse as Insurance Agent**

[.225--.226] [Deleted June 1991]

**[114.] Member's Firm Paying Employee Bonuses**

[.227--.228] [Deleted June 1991]

**[115.] Actuary**

[.229--.230] [Deleted December 1992]

**[116.] Bank Director**

[.231--.232] [Superseded June 1976]

**117. Consumer Credit Company Director**

**.233 Question**—A consumer credit company purchases installment sales contracts from retailers and receives payments from consumers. May a practicing CPA serve as a director or officer of such a corporation?

**.234 Answer**—Yes, as long as he does not audit the corporation and does not participate in matters which might involve a conflict of interest.

**[118.] Employment Agency**

[.235-.236] [Deleted March 1978]

**[119.] Finance Company**

[.237-.238] [Deleted March 1978]

**[120.] Insurance Broker**

[.239-.240] [Deleted March 1978]

**[121.] Insurance Salesman**

[.241-.242] [Deleted March 1978]

**[122.] Investment Advisor**

[.243-.244] [Deleted March 1978]

**[123.] Loan Broker**

[.245-.246] [Deleted March 1978]

**[124.] Mutual Fund Salesman**

[.247-.248] [Deleted March 1978]

**[125.] Private Investor in Business and Real Estate**

[.249-.250] [Deleted March 1978]

**[126.] Real Estate Broker**

[.251-.252] [Deleted March 1978]

**[127.] State Controller**

[.253-.254] [Deleted August 1989]

**[128.] State Secretary of Revenue**

[.255-.256] [Deleted March 1978]

**[129.] Travel Agency**

[.257-.258] [Deleted March 1978]

**[130.] Collection Agent**

[.259-.260] [Deleted March 1978]

**[131.] Bookkeeping Service as Feeder**

[.261-.262] [Deleted March 1978]

**[132.] Tax Practice: Conflict of Interest**

[.263–.264] [Deleted August 1989]

**[133.] Member Employed by Incorporated Law Firm**

[.265–.266] [Deleted March 1978]

**134. Association of Accountants Not Partners**

**.267 Question**—Two members who are not partners share an office, have the same employees, have a joint bank account, and work together on each other's engagements. Would it be proper to have a joint letterhead showing both names, "Certified Public Accountants," and their addresses?

**.268 Answer**—In these circumstances the public would assume that a partnership existed. If any reports were to be issued under the joint heading, rule 505 [ET section 505.01] would be violated.

Members should not use a letterhead showing the names of two accountants when a partnership does not exist.

**135. Association of Firms Not Partners**

**.269 Question**—Three CPA firms wish to form an association—not a partnership—to be known as "Smith, Jones & Associates." Is there any impropriety in this?

**.270 Answer**—The use of such a title is not permitted since it might mislead the public into thinking a true partnership exists. Instead, each firm is advised to use its own name on its letterhead, indicating the other two as correspondents.

**136. Audit with Former Partner**

**.271 Question**—A member's firm consisting of one certified and one non-certified partner has been dissolved. One account was retained which the two practitioners plan to continue to service together. Should the audit report be submitted on partnership stationery?

**.272 Answer**—It would appear proper for the audit to be carried out jointly by the two former partners. The opinion should be presented on plain paper and signed somewhat as follows:

John Doe, Certified Public Accountant

Richard Roe, Accountant

Such a signature would leave no doubt as to whether a partnership existed, and the client and others would have the assurance that both accountants participated in the audit.

**137. Nonproprietary Partners**

**.273 Question**—A member's firm wishes to institute the designation "non-proprietary partner" to describe certain high-ranking staff who were former partners of merged firms who did not qualify for partnership in the merging firm. With this title, they would be eligible to participate in the firm's pension plan. In holding themselves out to the public they would be required to use this designation. Is there any impropriety in the proposed title?

**.274 Answer**—The use of the designation "partner" should be restricted to those members of the firm who are legally partners. Those who are not parties to the partnership agreement should not hold themselves out in any manner which might lead others to believe that they are partners. The use of the designation "nonproprietary partner" by one who is not in fact a partner is considered misleading and therefore is not permitted.

### **138. Partner Having Separate Proprietorship**

**.275 Question**—May a member be a partner of a firm of public accountants, all other members of which are noncertified, and at the same time retain for himself a practice of his own as a CPA?

**.276 Answer**—Rule 505 [ET section 505.01] would not prohibit such a practice. However, clients and others interested should be advised about the dual position of the member to prevent any misunderstanding or misrepresentation.

### **[139.] Partnership with Non-CPA**

[.277-.278] [Deleted December 1998]

### **140. Political Election**

**.279 Question**—A member's firm, consisting of four members, practices under the name of the managing partner who is presently seeking election to high public office. If he is elected and withdraws from the partnership, may the three remaining partners continue to use the present firm name?

**.280 Answer**—It would not be a violation for the three remaining partners to continue to practice under the name of the managing partner followed by the designation "and Company."

### **141. Responsibility for Non-CPA Partner**

**.281 Question**—Is a member who has formed a partnership with a noncertified public accountant ethically responsible for all the acts of the partnership?

**.282 Answer**—Yes. If the noncertified partner should violate the Code, the member would be held accountable.

### **[142.] Retired Partners**

[.283-.284] [Deleted March 1978]

### **[143.] Partnership With Non-CPA**

[.285-.286] [Deleted March 1978]

### **144. Title: Partnership Roster**

**.287 Question**—Is there any prohibition in the Code to the use of an established firm name in a different state where there is some difference in the roster of partners?



**.288** *Answer*—It would be proper for the firm to use the established name in different states even though the roster of partners differed as long as the firm otherwise complies with rule 505 [ET section 505.01].

### **145. Firm Name of Merged Partnerships**

**.289** *Question*—When two partnerships merge, is it permissible for the newly merged firm to practice under a title which includes the name of a partner who had retired from one of the two firms prior to the merger?

**.290** *Answer*—Rule 505 [ET section 505.01] of the Code of Professional Conduct states that partnerships may practice under a firm title which includes the name or names of former partners. Since the retired partner was once a partner in one of the merged firms, it would be proper for his name to appear in the title of a newly created firm.

### **[146.] Membership Designation**

[.291–.292] [Deleted September 1999]

### **[147.] Firm Designation**

[.293–.294] [Deleted November 1989]

### **[148.] Firm Designation**

[.295–.296] [Deleted November 1989]

### **[149.] Data Processing: Accounting and Bookkeeping Assistance**

[.297–.298] [Deleted March 1978]

### **[150.] Data Processing: Billing Service**

[.299–.300] [Deleted March 1978]

### **[151.] Data Processing: Computer Center**

[.301–.302] [Deleted March 1978]

### **[152.] Data Processing: Computer Center**

[.303–.304] [Deleted March 1978]

### **[153.] Data Processing: Computer Center**

[.305–.306] [Deleted March 1978]

### **[154.] Data Processing: Computer Center, Service Bureau as Client**

[.307–.308] [Deleted March 1978]

### **[155.] Data Processing: Computer Corporation**

[.309–.310] [Deleted December 1992]

### **[156.] Data Processing: Consultant to Service Bureaus**

[.311–.312] [Deleted December 1992]

**[157.] Data Processing: Employee Not in Practice**

[.313-.314] [Deleted March 1978]

**[158.] Operation of Separate Data Processing Business by a Public Practitioner**

[.315-.316] [Deleted December 1998]

**[159.] Data Processing: Fees Paid to Other CPAs**

[.317-.318] [Deleted June 1991]

**[160.] Data Processing: Forwarding Fees**

[.319-.320] [Deleted March 1978]

**[161.] Time-Sharing Computer Programs Developed by Member's Firm**

[.321-.322] [Deleted March 1978]

**[162.] CPA Designation on Professional Organization Letterhead**

[.323-.324] [Superseded August 1975]

**[163.] Distribution of Firm Publications to News Media**

[.325-.326] [Deleted March 1978]

**[164.] Nonclients on Firm Publication Mailing List**

[.327-.328] [Deleted March 1978]

**[165.] Sale of Firm Publications**

[.329-.330] [Deleted March 1978]

**[166.] Announcement of Member's Withdrawal from Firm**

[.331-.332] [Deleted March 1978]

**[167.] Member Receiving Payment for Referral of Client to Others**

[.333-.334] [Deleted June 1991]

**[168.] Audit Guides Issued by Governmental Agencies**

[.335-.336] [Superseded by interpretation 501-3.]

**[169.] Firm Publications, Distribution to Client's Board of Directors**

[.337-.338] [Deleted March 1978]

**[170.] Sponsor's Announcement of Member's Participation in Educational Seminar**

[.339-.340] [Deleted March 1978]

**[171.] CPA Designation on Professional Organization or Corporation Letterhead**

[.341–.342] [Deleted March 1978]

**[172.] Outside Review of Firm Publication**

[.343–.344] [Deleted March 1978]

**[173.] Use of Credit Cards for Payment of Professional Services**

[.345–.346] [Deleted March 1978]

**[174.] Directory Listing, White Pages**

[.347–.348] [Deleted March 1978]

**[175.] Bank Director**

[.349–.350] [Replaced by ruling No. 85 under rule of conduct 102 and ruling No. 18 under rule of conduct 301.]

**176. Member's Association With Newsletters and Publications**

**.351 Question**—May a newsletter, tax booklet, or similar publication be attributed to a member or a member's firm (member) if it has not been prepared by the member?

**.352 Answer**—Yes, provided that the member has a reasonable basis to conclude that the information contained therein that is attributed to the member is not false, misleading, or deceptive.

[Replaces previous ruling No. 176, *Newsletters and Publications Prepared by Others*, effective August 31, 1989. Revised, effective November 30, 1997, by the Professional Ethics Executive Committee.]

**177. Data Processing: Billing Services**

**.353 Question**—A member in public practice plans to form a separate business to perform centralized billing services for local doctors. The member maintains that this service, which is similar to one currently offered and advertised by a local bank, does not constitute the practice of public accounting and that rules 502 [ET section 502.01] and 505 [ET section 505.01] do not apply. Is the member correct in this conclusion?

**.354 Answer**—No, the service in question does in fact constitute service of a type performed by public accountants and consequently the member could proceed with this plan only if the operation were conducted in accordance with the Institute's rules of conduct.

**[178.] Location of Separate Business**

[.355–.356] [Deleted December 1992]

**179. Practice of Public Accounting Under Name of Association or Group**

**.357 Question**—Several CPA firms wish to form an association or group whereby certain joint advertising, training, professional development and

management assistance will take place. The firms will otherwise remain separate and distinct. Would it be proper for such firms to practice public accounting under the name of an association or group in the United States?

**.358 Answer**—The practice of public accounting under such a name in the United States is not permitted since it would be likely to confuse the public as to the nature of the actual relationship which exists among the firms. Instead, each firm should practice only in its own firm name and may indicate the association or group name elsewhere on the firm stationery. Each firm may also list on its stationery the names of the other firms in the association or group.

### **[180.] Side Business Which Offers Services of a Type Performed by CPAs**

[.359–.360] [Deleted November 1993]

### **[181.] Sale of a Practice—Purchase of Accounts**

[.361–.362] [Deleted June 1991]

### **[182.] Termination of Engagement Prior to Completion**

[.363–.364] [Deleted April 30, 2006.]

## **183. Use of the AICPA Personal Financial Specialist Designation**

**.365 Question**—In what circumstances may a firm include the AICPA-awarded designation "Personal Financial Specialists" on the firm's letterhead and in marketing materials?

**.366 Answer**—It is permissible under rule 502 [ET section 502.01] for the designation "Personal Financial Specialists" (PFS) to be used on a firm's letterhead and in marketing materials if all partners or shareholders of the firm currently have the AICPA-awarded designation. An individual member who holds the designation may use it after his or her name.

## **184. Definition of the Receipt of a Contingent Fee or a Commission**

**.367 Question**—Rules 302 [ET section 302.01] and 503 [ET section 503.01] prohibit, among other acts, the receipt of contingent fees for the performance of certain services and the receipt of a commission for the referral of products or services under certain circumstances. When is a contingent fee or commission deemed to be received?

**.368 Answer**—A contingent fee or commission is deemed to be received when the performance of the related services is complete and the fee or the commission is determined. For example, if in one year a member sells a life insurance policy to a client and the member's commission payments are determined to be a fixed percentage of future years' renewal premiums, the commission is deemed to be received in the year the policy is sold.

## **185. Sale of Products to Clients**

**.369 Question**—May a member purchase a product from a third-party supplier and resell the product to a client without violating rule 503 [ET section 503.01]?

**.370 Answer**—Yes. If a member purchases a product and resells it to a client, any profit on the sale would not constitute a commission. Purchasing entails taking title to the product and having all the associated risks of ownership.

### 186. Billing for Subcontractor's Services

**.371 Question**—A member has contracted with a computer-hardware maintenance servicer to provide support for a client's computer operations. Would it be a violation of rule 503 [ET section 503.01] for that member to bill the client a higher service fee than that charged the member by the service provider?

**.372 Answer**—No. The increased fee would not constitute a commission.

### 187. Receipt of Contingent Fees or Commissions by Member's Spouse

**.373 Question**—May a member's spouse provide services to the member's attest client for a contingent fee or refer products or services for a commission to or from the member's attest client without causing the member to be in violation of rule 302 [ET section 302.01] or rule 503 [ET section 503.01]?

**.374 Answer**—Yes, if the activities of the member's spouse are separate from the member's practice and the member is not significantly involved in those activities. The member, however, should consider whether a conflict of interest may exist as described in rule 102 [ET section 102.01] and interpretation 102-2 [ET section 102.03].

### 188. Referral of Products of Others

**.375 Question**—A member refers computer products of wholesalers to clients of the firm through distributors and agents. A payment is received by the member from the wholesaler if the clients purchase the computer products. Must the member consider rule 503 [ET section 503.01] in connection with this payment?

**.376 Answer**—Yes. Section 91.02 [ET section 91.02] of the Code of Professional Conduct provides that a member shall not permit others to perform acts on behalf of the member that, if carried out by the member, would place the member in violation of the rules. Therefore, the member would be held responsible for the actions of the distributors and agents.

Rule 503 [ET section 503.01] provides that, if a member or the member's firm performs for a client a service described in rule 503 [ET section 503.01], the member may not recommend or refer to that client for a commission any product or service, or receive a commission for a recommendation or referral. This prohibition applies during the period in which the member is engaged to perform any of the services described in rule 503 [ET section 503.01] and during the period covered by any historical financial statements in such services.

If the products are referred on a commission basis to clients for which the member is not engaged to perform any of the services described in rule 503 [ET section 503.01], rule 503 [ET section 503.01] would not be violated as long as the commission is disclosed to the client. However, any subsequent performance of services described in rule 503 [ET section 503.01] during a period in which the commission was received would constitute a violation of rule 503 [ET section 503.01].

### 189. Requests for Records Pursuant to Interpretation 501-1

**.377 Question**—Individuals associated with a client entity who are currently on opposing sides in an internal dispute have each issued separate requests calling for the member to supply them with records pursuant to interpretation 501-1 [ET section 501.02]. Does the member have to comply with all such requests?

**.378 Answer**—In providing professional services to individuals, partnerships, or corporations, a member will usually deal with an individual who has been designated or held out as the client's representative. Such a representative might include, for example, a general partner or a majority shareholder. A member who has provided the records to the individual designated or held out as the client's representative has no obligation to provide such records to other individuals associated with the client.

[Revised, effective April 30, 2006, by the Professional Ethics Executive Committee.]

### 190. Non-CPA Partner

**.379 Question**—May a member who is in partnership with non-CPAs sign reports with the firm name and below it affix his own signature with the designation "Certified Public Accountant"?

**.380 Answer**—This would not be improper, provided it is clear that the partnership itself is not being held out as composed entirely of CPAs.

[Formerly ruling No. 7 under section 291. Transferred from section 291.013-.014, April 1995.]

### 191. Member Removing Client Files From an Accounting Firm

**.381 Question**—If the relationship of a member who is not an owner of a firm is terminated, may he or she take or retain originals or copies from the firm's client files or proprietary information without the firm's permission?

**.382 Answer**—No, except where permitted by contractual arrangement.

[Revised, effective December 31, 1998, by the Professional Ethics Executive Committee.]

### 192. Commission and Contingent Fee Arrangements With Nonattest Client

**.383 Question**—A member or member's firm (member) provides for a contingent fee investment advisory services, or refers for a commission products or services of a nonclient or a nonattest client, to the owners, officers, or employees of an attest client or to a nonattest client employee benefit plan sponsored by an attest client. Would the member be considered to be in violation of either rule 302 [ET section 302.01] or rule 503 [ET section 503.01]?

**.384 Answer**—No. The member would not be in violation of either rule 302 [ET section 302.01] or rule 503 [ET section 503.01] provided that, with respect to rule 503 [ET section 503.01], the member discloses the commission to the owners, officers, or employees or to the employee benefit plan. The member should also consider the applicability of interpretation 102-2, *Conflicts of Interest* [ET section 102.03], and his or her professional responsibility to clients under Rule 301, *Confidential Client Information* [ET section 301.01].



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## APPENDIXES

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### TABLE OF CONTENTS

	<i>Page</i>
Appendix A—Council Resolution Designating Bodies to Promulgate Technical Standards .....	1765
Appendix B—Council Resolution Concerning Rule 505—Form of Organization and Name .....	1769

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## ET Appendix A

# ***Council Resolution Designating Bodies to Promulgate Technical Standards***

[As amended January 12, 1988; Revised April 1992, October 1999, May 2004, October 2007, and May 2008.]

### **Federal Accounting Standards Advisory Board**

RESOLVED: That the Federal Accounting Standards Advisory Board, with respect to its statements of federal accounting standards and concepts adopted and issued in March of 1993 and subsequently, in accordance with its rules of procedure, the memorandum of understanding and public notice designating the FASAB's standards and concepts as having substantial authoritative support, be, and hereby is, designated by the Council of the American Institute of Certified Public Accountants as the body to establish financial accounting principles for federal governmental entities pursuant to rule 203 [ET section 203.01].

[Added by Council, October 1999.]

### **Financial Accounting Standards Board**

WHEREAS: In 1959 the Council designated the Accounting Principles Board to establish accounting principles, and

WHEREAS: The Council is advised that the Financial Accounting Standards Board (FASB) has become operational, it is

RESOLVED: That as of the date hereof the FASB, in respect of statements of financial accounting standards finally adopted by such board in accordance with its rules of procedure and the bylaws of the Financial Accounting Foundation, be, and hereby is, designated by this Council as the body to establish accounting principles pursuant to rule 203 [ET section 203.01] and standards on disclosure of financial information for such entities outside financial statements in published financial reports containing financial statements under rule 202 [ET section 202.01] of the Rules of the Code of Professional Conduct of the American Institute of Certified Public Accountants provided, however, any accounting research bulletins, or opinions of the accounting principles board issued or approved for exposure by the accounting principles board prior to April 1, 1973, and finally adopted by such board on or before June 30, 1973, shall constitute statements of accounting principles promulgated by a body designated by Council as contemplated in rule 203 [ET section 203.01] of the Rules of the Code of Professional Conduct unless and until such time as they are expressly superseded by action of the FASB.

### **Governmental Accounting Standards Board**

WHEREAS: The Governmental Accounting Standards Board (GASB) has been established by the board of trustees of the Financial Accounting Foundation (FAF) to issue standards of financial accounting and reporting with respect to activities and transactions of state and local governmental entities, and

WHEREAS: The American Institute of Certified Public Accountants is a signatory to the agreement creating the GASB as an arm of the FAF and has supported the GASB professionally and financially, it is

RESOLVED: That as of the date hereof, the GASB, with respect to statements of governmental accounting standards adopted and issued in July 1984 and subsequently in accordance with its rules of procedure and the bylaws of the FAF, be, and hereby is, designated by the Council of the American Institute of Certified Public Accountants as the body to establish financial accounting principles for state and local governmental entities pursuant to rule 203 [ET section 203.01], and standards on disclosure of financial information for such entities outside financial statements in published financial reports containing financial statements under rule 202 [ET section 202.01].

### **Public Company Accounting Oversight Board**

WHEREAS: The Public Company Accounting Oversight Board (PCAOB) has been established pursuant to the Sarbanes-Oxley Act of 2002 (the Act), and

WHEREAS: The PCAOB has authority under the Act to establish or adopt, or both, by PCAOB rule, auditing and related attestation standards, quality control, ethics, independence and other standards relating to the preparation and issuance of audit reports for issuers as defined in the Act.

RESOLVED: That the PCAOB be, and hereby is, designated by the Council of the American Institute of Certified Public Accountants as the body to establish standards relating to the preparation and issuance of audit reports for entities within its jurisdiction as defined by the Act pursuant to rules 201 [ET section 201.01] and 202 [ET section 202.01].

[Added by Council, May 2004.]

### **International Accounting Standards Board**

RESOLVED: That the International Accounting Standards Board (IASB) is hereby designated as the body to establish professional standards with respect to international financial accounting and reporting principles pursuant to Rule 202 [ET section 202.01] and Rule 203 [ET section 203.01]; and

BE IT FURTHER RESOLVED: That the Council shall reassess, no sooner than three years but no later than five years after the effective date of this resolution, whether continued recognition of the IASB as the body designated to establish professional standards with respect to international financial accounting and reporting principles under Rule 202 [ET section 202.01] and Rule 203 [ET section 203.01] is appropriate.

[Added by Council, May 18, 2008.]

### **AICPA COMMITTEES AND BOARDS**

WHEREAS: The membership of the Institute has adopted rules 201 [ET section 201.01] and 202 [ET section 202.01] of the Rules of the Code of Professional Conduct, which authorizes the Council to designate bodies to promulgate technical standards with which members must comply, and therefore it is

### **Accounting and Review Services Committee**

RESOLVED: That the AICPA accounting and review services committee is hereby designated to promulgate standards under rules 201 [ET section 201.01] and 202 [ET section 202.01] with respect to unaudited financial statements or

other unaudited financial information of an entity that is not required to file financial statements with a regulatory agency in connection with the sale or trading of its securities in a public market.

### **Auditing Standards Board**

RESOLVED: That with respect to standards relating to the preparation and issuance of audit reports not included within the resolution on the Public Company Accounting Oversight Board, the AICPA auditing standards board is hereby designated as the body authorized under rules 201 [ET section 201.01] and 202 [ET section 202.01] to promulgate auditing, attestation, and quality control standards and procedures.

RESOLVED: That the auditing standards board shall establish under statements on auditing standards the responsibilities of members with respect to standards for disclosure of financial information outside of the financial statements in published financial reports containing financial statements.

[Revised May 2004.]

### **Management Consulting Services Executive Committee**

RESOLVED: That the AICPA management consulting services executive committee is hereby designated to promulgate standards under rules 201 [ET section 201.01] and 202 [ET section 202.01] with respect to the offering of management consulting services, provided, however, that such standards do not deal with the broad question of what, if any, services should be proscribed.

AND FURTHER RESOLVED: That any Institute committee or board now or in the future authorized by the Council to issue enforceable standards under rules 201 [ET section 201.01] and 202 [ET section 202.01] must observe an exposure process seeking comment from other affected committees and boards, as well as the general membership.

[Revised April 1992.]

### **Attestation Standards**

RESOLVED: That the AICPA accounting and review services committee, auditing standards board, and management consulting services executive committee are hereby designated as bodies authorized under rules 201 [ET section 201.01] and 202 [ET section 202.01] to promulgate attestation standards in their respective areas of responsibility.

[Added by Council, May 1988; revised April 1992.]

### **Tax Executive Committee**

RESOLVED: That the Tax Executive Committee is hereby designated as the body authorized under AICPA Rules 201 [ET section 201.01] and 202 [ET section 202.01] to promulgate professional practice standards with respect to tax services.

[Added by Council, October 1999.]

**Forensic and Valuation Services Executive Committee**

RESOLVED: That the Forensic and Valuation Services Executive Committee is hereby designated as the body to promulgate professional standards with respect to forensic and valuation services under Rules 201 [ET section 201.01] and 202 [ET section 202.01].

[Added by Council, October 2007.]

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## ET Appendix B

# ***Council Resolution Concerning Rule 505—Form of Organization and Name***

[As adopted May 23, 1994; revised May 7, 1997, May 15, 2000, and May 22, 2006.]

A. RESOLVED: That with respect to a member engaged in the practice of public accounting in a firm or organization which performs (1) any audit or other engagement performed in accordance with the Statements on Auditing Standards, (2) any review of a financial statement performed in accordance with the Statements on Standards for Accounting and Review Services, or (3) any examination of prospective financial information performed in accordance with the Statements on Standards for Attestation Engagements, or which holds itself out as a firm of certified public accountants or uses the term "certified public accountant(s)" or the designation "CPA" in connection with its name, the characteristics of such a firm or organization under rule 505 [ET section 505.01] are as set forth below.

1. A majority of the ownership of the firm in terms of financial interests and voting rights must belong to CPAs. Any non-CPA owner would have to be actively engaged as a member of the firm or its affiliates. Ownership by investors or commercial enterprises not actively engaged as members of the firm or its affiliates is against the public interest and continues to be prohibited.
2. There must be a CPA who has ultimate responsibility for all the services described in A above, compilation services and other engagements governed by Statements on Auditing Standards or Statements on Standards for Accounting and Review Services and non-CPA owners could not assume ultimate responsibility for any such services or engagements.
3. Non-CPA owners would be permitted to use the title "principal," "owner," "officer," "member" or "shareholder," or any other title permitted by state law, but not hold themselves out to be CPAs.
4. A member shall not knowingly permit a person, whom the member has the authority or capacity to control, to carry out on his or her behalf, either with or without compensation, acts which, if carried out by the member, would place the member in violation of the rules. Further, a member may be held responsible for the acts of all persons associated with him or her in the practice of public accounting whom the member has the authority or capacity to control.
5. Owners shall at all times own their equity in their own right and shall be the beneficial owners of the equity capital ascribed to them. Provision would have to be made for the ownership to be transferred, within a reasonable period of time, to the firm or to other qualified owners if the owner ceases to be actively engaged in the firm or its affiliates.
6. Non-CPA owners would not be eligible for regular membership in the AICPA.

B. RESOLVED: The characteristics of all other firms or organizations are deemed to be whatever is legally permissible under applicable law or regulation except as otherwise provided in paragraph C below.

C. RESOLVED: That with respect to a member engaged in the practice of public accounting in a firm or organization which is not within the description of a firm or organization set forth in paragraph A above, but who performs compilations of financial statements performed in accordance with the Statements on Standards for Accounting and Review Services, the characteristics of such a firm or organization under rule 505 [ET section 505.01] are as set forth below.

1. There must be a CPA who has ultimate responsibility for any financial statement compilation services provided by the firm and by each business unit performing such compilation services and non-CPA owners could not assume ultimate responsibility for any such services.
  2. Any compilation report must be signed individually by a CPA, and may not be signed in the name of the firm or organization.
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**ET****RULES COMPLIANCE GUIDE**

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## TABLE OF CONTENTS

	<i>Paragraph</i>
ET Guide for Complying With Rules 102–505	.01-.23
Notice to Readers	
Introduction .....	.01-.03
Definitions .....	.04-.06
Rules of Conduct Covered by This Guide .....	.07
Threats and Safeguard Approach .....	.08-.12
Threats and Safeguards .....	.13-.18
Threats .....	.13-.14
Safeguards .....	.15-.18
Ethical Conflict Resolution .....	.19-.23

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# ET Guide for Complying With Rules 102–505

## Notice to Readers

This guide is designed as educational and reference material for the members of the AICPA and others interested in the subject. It is not an authoritative document. It does not establish policy positions, standards, or preferred practices. This guide is distributed with the understanding that the AICPA is not rendering any ethical or legal advice.

This Code of Professional Conduct (Code) cannot address every possible relationship or circumstance a member may need to address in order to comply with the rules. Accordingly, in achieving compliance with the rules, members may need to make decisions unrelated to independence regarding relationships or circumstances that are not explicitly addressed by the interpretations and rulings. This guide describes an approach that members can use to evaluate those relationships or circumstances. Although use of this guide is not required by the Code, use of this guide often will be a prudent step in achieving compliance with the rules.

## Introduction

**.01** Members who provide professional services may hold various positions. For example, a member may be a salaried employee, a partner, a director (executive or nonexecutive), an owner-manager, a volunteer, or a consultant working for an employer, a firm, or for one or more clients. The legal relationship between the member, the employer, the firm, or the client does not affect the member's responsibility to comply with the ethical requirements of the AICPA Code of Professional Conduct (Code).

**.02** The Code provides members with principles for properly fulfilling their ethical responsibilities. The Rules of Conduct (the rules) set out in the Code govern the performance of professional services by members. The bylaws of the AICPA require that all members comply with these rules. Other sections of the Code contain additional authoritative guidance set forth in interpretations and rulings, which address the application of the rules to specific situations that members may encounter when providing professional services. ET section 100.01, *Conceptual Framework for AICPA Independence Standards* (AICPA, *Professional Standards*, vol. 2), provides authoritative guidance for members when making decisions on independence matters that are not explicitly addressed by the Code under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 100), and its interpretations and rulings.

**.03** The Code cannot address every possible relationship or circumstance a member may need to address in order to comply with the rules. Accordingly, in achieving compliance with the rules, members may need to make decisions unrelated to independence regarding relationships or circumstances that are not explicitly addressed by the interpretations and rulings. This guide describes an approach that members can use to evaluate those relationships or circumstances, and members are encouraged to use it for that purpose. Although use of this guide is not required by the Code, it can assist members in complying with the rules in those situations. Therefore, use of this guide will often be a prudent step in achieving compliance with the rules. Under no circumstances, however,

may this guide be used to justify noncompliance with the rules, interpretations, and rulings in the Code.

## Definitions

**.04 Acceptable level.** A level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that compliance with the rules is not compromised.

**.05 Safeguards.** Actions or other measures that eliminate threats or reduce them to an acceptable level.

**.06 Threats.** The risk that relationships or circumstances could compromise a member's compliance with the rules.

## Rules of Conduct Covered by This Guide

**.07** In addition to Rule 101, the bylaws of the AICPA require that members comply with the following rules:

- a. Rule 102, *Integrity and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 100)
- b. Rule 201, *General Standards* (AICPA, *Professional Standards*, vol. 2, ET sec. 200)
- c. Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, vol. 2, ET sec. 200)
- d. Rule 203, *Accounting Principles* (AICPA, *Professional Standards*, vol. 2, ET sec. 200)
- e. Rule 301, *Confidential Client Information* (AICPA, *Professional Standards*, vol. 2, ET sec. 300)
- f. Rule 302, *Contingent Fees* (AICPA, *Professional Standards*, vol. 2, ET sec. 300)
- g. Rule 501, *Acts Discreditable* (AICPA, *Professional Standards*, vol. 2, ET sec. 500)
- h. Rule 502, *Advertising and Other Forms of Solicitation* (AICPA, *Professional Standards*, vol. 2, ET sec. 500)
- i. Rule 503, *Commissions and Referral Fees* (AICPA, *Professional Standards*, vol. 2, ET sec. 500)
- j. Rule 505, *Form of Organization and Name* (AICPA, *Professional Standards*, vol. 2, ET sec. 500)

Each of these rules (that is, Rules 102–505), along with its related authoritative interpretations and rulings, can be accessed by selecting the link preceding the name of each rule in the preceding list.

## Threats and Safeguard Approach

**.08** The Code cannot address every situation in which a relationship or circumstance creates an unacceptable threat to a member's compliance with rules 102–505. Accordingly, the threats and safeguard approach<sup>1</sup> described in this

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<sup>1</sup> The Professional Ethics Executive Committee uses the threats and safeguard approach described in this guide when it develops ethics interpretations and rulings. Accordingly, reference to this guide may assist AICPA members and others in understanding the basis for those interpretations and rulings.

section can assist a member in complying with the rules when the guidance in the interpretations and rulings in the Code do not explicitly address the situation encountered. This method involves identifying threats to compliance with the rules and evaluating the significance of those threats. If the threats are not at an acceptable level, the threats and safeguards approach involves determining whether safeguards are available to eliminate the threats or reduce them to an acceptable level and, if so, applying such safeguards or, if not, avoiding the situation that creates the threats. Threats are identified and evaluated both individually and in the aggregate because they can have a cumulative effect on a member's compliance with the rules of conduct.

**.09 *Identifying Threats.*** The relationships or circumstances encountered by a member in various engagements and work assignments will often create different threats to complying with the rules. When a relationship or circumstance is encountered that is not specifically addressed by the interpretations or rulings in the Code, under this approach, members would determine whether the relationship or circumstance creates one or more threats, such as those identified in paragraph .13. The existence of a threat does not mean that the member is not in compliance with the rules; rather, the significance of the threat would be evaluated.

**.10 *Evaluating the Significance of a Threat.*** In evaluating the significance of a threat that has been identified in order to determine whether it is at an acceptable level, the standard of acceptable level is whether a reasonable and informed third party, weighing all the specific facts and circumstances, would be likely to conclude that the threat would compromise the member's compliance with the rules. Qualitative as well as quantitative factors are relevant when evaluating the significance of a threat, including the extent to which existing safeguards already reduce the threat to an acceptable level. If the evaluation supports a conclusion that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the threat would not compromise a member's compliance with the rules, the threat is at an acceptable level. In that case, no further evaluation under this framework would be necessary.

**.11 *Identifying and Applying Safeguards.*** If the evaluation of the significance of an identified threat results in the member concluding that the threat is not at an acceptable level, safeguards would need to be applied in order to eliminate the threat or reduce it to an acceptable level. When identifying appropriate safeguards to apply, one safeguard may eliminate or reduce multiple threats, but in some cases multiple safeguards may be necessary to eliminate or reduce one threat to an acceptable level. Determining the nature of the safeguards to be applied requires the exercise of judgment because the effectiveness of safeguards will vary, depending on the circumstances. Again, the issue is whether a reasonable and informed third party, who has weighed all the specific facts and circumstances, would be likely to conclude the level of threat is acceptable. A threat has been reduced to an acceptable level by safeguards if, after application of the safeguards, a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that compliance with the rules is not compromised.

**.12** Some threats identified may be so significant that no safeguards will eliminate the threats or reduce them to an acceptable level. If a significant threat cannot be eliminated or reduced to an acceptable level by the application of safeguards, or if a member is unable to implement appropriate safeguards, providing the specific professional service will in all likelihood result in the member's noncompliance with the rules. Although declining or discontinuing the service would prevent this result, depending on the facts and circumstances,

it might be prudent for the member to also consider whether to resign from the client or the employer.

## Threats and Safeguards

### Threats

.13 Many threats fall into the following categories:

- a. **Self-review threat.** The threat that a member will not appropriately evaluate the results of a service performed by the member, or by an individual in the member's firm or employing organization, that the member will rely upon in forming a judgment as part of providing another service.
- b. **Advocacy threat.** The threat that a member will promote a client or employer's position or opinion to the point that his or her objectivity is compromised.
- c. **Adverse interest threat.** The threat that a member will not be objective because the member's interests are in opposition to the interests of a client or employer.
- d. **Familiarity threat.** The threat that because of a long or close relationship with a client or employer, a member will become too sympathetic to their interests or too accepting of their work.
- e. **Undue influence threat.** The threat that a member will subordinate his or her judgment to that of an individual associated with a client, employer, or other relevant third party because of the individual's (1) reputation or expertise, (2) aggressive or dominant personality, or (3) attempts to coerce or exercise excessive influence over the member.
- f. **Self-interest threat.** The threat that a member will act in a manner that is adverse to the legitimate interests of his or her firm, employer, client, or the public, as a result of the member or his or her immediate or close family member's financial interest in or other relationship with a client or the employer.

.14 The types of threats that are created will generally be the same for all members, although the circumstances that create threats will differ depending on whether the member is in public practice, business and industry, government, or academia. In addition, due to the nature of services provided by some members, such as employees of a governmental audit organization, the threats those members face can arise from the same or similar types of circumstances as for members in public practice.

Following are some examples of how threats may impact a member's compliance with certain of the rules:

- a. If a member is being pressured to become associated with misleading information, there is an undue influence threat to compliance with Rule 102 and Rule 201.
- b. If a member is reviewing work he or she previously performed that will be relied upon as part of providing a current professional service and the member discovers a significant error in the previous work, there is a self-interest threat to compliance with Rule 102 and Rule 201.
- c. If a member's firm provides nonattest services to an audit client where a member's brother-in-law is the CFO, there are self-interest and familiarity threats to compliance with Rule 102.

- d.* If a member is directed to complete a task within an unrealistic time frame, there is an undue influence threat to compliance with Rule 102 and Rule 201.
- e.* If a member has charged his or her employer with violating certain labor laws, there is an adverse interest threat to compliance with Rule 102.
- f.* If the revenue received from a single client is significant to the firm, a self-interest threat to compliance with Rule 102 may be created.

## Safeguards

**.15** Safeguards fall into two broad categories:

- a.* Safeguards created by the profession, legislation, or regulation
- b.* Safeguards in the work environment

In addition, a member in public practice also may be able to consider safeguards implemented by the client in combination with the preceding safeguards when evaluating the significance of a threat.

**.16** To be effective, safeguards should eliminate a threat or reduce to an acceptable level the threat's potential to compromise the member's compliance with the rules. The effectiveness of safeguards depends on many factors, including the following:

- The facts and circumstances of a particular situation
- The proper identification of threats
- Whether the safeguard is suitably designed to meet its objectives
- The party or parties that will be subject to the safeguard
- How the safeguard is applied
- The consistency with which the safeguard is applied
- Who applies the safeguard

**.17** Certain safeguards may not need to be implemented by the member because they are already in place either by the member's firm (concurring partner review) or through the existence of professional requirements (peer review), legislation (preapproval of allowable nonaudit services by audit committees), or regulation (quality control reviews performed by a federal Office of Inspector General for OMB Circular A-133 engagements). Such safeguards may be effective in eliminating or reducing threats to an acceptable level and, therefore, may be considered in applying the framework approach.

**.18** Other safeguards that may be effective in eliminating or reducing threats to an acceptable level are those in a member's work environment. For example, work environments with strong internal controls can be very effective in eliminating or reducing the self-review, adverse interest, and self-interest threats. Additionally, the undue influence threat can be reduced when leadership of a firm or the organization that employs the member stresses the importance of ethical behavior and implements policies and procedures to empower and encourage employees to communicate to senior individuals within the firm or organization about any ethical issues that concern them without fear of retribution.

## Ethical Conflict Resolution

**.19** An ethical conflict arises when a member encounters obstacles to following an appropriate course of action due to internal or external pressures or because of conflicts within the professional standards. For example, a member may have encountered a fraud, the reporting of which could breach the member's responsibility to maintain client confidentiality. Once encountered, a member may be required to take steps to resolve the ethical conflict in order to comply with the rules.

**.20** To resolve an ethical conflict, a member should consider the following factors and select the course of action that will best enable him or her, after weighing the consequences of each, to comply with the rules:

- a.* Relevant facts and circumstances, including applicable rules, laws, or regulations
- b.* Ethical issues involved
- c.* Established internal procedures
- d.* Alternative courses of action

**.21** Before pursuing this course of action, the member may want to consult with appropriate persons within the firm or the organization that employs the member. If the conflict remains unresolved after pursuing the selected course of action, the member should consider consulting with those individuals for help in reaching a resolution.

**.22** The member also may wish to obtain advice from an appropriate professional body or legal counsel. The member should consider documenting the substance of the issue and details of any discussions held or decisions made concerning that issue.

**.23** If, after exhausting all reasonable possibilities, the ethical conflict remains unresolved, the member will in all likelihood be in noncompliance with the rules if he or she remains associated with the matter creating the conflict. Accordingly, the member may determine that, in the circumstances, it is appropriate to withdraw from the engagement team or specific assignment, or to resign altogether from the client, firm, or organization that employs the member.

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# ET TOPICAL INDEX

References are to ET section and paragraph numbers.

## A

### ACCOUNTING SERVICES

- Litigation Support Services ..... 291.021-022
- Member Owning Separate Business ..... 505.03; 591.275-276
- Nonattest ..... 101.05
- Relation to Independence ..... 101.05

### ACTS DISCREDITABLE

- Confidential Information From Nonclient ..... 391.027-028
- Discrimination and Harassment in Employment ..... 501.03
- Failure to File Tax Return or Pay Tax Liability ..... 501.08
- Failure to Follow Requirements of Governmental Bodies, Commissions, or Other Regulatory Agencies on Indemnification and Limitation of Liability Provisions in Connection With Audit and Other Attest Services ..... 501.09
- Negligence in Financial Statement Preparation ..... 501.05
- Response to Requests by Clients for Records ..... 501.02
- Rule 501, Violation of ..... 501.08
- Rule of Conduct ..... 501.01
- Service Performed for Governmental Agencies ..... 501.04; 501.06
- Solicitation or Disclosure of CPA Examination Questions and Answers ..... 501.07

### ADVERTISING

- Course Promotion ..... 591.065-066
- CPA Examination Questions and Answers ..... 501.07
- Efforts by Third Parties ..... 502.06
- False or Misleading ..... 502.03
- Member's Association With Newsletters and Publications ..... 591.351-352
- Personal Financial Specialist Designation ..... 591.365-366
- Rule of Conduct ..... 502.01
- Use of CPA Title ..... 591.075-076

### ALTERNATIVE PRACTICE STRUCTURE

- Applicability of Rule 505 ..... 505.04
- Effect on Applicability of Independence Rules ..... 101.16
- Illustrative Example ..... 101.16
- Traditional Versus Nontraditional Structures ..... 101.16

### AMERICAN INSTITUTE OF CPAs

- Definition ..... 92.14
- Designation of Firm ..... 505.01
- Membership ..... 51.01-02
- Personal Financial Specialist Designation ..... 591.365-366

### APPRAISALS

- Performance of Nonattest Services ..... 101.05

### APS—See Alternative Practice Structure

### ATTEST ENGAGEMENTS

- Attest Engagement Team ..... 92.02
- Covered Member, Attest Engagement Team ..... 92.06
- Definition ..... 92.01
- Gifts or Entertainment to or From Client ..... 191.226-229

### ATTEST SERVICES

- Use of Third-Party Service Provider ..... 191.224-225; 291.023-024; 391.001-002

### ATTESTATION ENGAGEMENTS

- Investment Advisory Services Provided by Member ..... 391.047-048
- Modified Application of Independence Rules ..... 101.13
- Performance of Nonattest Services ..... 101.05; 391.047-050
- Report on Internal Controls ..... 191.206-207

### AUDIT ENGAGEMENT

- Commissions or Referral Fees ..... 503.01
- Compliance With Standards ..... 202.01
- Contingent Fees ..... 302.01
- Employee Benefit Plans ..... 191.119-120
- Extended Audit Services ..... 191.206-207
- Governmental ..... 501.04
- Joint Audit With Former Partners ..... 591.271-272
- Litigation With Client ..... 101.08
- Member as Director and Auditor of Profit-Sharing and Retirement Trust ..... 191.041-042
- Withdrawal From Engagement ..... 391.005-006

### AUDITORS' OPINIONS—See Opinions, Auditors'

### AUDITORS' REPORTS—See Reports, Auditors'

## B

### BILLINGS TO CLIENTS

- Subcontractor's Services ..... 591.371-372
- Unpaid/Notes Receivable ..... 191.103-104



References are to ET section and paragraph numbers.

**BOARD OF DIRECTORS**

- Consumer Credit Company ..... 591.233-234
- Fund-Raising Organization ..... 191.128-129;  
..... 191.186-187
- Honorary Directorships of  
Not-for-Profit Organizations ..... 101.06;  
..... 191.128-129
- Social Club ..... 191.031-032

**BONDHOLDERS**

- Municipal Authority ..... 191.057-058

**BOOKKEEPING**

- Use of Third-Party Service  
Provider ..... 191.224-225;  
..... 291.023-024; 391.001-002

**BORROWING CONTRACT**

- Bondholders in Municipal  
Authority ..... 191.057-058
- Definition of Loan ..... 92.18
- Grandfathered Loans ..... 101.07
- Loans From Financial Institution  
Client ..... 101.07
- Loans From Nonclient Subsidiary or  
Parent of Attest Client ..... 191.196-197
- Loans to/From Entity Connected  
With Member ..... 191.220-221
- Loans to Partnerships Where Covered  
Members Are General Partners ..... 101.07
- Loans to Partnerships Where Covered  
Members Are Limited Partners ..... 101.07
- Partially Secured Loans ..... 101.07

**BUSINESS COMBINATIONS**

- Confidential Client Information ..... 301.04
- Former Partner in Firm  
Name ..... 591.289-290
- Nonproprietary Partner  
Title ..... 591.273-274

**C****CERTIFIED PUBLIC ACCOUNTANTS**

- Acts Discreditable—See Acts Discreditable
- Advertising—See Advertising
- AICPA Membership ..... 51.01-02
- Alternative Practice  
Structures ..... 101.16; 505.04
- Applicability of Code of Conduct ..... 91.01-02
- Commissions—See Commissions
- Competence—See Competence
- Confidential Client Information—See  
Confidential Client Information
- Contingent Fees—See Contingent Fees
- Diligence ..... 56.04
- Due Professional Care—See Due  
Professional Care
- Employment or Association With Attest  
Clients ..... 101.04
- Form of Organization or Name—See Form  
of Organization
- Holding Out Definition ..... 92.11

**CERTIFIED PUBLIC ACCOUNTANTS—continued**

- Independence—See Independence
- Integrity—See Integrity
- Letterhead for Lawyer/CPA ..... 591.155-156
- Members Not in Public Practice—See  
Members Not in Public Practice
- Member or Member's Firm—See Member or  
Member's Firm
- Objectivity—See Objectivity
- Partnership With Non-CPAs ..... 591.005-006;  
..... 591.271-272;  
..... 591.281-282; 591.379-380
- Planning and Supervision—See Planning  
and Supervision
- Principles of Professional  
Conduct ..... 51.01-02
- Professional Responsibilities ..... 52.01;  
..... 53.01-04
- Responsibility for Non-CPAs ..... 591.005-006;  
..... 591.281-282
- Scope and Nature of Services ..... 57.01-03
- Sufficient Relevant Data ..... 201.01
- Use of CPA Title ..... 591.075-076

**CHARITABLE ORGANIZATIONS**

- Auditor as Director  
or Officer ..... 191.128-129
- Director of Fund-Raising  
Organization ..... 191.027-028;  
..... 191.128-129; 191.186-187
- Honorary Directorships of  
Not-for-Profit Organizations ..... 101.06;  
..... 191.128-129
- Member as Trustee ..... 191.023-024

**CIRA—See Common Interest Realty Association****CIVIC ORGANIZATIONS**

- Citizens' Committees ..... 191.039-040

**CLIENTS**

- Advisory Services Provided by  
Member ..... 191.015-016
- Agreement With Member to Use ADR  
Techniques ..... 191.190-193
- Attest and Other Services ..... 101.04-05;  
..... 391.047-050
- Billing for Subcontractor's  
Services ..... 591.371-372
- Commissions or Referral Fee  
Arrangements With  
Nonattest Client ..... 391.049-050;  
..... 591.383-384
- Confidential Information—See Confidential  
Client Information
- Cooperative Arrangements With  
Member's Firm ..... 101.14
- Deferred Compensation  
Committee ..... 191.037-038

References are to ET section and paragraph numbers.

**CLIENTS**—continued

- Definition ..... 92.03; 101.10
- Disclosure of Information From Previous Engagement ..... 391.029-030
- Dual Practice of Member ..... 591.275-276
- Employee Benefit Plan Audit ..... 191.119-120
- Employment or Association With Attest ..... 101.04
- Engaging Member to Perform Other Professional Services for Company Executives ..... 191.198-199; ..... 391.041-042
- Engaging Members to Provide Extended Audit Services ..... 191.206-207
- Fees Collected by Bank ..... 591.003-004
- Gifts or Entertainment to or From Client ..... 191.226-229
- Governmental Reporting Entity ..... 101.12
- Having Loan(s) to/From Entity Connected With Member's Firm ..... 191.220-221
- Indemnification Clause in Engagement Letter ..... 191.188-189
- Investment Advisory Services Provided by Member to Attest Client ..... 391.047-048
- Investment Advisory Services Provided by Member to Nonattest Client ..... 391.049-050; ..... 591.383-384
- Investor/Investee Relationship to Nonclients ..... 101.10
- Joint Audit With Former Partners ..... 591.271-272
- Joint Interest in Vacation Home With Member ..... 191.184-185
- Lessee to Member ..... 191.182-183
- Lessor to Member ..... 191.182-183
- Litigation With Covered Member ..... 101.08
- Loans From Nonclient Subsidiary or Parent of Attest Client ..... 191.196-197
- Loans to/From Entity Connected With Member ..... 191.220-221
- Loans to Member ..... 101.07
- Member Has Significant Influence Over Entity That Has Significant Influence Over Client ..... 191.212-213
- Member Leasing Property ..... 191.182-183
- Member on Advisory Board ..... 191.144-145
- Member Participation in Health and Welfare Plan of Client ..... 191.214-215
- Member Performing Management Functions ..... 101.05; 191.017-018; ..... 191.037-038; 191.041-042
- Member Performing Professional Services Involving Client Advocacy ..... 102.07

**CLIENTS**—continued

- Member's Depository Relationship With Client Financial Institution ..... 191.140-141
- Member's Disclosure of Client's Name ..... 391.013-014
- Member's Sale of Products to Clients ..... 591.369-370
- Membership in Trade Association With Member ..... 191.003-004
- Nonattest Services—See Nonattest Services
- Notes Payable to Member ..... 191.103-104
- Obtained Through Third Parties ..... 502.06
- Referral of Products by Member ..... 591.375-376
- Request for Indemnification ..... 191.204-205
- Request for Records ..... 591.377-378
- Response to Requests for Records ... 501.02
- Servicing Member's Loan ..... 191.134-135
- Spouse Participation in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in, Client ..... 101.02
- Tax Return Irregularities ..... 391.005-006
- Trade Association Request for Information ..... 391.003-004
- Unpaid Fees ..... 191.103-104
- Use of Third-Party Service Provider ..... 191.224-225; ..... 291.023-024; 391.001-002

**CLOSE RELATIVE**

- Definition ..... 92.04

**CLOSELY HELD COMPANIES**

- Investment With a General Partner ..... 191.138-139; ..... 191.162-163

**CODE OF PROFESSIONAL CONDUCT**—See

Conduct, Code of Professional

**COLLECTION AGENTS**

- Fee Collection by Bank ..... 591.003-004

**COMMISSIONS**

- Billing for Subcontractor's Services ..... 591.371-372
- Definition of Receipt ..... 391.033-034; ..... 591.367-368
- Disclosure ..... 503.01
- Or Referral Fee Arrangements With Nonattest Client ..... 391.049-050; ..... 591.383-384
- Receipt by Member's Spouse ... 391.037-038; 591.373-374
- Referral of Products ..... 591.375-376
- Rule of Conduct ..... 503.01
- Sale of Products to Clients ..... 591.369-370

References are to ET section and paragraph numbers.

**COMMON INTEREST REALTY ASSOCIATION**

- Association With Real Estate Developer or Management Company . . . . 191.061-062
- Member as Owner or Lessee . . . 191.061-062
- Performance of Services for . . . . 191.061-062

**COMMUNICATION**

- GAAP Conformity of Financial Statements . . . . . 203.05
- Subordination of Judgment to Others . . . . . 102.05

**COMPENSATION PLANS**

- Financial Relationships . . . . . 101.17

**COMPETENCE**

- Characteristics . . . . . 56.01-03
- Due Professional Care . . . . . 56.01-03
- Performance of Engagement . . . . . 201.02
- Rule of Conduct . . . . . 201.01
- Supervision of Specialists . . . . . 291.017-018
- Training and Education . . . . . 56.02
- Use of Consultation . . . . . 201.02

**COMPILATION ENGAGEMENT**

- Commissions or Referral Fees . . . . . 503.01
- Compliance With Standards . . . . . 202.01
- Contingent Fees . . . . . 302.01

**CONDOMINIUM ASSOCIATIONS**—See Common Interest Realty Association**CONDUCT, CODE OF PROFESSIONAL**

- Acts Discreditable—See Acts Discreditable
- Advertising—See Advertising
- Alternative Practice Structures . . . . . 101.16; 505.04
- Applicability . . . . . 91.01-02
- Associated Member . . . . . 91.02
- Commissions—See Commissions
- Confidential Client Information—See Confidential Client Information
- Contingent Fees—See Contingent Fees
- Covered Member . . . . . 91.02
- Definitions Applicable . . . . . 92.01-27
- Due Professional Care—See Due Professional Care
- Form of Organization or Name—See Form of Organization
- General Standards . . . . . 201.01
- Independence—See Independence
- Integrity—See Integrity
- Member, as Defined by the Applicability Section of the Code . . . . . 91.02
- Members Not in Public Practice—See Members Not in Public Practice
- Objectivity—See Objectivity
- Preamble . . . . . 51.01-02
- Principles of Professional Conduct . . . . . 51.01-02; 52.01; 53.01-04; . . . . . 54.01-04; 55.01-04; . . . . . 56.01-05; 57.01-03
- Professional Responsibilities . . . . . 52.01; . . . . . 53.01-04

**CONFIDENTIAL CLIENT INFORMATION**

- Business Combinations . . . . . 301.04
- Disclosure in Legal or Alternative Dispute Resolution Proceedings . . . . . 391.045-046
- Disclosure of Client's Name . . . . 391.013-014
- Disclosure of Information From Previous Engagement . . . . . 391.029-030
- Disclosure of Joint Tax Information . . . . . 391.031-032
- From Nonclient . . . . . 391.027-028
- Information to Competitors . . . . 391.011-012
- Information to Professional Liability Insurance Carrier . . . . . 391.039-040
- Information to Successor Accountant . . . . . 391.005-006
- Member as Bank Director . . . . . 191.170-171; . . . . . 391.035-036
- Member Providing Other Professional Services for Company Executives . . . . . 191.198-199; . . . . . 391.041-042
- Rule of Conduct . . . . . 301.01
- Trade Association Request for Client Information . . . . . 391.003-004
- Use of Third-Party Service Provider . . . . . 191.224-225; . . . . . 291.023-024; 391.001-002

**CONFLICT OF INTERESTS**

- Consumer Credit Company Director . . . . . 591.233-234
- Educational Services Performed by Member . . . . . 102.06
- Examples . . . . . 102.03
- Fund-Raising Activities . . . . . 191.186-187
- Member as Bank Director . . . . . 191.170-171; . . . . . 391.035-036
- Relationship Between Parties . . . . . 102.03

**CONSULTING SERVICES**

- Nonattest . . . . . 101.05
- Use of Third-Party Service Provider . . . . . 191.224-225; . . . . . 291.023-024; 391.001-002

**CONTINGENT FEES**

- Commissions or Referral Fee Arrangements With Nonattest Client . . . . . 391.049-050; . . . . . 591.383-384
- Definition of Receipt . . . . . 391.033-034; . . . . . 591.367-368
- Examples . . . . . 302.02
- Investment Advisory Services . . . 391.047-048
- Receipt by Member's Spouse . . . 391.037-038; . . . . . 591.373-374
- Rule of Conduct . . . . . 302.01
- Terminology . . . . . 302.01-02

**CONTROLLERS**

- Use of CPA Title . . . . . 591.075-076

References are to ET section and paragraph numbers.

**COOPERATIVE ARRANGEMENTS**

- Definition and Examples ..... 101.14
- Independence ..... 101.14

**COOPERATIVES**—See Common Interest Realty Association**COUNCIL OF INSTITUTE**

- Definition ..... 92.05

**COVERED MEMBERS**

- Alternative Practice Structures ..... 505.04
- Applicability of Code of Professional Conduct ..... 91.02
- Applicability of Independence Rules ..... 101.02
- Definition ..... 92.06
- Family Relationships ..... 101.02
- Financial Relationships ..... 101.02
- Honorary Directorships of Not-for-Profit Organizations ..... 101.06
- Independence, Factors Affecting ..... 101.08; 101.10
- Litigation With Client, Security Holders, or Other Third Party Litigation ..... 101.08
- Loans From Financial Institution Clients ..... 101.07
- Modified Definition for Certain Attestation Engagements ..... 101.13
- Participation in Health and Welfare Plan of Client ..... 191.214-215
- Property Leased to or From a Client ..... 191.182-183
- Rules of Conduct Applied to Members Owning a Separate Business ..... 505.03

**CREDIT UNIONS**

- Members Joining Client Credit Union ..... 191.150-151

**D****DATA PROCESSING**

- Disclosure of Information From Previous Engagement ..... 391.029-030
- Member Owning Separate Business ..... 505.03; 591.353-354
- Subcontractor Selection ..... 291.015-016
- Supervision of Specialists ..... 291.017-018
- Use of Third-Party Service Provider ..... 191.224-225; 291.023-024; 391.001-002

**DEPARTURES FROM ESTABLISHED PRINCIPLES**

- Determining ..... 203.03
- Financial Statements ..... 203.01-02; 203.05
- Governmental Audits ..... 501.04; 501.06

**DESIGNATION OF FIRM**

- AICPA Members ..... 505.01
- Former Partner's Names ..... 591.279-280; 591.289-290
- Non-CPA Partners ..... 591.379-380
- Personal Financial Specialist Designation ..... 591.365-366

**DILIGENCE**

- Characteristics ..... 56.04
- Due Professional Care ..... 56.04

**DISCLOSURE**

- Commissions or Referral Fees ..... 503.01
- Confidential Client Information—See Confidential Client Information
- Conflicts of Interest ..... 102.03
- CPA Examination Questions and Answers ..... 501.07
- Governmental Requirements ..... 501.06
- Relationship Between Parties ..... 102.03

**DISCRIMINATION**

- Employment Practices ..... 501.03

**DISPUTES WITH CLIENTS**

- Disclosure of Confidential Information in Legal or Alternative Resolution Proceedings ..... 391.045-046
- Irregularities in Tax Return ..... 391.005-006
- Use of ADR Techniques ..... 191.190-193; 391.045-046

**DUE PROFESSIONAL CARE**

- Characteristics ..... 56.01-05
- Competence ..... 56.01-03
- Diligence ..... 56.04
- Planning and Supervision ..... 56.05
- Rule of Conduct ..... 201.01
- Training and Education ..... 56.02

**E****EDUCATIONAL INSTITUTIONS**

- Faculty Member as Auditor of Student Fund ..... 191.095-096

**EDUCATIONAL SERVICES**

- Advertising Material ..... 591.065-066
- Examples ..... 102.06
- Integrity and Objectivity of Member ..... 102.06

**EDUCATORS**

- Integrity and Objectivity of Member ..... 102.06

**ELECTED OFFICIALS**

- Firm Name of Former Partner ..... 591.279-280
- Member as Legislator ..... 191.019-020

**EMPLOYEE BENEFIT PLANS**

- Member Participation in Health and Welfare Plan of Client ..... 191.214-215
- Member's Relationships With Participating Employers ..... 191.119-120
- Spouse Participation in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in Client ..... 101.02

References are to ET section and paragraph numbers.

**EMPLOYEES**

- Benefit Plan Audit ..... 191.119-120
- Financial Services Managed by Client ..... 191.081-082
- Independence With Respect to Alternative Practice Structures ..... 101.16
- Member in Non-CPA Firm ..... 591.005-006
- Member Participation in Health and Welfare Plan of Client ..... 191.214-215
- Obligation to Employer's External Accountant ..... 102.04
- Preparation and Transmittal of Financial Statements to Third Parties ..... 291.019-020
- Responsibility for Preparation of Financial Statements ..... 203.05
- Spouse Participation in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in Client ..... 101.02
- Subordination of Judgment ..... 102.05
- Supervision of Specialists ..... 291.017-018
- Use of CPA Designation ..... 191.130-131

**EMPLOYERS**

- Definition, as Used in Client ..... 92.03
- Employee Benefit Plans ..... 191.119-120

**EMPLOYMENT**

- Discrimination in Employment ..... 501.03
- Harassment in Employment ..... 501.03
- Member in Non-CPA Firm ..... 591.005-006

**ENGAGEMENT LETTERS**

- Inclusion of Indemnification Clause ..... 191.188-189

**ENTERTAINMENT**

- To or From Client ..... 191.226-229

**ESTATES**

- Gifts or Entertainment to or From Client ..... 191.226-229
- Member Co-Fiduciary With Client Bank ..... 191.075-076

**EXPERT WITNESS SERVICES—See Forensic Accounting Services****F****FACULTY MEMBERS**

- Advertising Material ..... 591.065-066
- Auditor of Student Funds ..... 191.095-096

**FAMILY RELATIONSHIPS**

- Close Relatives ..... 92.04; 101.02
- Effect on Independence ..... 101.02
- Member Participation in Health and Welfare Plan of Client ..... 191.214-215
- Receipt of Contingent Fees or Commissions by Member's Spouse ..... 391.037-038; 591.373-374
- Significant Influence ..... 92.27

**FAMILY RELATIONSHIPS—continued**

- Spouse Participation in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in Client ..... 101.02

**FEASIBILITY STUDIES**

- Confidential Information From Nonclient ..... 391.027-028

**FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD (FASAB)**

- Authority Over Federal Government Entities Pursuant to Rule 203 ..... 203.03
- Body Designated to Establish Principles ..... 203.03

**FEES**

- Billing for Subcontractor's Services ..... 591.371-372
- Collection by Bank ..... 591.003-004
- Contingent ..... 302.01-02
- Referral ..... 503.01
- Response to Requests by Clients for Records ..... 501.02
- Unpaid ..... 191.103-104

**FIDUCIARY**

- Member Co-Fiduciary With Client Bank ..... 191.075-076

**FINANCIAL ACCOUNTING STANDARDS BOARD (FASB)**

- Body Designated to Establish Principles ..... 203.03
- Status of Codification, Statements, and Interpretations Under Rule 203 ..... 203.03

**FINANCIAL ACCOUNTING STANDARDS BOARD (FASB) ACCOUNTING STANDARDS CODIFICATION (ASC)**

- Status Under Rule 203 ..... 203.03

**FINANCIAL INSTITUTIONS**

- Collection Agent for Fees ..... 591.003-004
- Controller's Use of CPA Title .... 591.075-076
- Credit Card Balances and Overdraft Reserve Accounts ..... 101.07
- Definition ..... 92.08
- Grandfathered and Other Permitted Loans ..... 101.07
- Member as Bank Director ..... 191.170-171; 391.035-036
- Member Co-Fiduciary of Estate or Trust ..... 191.075-076
- Member's Depository Relationship ..... 191.140-141
- Servicing Member's Loan ..... 191.134-135

**FINANCIAL INTEREST**

- Bondholders in Municipal Authority ..... 191.057-058
- Common Interest Realty Association Services ..... 191.061-062
- Conflict of Interests ..... 102.03
- Employee Benefit Plans ..... 191.119-120
- Family Relationships ..... 101.02

References are to ET section and paragraph numbers.

**FINANCIAL INTEREST—continued**

- Financial Relationships ..... 101.17
- Impairment of Independence ..... 101.01;  
..... 101.10
- Investment With a General  
Partner ..... 191.138-139; 191.162-163
- Materiality ..... 101.10
- Member Participation in Health and  
Welfare Plan of Client ..... 191.214-215
- Nonclients Related to Clients ..... 101.10
- Spouse Participation in Retirement,  
Savings, or Similar Plan Sponsored  
by, or That Invests in Client ..... 101.02
- Stockholder in Social Club ..... 191.033-034

**FINANCIAL RELATIONSHIPS**

- Definitions ..... 101.17
- Financial Interests, Direct, Indirect,  
Unsolicited, Beneficially Owned ..... 101.17
- Limited Liability Companies ..... 101.17
- Mutual Funds ..... 101.17
- Retirement, Savings, Compensation  
Plans ..... 101.17
- Section 529 Plans ..... 101.17
- Trust Investments ..... 101.17
- Partnerships ..... 101.17

**FINANCIAL STATEMENTS**

- Accounting Principles ..... 203.01-02; 203.05
- Definition ..... 92.09
- Departures From Established  
Principles ..... 203.01-02; 203.05
- Designation of CPAs Not in Public  
Practice ..... 191.130-131
- Employee Benefit Plans ..... 191.119-120
- Knowing Misrepresentation ..... 102.02
- Negligence in Preparation ..... 501.05
- Preparation and Transmittal to  
Third Parties ..... 291.019-020
- Representation Regarding GAAP  
Conformity ..... 203.05

**FIRM**

- Definition ..... 92.10; 101.14

**FIRM NAME**

- Associated Firms Not  
Partnership ..... 591.269-270;  
..... 591.357-358
- Designation as AICPA Member ..... 505.01
- Former Partner's Name ..... 591.279-280;  
..... 591.289-290
- Newsletters and Publications ..... 591.351-352
- Partner's Roster Differs by  
States ..... 591.287-288
- Partnerships With Non-CPAs ..... 591.379-380
- Past Owners ..... 505.01
- Rule of Conduct ..... 505.01

**FORENSIC ACCOUNTING SERVICES**

- Definition ..... 101.05
- Expert Witness Services ..... 101.05
- Investigative Services ..... 101.05
- Litigation Services ..... 101.05
- Performance of Nonattest Services ..... 101.05

**FORM OF ORGANIZATION**

- Alternative Practice Structures ..... 101.16;  
..... 505.04
- Associated Firms Not  
Partnership ..... 591.269-270; 591.357-358
- Associated Members Not  
Partners ..... 591.267-270
- Cooperative Arrangements ..... 101.14
- Designation of Firm as AICPA  
Members ..... 505.01
- Nonproprietary Partner Title ..... 591.273-274
- Ownership of Separate Business ..... 505.03;  
..... 591.275-276; 591.353-354
- Partners' Roster Differs by  
States ..... 591.287-288
- Partnerships With Non-CPAs ..... 591.271-272;  
..... 591.379-380
- Past Owners ..... 505.01
- Rule of Conduct ..... 505.01

**FUND-RAISING ORGANIZATIONS**

- Member on Board of  
Directors ..... 191.027-028;  
..... 191.128-129; 191.186-187

**G****GENERAL STANDARDS**

- Rule of Conduct ..... 201.01

**GENERALLY ACCEPTED ACCOUNTING PRINCIPLES**

- Departures ..... 203.01-03; 203.05
- Designation of Bodies to Establish  
Principles ..... 203.03
- Pronouncements Establishing ..... 203.03
- Representation Regarding Conformity  
of Financial Statements ..... 203.05
- Rule of Conduct ..... 203.01

**GIFTS**

- To or From Client ..... 191.226-229

**GOVERNMENTAL ACCOUNTING STANDARDS BOARD**

- Body Designated to Establish  
Principles ..... 203.03
- Status of Statements and Interpretations  
Under Rule 203 ..... 203.03

**GOVERNMENTAL AGENCIES**

- Fees Based on Findings ..... 302.01-02
- Member on Citizen's  
Committee ..... 191.039-040

**GOVERNMENTAL REPORTING ENTITY**

- Auditor Independence ..... 101.12
- Failure to Follow  
Requirements ..... 501.04; 501.06

**H****HARASSMENT**

- Employment Practices ..... 501.03

**HEALTH AND WELFARE PLANS**

- Member Participation in Health  
and Welfare Plan of Client ..... 191.214-215

References are to ET section and paragraph numbers.

**HOLDING OUT**

- Definition ..... 92.11

**HOMEOWNERS ASSOCIATIONS**—See Common Interest Realty Association**I****INDEPENDENCE**

- Actions Permitted Upon Impairment ..... 191.200-201
- Advisory Board of Client ..... 191.144-145
- Advisory Services to Client ..... 191.015-016
- Alternative Practice Structures ..... 101.16; 505.04
- Applicability of Code of Conduct ..... 91.02
- Application to All Partners and Professional Employees ..... 101.02
- Attestation Engagements ..... 101.13
- Audit Report ..... 191.148-149
- Bondholders in Municipal Authority ..... 191.057-058
- Broad Categories of Impairment ..... 101.02
- Campaign Organization Treasurer ..... 191.164-165
- Characteristics ..... 55.01-04
- Client Advocacy ..... 102.07
- Client Servicing Member's Loan ..... 191.134-135
- Co-Fiduciary With Client Bank ..... 191.075-076
- Commencement of ADR Proceedings ..... 191.192-193
- Common Interest Realty Association Services ..... 191.061-062
- Compensation Plans ..... 101.17
- Compilation Report ..... 191.148-149
- Cooperative Arrangements With Clients ..... 101.14
- Credit Card Balances and Overdraft Reserve Accounts ..... 101.07
- Deferred Compensation Committee of Client ..... 191.037-038
- Depository Relationship With Client Financial Institution ..... 191.140-141
- Documentation, Failure to Prepare ..... 101.02
- Employee Benefit Plans ..... 191.119-120
- Employment or Association With Attest Clients ..... 101.04
- Examples of Impaired Independence ..... 101.02; 191.220-221
- Executor Relationships ..... 101.02; 191.220-221
- Extended Audit Services ..... 191.206-207
- Faculty Member Auditor of Student Fund ..... 191.095-096
- Family Relationships ..... 101.02
- Financial Interest in Nonclients ..... 101.10
- Financial Interests ..... 101.17
- Financial Relationships ..... 101.17
- Financial Services Managed by Client ..... 191.081-082

**INDEPENDENCE**—continued

- Fund-Raising Activities ..... 191.027-028; 191.128-129
- Gifts or Entertainment to or From Client ..... 191.226-229
- Governmental Advisory Units ..... 191.039-040
- Governmental Reporting Entity ..... 101.12
- Grandfathered Loans ..... 101.07
- Honorary Directorships of Not-for-Profit Organizations ..... 101.06; 191.128-129
- Indemnification Agreement ..... 191.204-205
- Indemnification Clause in Engagement Letter ..... 191.188-189
- Investment Advisory Services, Rule 101 Considered ..... 391.047-048
- Investment With a General Partner ..... 191.138-139; 191.162-163
- Joint Closely Held Investment ..... 92.16
- Leasing Property to or From Client ..... 191.182-183
- Limited Liability Companies ..... 101.17
- Litigation ..... 101.08
- Loans From Financial Institution Client ..... 101.07
- Loans From Nonclient Subsidiary or Parent of Attest Client ..... 191.196-197
- Loans to/From Entity Connected With Member ..... 191.220-221
- Loans to Partnerships Where Covered Members Are General Partners ..... 101.07
- Loans to Partnerships Where Covered Members Are Limited Partners ..... 101.07
- Member as Legislator ..... 191.019-020
- Member Has Significant Influence Over Entity That Has Significant Influence Over Client ..... 191.212-213
- Member Joining Client Credit Union ..... 191.150-151
- Member Participation in Health and Welfare Plan of Client ..... 191.214-215
- Member Performing Management Functions ..... 101.15; 191.017-018; 191.037-038; 191.041-042
- Member Providing Attest Report on Internal Controls ..... 191.206-207
- Members Not in Public Practice ..... 55.04
- Membership in Client Credit Union ..... 191.150-151
- Membership in Trade Association With Client ..... 191.003-004
- Mutual Funds ..... 101.17
- Nonattest Services—See Nonattest Services
- Nonindependent Firm on Engagement ..... 191.142-143
- Partially Secured Loans ..... 101.07
- Partnerships ..... 101.17
- Period of Professional Engagement ..... 92.24

References are to ET section and paragraph numbers.

**INDEPENDENCE**—continued

- Predispute Agreement to Use ADR Techniques ..... 191.190-191
- Preparation and Transmittal of Financial Statements to Third Parties ..... 291.019-020
- Profit-Sharing and Retirement Trusts ..... 191.041-042
- Retirement Plans ..... 101.17
- Review Report ..... 191.148-149
- Rule 101 Considered When Member Provides Investment Advisory Services ..... 391.047-048
- Rule of Conduct ..... 101.01
- Savings Plans ..... 101.17
- Section 529 Plans ..... 101.17
- Significant Influence ..... 92.27
- Social Club Board of Directors ..... 191.031-032
- Spouse Participation in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in Client ..... 101.02
- Stockholder in Social Club ..... 191.033-034
- Trust Investments ..... 101.17
- Trustee Relationships ..... 101.02; ..... 191.021-024
- Unpaid Fees/Notes Receivable ..... 191.103-104
- Use of CPA Designation by Member Not in Public Practice ..... 191.130-131
- Vacation Home Joint Interest With Client ..... 191.184-185

**INDEPENDENCE STANDARDS**

- Acceptable Risk ..... 100.01.04
- Conceptual Framework for ..... 100.01.01-26
- Definitions ..... 100.01.06-21
- Documentation Preparation ..... 100.01.02
- Judgment ..... 100.01.01-26
- Risk-Based Approach ..... 100.01.01-26
- Risk-Based Approach, Steps ..... 100.01.05
- Unacceptable Risk ..... 100.01.01
- Use of Framework to Overcome Prohibitions or Requirements in Independence Interpretations and Rulings ..... 100.01.03

**INDIVIDUAL IN A POSITION TO INFLUENCE AN ATTEST ENGAGEMENT**

- As Covered Member ..... 92.06
- Definition ..... 92.13

**INSTITUTE**—See American Institute of CPAs**INSURANCE COMPANIES**

- Financial Services Managed for Member or Member's Firm ..... 191.081-082

**INTEGRITY**

- Client Advocacy ..... 102.07
- Considerations ..... 54.01-04
- Educational Services Performed by Member ..... 102.06

**INTEGRITY**—continued

- Gifts or Entertainment to or From Client ..... 191.226-229
- Knowing Misrepresentation of Financial Statements ..... 102.02
- Obligation to Employer's External Accountant ..... 102.04
- Professional Responsibility ..... 102.04-05
- Rule of Conduct ..... 102.01
- Subordination of Judgment ..... 102.05
- Use of Third-Party Service Provider ..... 191.224-225

**INTERNATIONAL ASSOCIATE**

- Applicability of Code of Professional Conduct ..... 91.02

**INTERPRETATIONS OF RULES OF CONDUCT**

- Definition ..... 92.15

**INVESTEEES**

- Definition ..... 101.10

**INVESTIGATIVE SERVICES**—See Forensic Accounting Services**INVESTMENT ADVISORY SERVICES**

- Fee Arrangements With Nonattest Client ..... 391.049-050; 591.383-384
- Fee Based on Percentage of Client's Investment Portfolio ..... 391.047-048
- Rule 101, Consideration of ..... 391.047-048
- Rule 301, Professional Responsibility to Clients Under ..... 391.047-048
- Rule 302, Member in Violation of ..... 391.047-050
- Rule 503, Member in Violation of ..... 391.047-050
- Professional Responsibility to Clients Under Rule 301 ..... 391.047-048
- Provided by Member to Attest Client ..... 391.047-048
- Provided by Member to Nonattest Client ..... 391.049-050; 591.383-384

**INVESTMENTS**

- Advisory Services ..... 391.047-050; ..... 591.383-384
- Bondholders in Municipal Authority ..... 191.057-058
- Financial Services Managed by Client ..... 191.081-082
- Joint Closely Held Investment ..... 92.16; 101.02
- Spouse Participation in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in Client ..... 101.02
- With a General Partner ..... 191.138-139; ..... 191.162-163

**INVESTORS**

- Definition ..... 101.10

**J****JOINT CLOSELY HELD INVESTMENT**

- Competence in Performance of Engagement ..... 92.16



References are to ET section and paragraph numbers.

**JUDGMENT**

- Competence in Performance of Engagement ..... 201.02
- Conceptual Framework for Independence Standards ..... 100.01.01-26
- Gifts or Entertainment to or From Client ..... 191.226-229
- Scope in Nature of Services ..... 57.01-03
- Subcontractor Selection ..... 291.015-016
- Subordination of ..... 102.05
- Supervision of Specialists ..... 291.017-018

**K****KEY POSITION**

- Definition ..... 92.17
- Prohibitions for Immediate Family and Close Relatives ..... 101.02

**L****LAWS**

- Alternative Practice Structures ..... 101.16; 505.04

**LAWYERS**

- Letterhead for CPA/Lawyers .... 591.155-156

**LEASES**

- Member as Lessee of Client .... 191.061-062; 191.182-183
- Member as Lessor of Client .... 191.182-183

**LEGISLATORS**

- Members in Local Government ..... 191.019-020

**LETTERHEADS**

- Associated Firms Not Partnerships ..... 591.357-358
- Associated Members Not Partners ..... 591.267-270
- Designation of CPAs Not in Public Practice ..... 191.130-131; 591.075-076
- Joint Audit With Former Partners ..... 591.271-272
- Lawyer/CPA ..... 591.155-156
- Personal Financial Specialist Designation ..... 591.365-366
- Transmittal of Financial Statements Prepared by Member to Third Parties ..... 291.019-020

**LIENS**

- Response to Requests by Clients for Records ..... 501.02

**LIMITED LIABILITY COMPANIES**

- Financial Relationships ..... 101.17

**LIMITED PARTNERSHIPS**

- Investment With a General Partner ..... 191.138-139; 191.162-163
- Loans to Partnerships Where Members Are Limited Partners ..... 101.07

**LITIGATION**

- Accounting Principles for Support Services ..... 291.021-022
- Confidential Client Information ..... 391.045-046
- Conflict of Interests ..... 102.03
- Consulting Services—See Forensic Accounting Services
- Effect on Independence ..... 101.08
- Services—See Forensic Accounting Services

**LOAN AGREEMENTS—See Borrowing Contract****M****MANAGEMENT**

- Conflict of Interests ..... 102.03
- Deferred Compensation Committee ..... 191.037-038
- Member Performing Management Functions ..... 191.017-018; 191.037-038; 191.041-042

**MANAGEMENT CONSULTING SERVICES—See Consulting Services****MANAGER**

- As Covered Member ..... 92.06
- Definition ..... 92.19

**MATERIALITY**

- Financial Interest ..... 101.10
- Independence With Respect to Alternative Practice Structures ..... 101.16
- Independence With Respect to Governmental Reporting Entities ..... 101.12

**MEMBER OR MEMBER'S FIRM**

- Accounting Principles .... 203.01-02; 203.05
- Acts Discreditable—See Acts Discreditable
- Advertising—See Advertising
- Alternative Practice Structures ..... 101.16; 505.04
- Association ..... 591.267-270; 591.357-358
- Billing for Subcontractor's Services ..... 591.371-372
- Client Advocacy ..... 102.07
- Commissions—See Commissions
- Commissions or Referral Fee Arrangements With Nonattest Client ..... 391.049-050; 591.383-384
- Competence—See Competence
- Compliance With Standards ..... 202.01
- Confidential Client Information—See Confidential Client Information
- Conflicts of Interest ..... 102.03
- Contingent Fees—See Contingent Fees
- Cooperative Arrangement With Client ..... 101.14
- Covered Member ..... 92.06; 101.16
- Definition ..... 92.20; 101.16
- Departures From Established Accounting Principles ..... 203.01-02; 203.05

References are to ET section and paragraph numbers.

**MEMBER OR MEMBER'S FIRM**—continued

- Discrimination and Harassment in Employment Practices ..... 501.03
- Due Professional Care ..... 201.01
- Extended Audit Services to Client ..... 191.206-207
- Failure to File Tax Return or Pay Tax Liability ..... 501.08
- Form of Organization or Name—See Form of Organization
- Governmental Requirements ..... 501.04; ..... 501.06
- Indemnification of Client ..... 191.204-205
- Independence—See Independence
- Integrity—See Integrity
- Interviews With Press ..... 591.215-216
- Investment Advisory Services ..... 391.047-050
- Knowing Misrepresentation of Financial Statements ..... 102.02
- Litigation With Client ..... 291.021-022; ..... 391.045-046
- Loans to/From Entity Connected With Member ..... 191.220-221
- Members Not in Public Practice—See Members Not in Public Practice
- Negligence in Financial Statement Preparation ..... 501.05
- Newsletters and Publications, Member's Association With ..... 591.351-352
- Nonattest Services to Client ..... 101.05
- Notes Receivable Arising From Client's Unpaid Fees ..... 191.103-104
- Objectivity—See Objectivity
- Obligation to Employer's External Accountant ..... 102.04
- Ownership of Separate Business ..... 505.03; ..... 591.275-276; ..... 591.353-354
- Planning and Supervision—See Planning and Supervision
- Practice of Public Accounting Criteria ... 92.25
- Preparation and Transmittal of Financial Statements ..... 291.019-020
- Professional Responsibilities ..... 52.01
- Referrals—See Referrals
- Relationship Between Parties ..... 102.03
- Representation Regarding GAAP Conformity ..... 203.05
- Response to Requests by Clients for Records ..... 501.02
- Sale of Products to Clients ..... 591.369-370
- Subordination of Judgment ..... 102.05
- Sufficient Relevant Data ..... 201.01
- Third Party Solicitation ..... 502.06
- Use of Third-Party Service Provider ..... 191.224-225; ..... 291.023-024; 391.001-002

**MEMBERS**

- Associate Member ..... 92.20
- Definition ..... 92.20
- International Associate ..... 91.02; 92.20

**MEMBERS NOT IN PUBLIC PRACTICE**

- Applicability of Code of Conduct ..... 91.01-02
- Objectivity Considerations ..... 55.04
- Ownership of Separate Business ..... 505.03
- Practice of Public Accounting Criteria ..... 92.25
- Use of CPA Designation ..... 191.130-131; ..... 591.075-076

**MISREPRESENTATION**

- Educational Services Performed by Member ..... 102.06
- Knowingly False and Misleading Financial Statements ..... 102.02

**MUNICIPALITIES**

- Members as Bondholders ..... 191.057-058

**MUTUAL FUNDS**

- Financial Relationships ..... 101.17

**N****NEWSLETTERS**

- Member's Association With ..... 591.351-352

**NONATTEST SERVICES**

- Appraisal, Valuation, and Actuarial ..... 101.05
- Benefit Plan Administration ..... 101.05
- Bookkeeping ..... 101.05
- Consulting ..... 101.05
- Corporate Finance ..... 101.05
- Examples ..... 101.05
- Executive or Employee Search ..... 101.05
- Forensic Accounting Services ..... 101.05
- Information Systems ..... 101.05
- Internal Audit Assistance ..... 101.05
- Investment ..... 101.05
- Nontax Disbursement ..... 101.05
- Regulatory Bodies ..... 101.05
- Relation to Independence ..... 101.05
- Tax Services ..... 101.05

**NONCLIENTS**

- Confidential Information From MCS Client ..... 391.027-028
- Investor/Investee Relationship to Clients ..... 101.10

**NORMAL LENDING PROCEDURES, TERMS, AND REQUIREMENTS**

- Definition ..... 92.21

**NOT-FOR-PROFIT ORGANIZATIONS**

- Honorary Directorships ..... 101.06; ..... 191.128-129
- Member on Board of Directors of Social Club ..... 191.031-032

**O****OBJECTIVITY**

- Characteristics ..... 55.01-04
- Client Advocacy ..... 102.07

References are to ET section and paragraph numbers.

**OBJECTIVITY**—continued

- Conflicts of Interest ..... 102.03
- Educational Services Performed by Member ..... 102.06
- Gifts or Entertainment to or From Client ..... 191.226-229
- Knowing Misrepresentation of Financial Statements ..... 102.02
- Member as Bank Director ..... 191.170-171; 391.035-036
- Member as Director of Federated Fund-Raising Organization ..... 191.186-187
- Member Providing Other Professional Services for Company Executives ..... 191.198-199; 391.041-042
- Members Not in Public Practice ..... 55.04
- Obligation to Employer’s External Accountant ..... 102.04
- Professional Responsibility ..... 102.04-05
- Relationship Between Parties ..... 102.03
- Rule of Conduct ..... 102.01
- Subordination of Judgment ..... 102.05
- Use of Third-Party Service Provider ..... 191.224-225

**OFFICE**

- Definition ..... 92.22

**OFFICERS**

- Independence With Respect to Alternative Practice Structures ..... 101.16

**OPINIONS, AUDITORS’**

- Departures From Established Principles ..... 203.01
- Impairment of Independence .... 191.200-201
- Joint Audit With Former Partners ..... 591.271-272
- Lack of Independence ..... 191.148-149

**P**

**PARTNERS**

- Definition ..... 92.23
- Former Partner in Firm Name ..... 591.279-280; 591.289-290
- Joint Audit With Former Partners ..... 591.271-272
- Member With Non-CPA Partners ..... 591.005-006; 591.271-272; 591.281-282; 591.379-380
- Nonproprietary Partner Title ..... 591.273-274
- Preparation and Transmittal of Financial Statements to Third Parties ..... 291.019-020
- Responsibility for Non-CPA Partner ..... 591.005-006; 591.281-282
- Roster Differs by States ..... 591.287-288

**PARTNERS**—continued

- Separate Proprietorship Practice ..... 591.275-276

**PARTNERS AND PROFESSIONAL EMPLOYEES**

- Broadly Defined Independence Rules ..... 101.02
- Employment or Association With Attest Clients ..... 101.04

**PARTNERSHIPS**

- Associations But Not Partnerships ..... 591.267-270; 591.357-358
- Financial Relationships ..... 101.17
- Former Partner in Firm Name ..... 591.279-280; 591.289-290
- Investment With a General Partner ..... 191.138-139; 191.162-163
- Joint Audit With Former Partners ..... 591.271-272
- Limited—See Limited Partnerships
- Loans to Partnerships Where Covered Members Are General Partners ..... 101.07
- Loans to Partnerships Where Covered Members Are Limited Partners ..... 101.07
- Member With Non-CPA Partners ..... 591.005-006; 591.271-272; 591.281-282; 591.379-380
- Nonproprietary Partner Title ..... 591.273-274
- Partner With Separate Practice ..... 591.275-276; 591.353-354
- Partner’s Roster Differs by States ..... 591.287-288
- Responsibility for Non-CPA Partner ..... 591.005-006; 591.281-282

**PERIOD OF THE PROFESSIONAL ENGAGEMENT**

- Definition ..... 92.24

**PERSONAL FINANCIAL PLANNING**

- Conflict of Interests ..... 102.03
- Member Providing Services for Company Executives ..... 191.198-199; 391.041-042
- Personal Financial Specialist Designation ..... 591.365-366

**PLANNED UNIT DEVELOPMENTS**—See Common Interest Realty Association

**PLANNING AND SUPERVISION**

- Due Professional Care ..... 56.05
- Rule of Conduct ..... 201.01

**POLITICAL CAMPAIGNS**

- Member as Campaign Treasurer ..... 191.164-165

References are to ET section and paragraph numbers.

**PRACTICE-MONITORING PROGRAMS**

- Alternative Practice Structures ..... 101.16; 505.04

**PRACTICE OF PUBLIC ACCOUNTING**

- Alternative Practice Structures ..... 101.16; 505.04
- Associated Firms Not Partnership.... 591.269-270; 591.357-358
- Definition ..... 92.25
- Letterhead of Lawyer/CPA ..... 591.155-156
- Nonattest Services to Client ..... 101.05
- Ownership of Separate Business..... 505.03; 591.275-276; ..... 591.353-354
- Principles of Professional Conduct ..... 51.01-02
- Professional Responsibilities ..... 52.01
- Responsibility for Non-CPA Partner ..... 591.281-282

**PROFESSIONAL SERVICES**

- Accounting Principles ..... 291.021-022
- Alternative Practice Structures ..... 101.16; ..... 505.04
- Applicability of Code of Conduct..... 91.01-02
- Associated Firms Not Partnership ..... 591.269-270; ..... 591.357-358
- Client Advocacy ..... 102.07
- Clients by Third Parties ..... 502.06
- Competence ..... 201.01-02
- Compliance With Standards ..... 202.01
- Confidential Information ..... 391.011-012
- Conflicts of Interest ..... 102.03
- Contingent Fees ..... 302.01-02
- Deciding to Perform ..... 191.221
- Definition ..... 92.26
- Due Professional Care ..... 201.01
- Educational Services ..... 102.06
- General Standards ..... 201.01
- Governmental Requirements ..... 501.04; ..... 501.06
- Indemnification Agreement as Condition for Performance ..... 191.204-205
- Investment Advisory Services..... 391.047-050; ..... 591.383-384
- Joint Audit With Former Partners ..... 591.271-272
- Loans to/From Entity Connected With Member ..... 191.220-221
- Member Providing Other Services for Company Executives ..... 191.198-199; ..... 391.041-042
- Membership in Client Credit Union ..... 191.150-151
- Nonattest Services—See Nonattest Services

**PROFESSIONAL SERVICES—continued**

- Ownership of Separate Business ..... 505.03; ..... 591.275-276; ..... 591.353-354
- Period of Professional Engagement ..... 92.24
- Planning and Supervision ..... 201.01
- Referral of Products to Clients ..... 591.375-376
- Relationship Between Parties ..... 102.03
- Scope and Nature ..... 57.01-03
- Subcontractor's Services, Billings to Clients ..... 591.371-372
- Subordination of Judgment ..... 102.05
- Sufficient Relevant Data ..... 201.01
- Unpaid Fees/Notes Receivable ..... 191.103-104
- Use of Third-Party Service Provider ..... 191.224-225; ..... 291.023-024; 391.001-002

**PROMOTERS**

- Independence With Respect to Alternative Practice Structures ..... 101.16

**PUBLICATIONS**

- Member's Association With ..... 591.351-352

**PURCHASE/SALE OF PRACTICE**

- Confidential Client Information ..... 301.04

**R****RECEIVABLES**

- Notes Receivable/Unpaid Fees ..... 191.103-104

**RECORDS**

- Requests From Client's Representative ..... 591.377-378

**REFERRALS**

- Independence With Respect to Alternative Practice Structures ..... 101.16
- Products to Clients ..... 591.375-376
- Rule of Conduct ..... 503.01

**REGULATIONS**

- Alternative Practice Structures ..... 101.16; 505.04

**RELATIONSHIP WITH CLIENTS**

- ADR Techniques ..... 191.190-193
- Advisory Services ..... 191.015-016
- Co-Fiduciary With Client Bank.... 191.075-076
- Confidential Information From Nonclient ..... 391.027-028
- Cooperative Arrangements ..... 101.14
- Disclosure of Information From Previous Engagement ..... 391.029-030
- Independence With Respect to Alternative Practice Structures ..... 101.16
- Indirect Financial Interests ..... 101.10
- Loan to/From Entity Connected With Member ..... 191.220-221

References are to ET section and paragraph numbers.

**RELATIONSHIP WITH CLIENTS—continued**

- Member Has Significant Influence Over Entity That Has Significant Influence Over Client ..... 191.212-213
- Member Participation in Health and Welfare Plan of Client ..... 191.214-215
- Member Preparation and Transmittal of Financial Statements to Third Parties ..... 291.019-020
- Member's Depository Relationship With Client Financial Institution ..... 191.140-141
- Nonattest Services ..... 101.05
- Response to Requests for Records .... 501.02
- Retirement Fund Managed for Member or Member's Firm ..... 191.081-082
- Servicing Member's Loan ..... 191.134-135
- Spouse Participation in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in Client ..... 101.02

**REPORTS**

- Associated Members Not Partners ..... 591.267-268
- Partnership With Non-CPA ..... 591.271-272; ..... 591.379-380

**REPORTS, AUDITORS'**

- Compilation Reports ..... 191.148-149
- Impairment of Independence .... 191.200-201
- Independence ..... 191.148-149
- Joint Audit With Former Partners ..... 591.271-272
- Review Reports ..... 191.148-149
- Unpaid Fees/Notes Receivable ..... 191.103-104

**REQUESTS FOR RECORDS**

- Response to Requests by Clients ..... 501.02

**RESOLUTIONS OF COUNCIL**

- FASB Designated to Establish Principles ..... 203.03
- GASB Designated to Establish Principles ..... 203.03

**RESPONSIBILITIES TO CLIENTS**

- Competitive Information ..... 391.011-012
- Confidential Client Information ..... 191.198-199; 301.01; ..... 301.04; 391.029-030; 391.041-042
- Disclosure of Client's Name ..... 391.013-014
- Disclosure of Confidential Information to Professional Liability Insurance Carrier ..... 391.039-040
- Irregularities in Tax Return ..... 391.005-006
- Subcontractor Selection ..... 291.015-016
- Trade Association Request for Client Information ..... 391.003-004

**RESPONSIBILITIES TO COLLEAGUES**

- Non-CPAs ..... 591.005-006; ..... 591.281-282
- Principles of Professional Conduct ..... 52.01

**RESPONSIBILITIES TO PUBLIC**

- Alternative Practice Structures ..... 101.16; ..... 505.04
- Associated Members Not Partners ..... 591.267-270; ..... 591.357-358
- Definition ..... 53.01-04
- False or Misleading Advertising ..... 502.03
- Principles of Professional Conduct ..... 52.01; ..... 53.01-04

**RETIREMENT PLANS**

- Financial Relationships ..... 101.17
- Managed by Client ..... 191.081-082
- Spouse Participation in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in, Client ..... 101.02

**REVIEW ENGAGEMENT**

- Commissions or Referral Fees ..... 503.01
- Compliance With Standards ..... 202.01
- Contingent Fees ..... 302.01

**RISK-BASED APPROACH—See Independence Standards****S****SAFEGUARDS**

- Categories ..... 100.01.01-22
- Definition ..... 100.01.20
- Effectiveness ..... 100.01.21
- Examples Created by the Profession, Legislation, or Regulation ..... 100.01.24
- Examples Implemented by the Attest Client ..... 100.01.25
- Examples Implemented by the Firm ..... 100.01.26

**SAVINGS PLANS**

- Financial Relationships ..... 101.17
- Spouse Participation in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in Client ..... 101.02

**SEC PRACTICE SECTION**

- Alternative Practice Structures ..... 505.04

**SECTION 529 PLANS**

- Financial Relationships ..... 101.17

**SIGNIFICANT INFLUENCE**

- Definition ..... 92.27
- Effect on Independence ..... 101.02; 101.16

**SOCIAL CLUBS**

- Member as Stockholder ..... 191.033-034
- Member on Board of Directors ..... 191.031-032

**SOLICITATION—See Advertising****SPECIALIZATION**

- Subcontractor Selection ..... 291.015-016
- Supervision of Specialists ..... 291.017-018

References are to ET section and paragraph numbers.

**SPOUSE OF MEMBER**

- Participation in Retirement, Savings, or Similar Plan Sponsored by, or That Invests in, Client ..... 101.02
- Receipt of Contingent Fees or Commissions From Attest Client ..... 391.037-038; ..... 591.373-374

**STAFF MEMBERS**

- Competence ..... 201.02
- Supervision of Specialists ..... 291.017-018

**STATEMENTS ON STANDARDS FOR****ATTESTATION ENGAGEMENTS—See**  
Attestation Engagements**STOCKHOLDERS/OWNERS**

- Common Interest Realty Association Services ..... 191.061-062
- Form of Organization and Name ..... 505.01
- Member, as Principle Shareholder, Connected With Entity Having Loan to/From a Client ..... 191.220-221
- Past Owners, Use of Names ..... 505.01
- Preparation and Transmittal of Financial Statements to Third Parties ..... 291.019-020

**STUDENT FUNDS**

- Faculty Member as Auditor ..... 191.095-096

**SUBCONTRACTORS**

- Management Consulting Services Engagements ..... 291.015-016

**SUBORDINATION**

- Judgment to Others ..... 102.06

**SUCCESSOR ACCOUNTANT**

- Tax Return Irregularities ..... 391.005-006

**SUPERVISION**

- Specialists ..... 291.017-018

**T****TAX SERVICES**

- Compliance With Standards ..... 202.01
- Conflict of Interests ..... 102.03
- Contingent Fees ..... 302.01-02
- Definitions ..... 101.05
- Disclosure of Joint Tax Information ..... 391.031-032
- Engagement Involving Client Advocacy ..... 102.07
- Failure to File Tax Return or Pay Tax Liability ..... 501.08
- Information to Successor Accountant ..... 391.005-006
- Member Providing Services for Company Executives ..... 191.198-199; ..... 391.041-042
- Performance of Nonattest Services ..... 101.05
- Use of Third-Party Service Provider ..... 191.224-225; ..... 291.023-024; ..... 391.001-002

**TERMINATION OF ENGAGEMENT**

- Effect of Litigation ..... 101.08
- Information to Successor Accountant ..... 391.005-006

**TERMINOLOGY**

- Adverse Interest Threat ..... 100.01.15
- Advocacy Threat ..... 100.01.14
- Attest Engagement ..... 92.01
- Attest Engagement Team ..... 92.02
- Beneficially Owned ..... 101.17
- Client ..... 92.03; 101.10
- Close Relative ..... 92.04
- Contingent Fees ..... 302.01-02
- Cooperative Arrangements ..... 101.14
- Council ..... 92.05
- Covered Member ..... 92.06
- Direct Financial Interest ..... 101.17
- Direct Superiors ..... 101.16
- Directly Control ..... 101.16
- Engagement Team ..... 101.13
- Expert Witness Services ..... 101.05
- Familiarity Threat ..... 100.01.16
- Financial Institution ..... 92.08
- Financial Relationships ..... 101.17
- Financial Self-Interest Threat ..... 100.01.18
- Financial Statements ..... 92.09
- Firm ..... 92.10
- Forensic Accounting Services ..... 101.05
- Holding Out ..... 92.11
- Immediate Family ..... 92.12
- Impair ..... 100.01.09
- Independence in Appearance ..... 100.01.06
- Independence of Mind ..... 100.01.06
- Indirect Financial Interest ..... 101.17
- Indirect Superiors ..... 101.16
- Individual in a Position to Influence the Attest Engagement ..... 92.13
- Institute ..... 92.14
- Interpretations of Rules of Conduct ..... 92.15
- Investee ..... 101.10
- Investigative Services ..... 101.05
- Investor ..... 101.10
- Joint Closely Held Investment ..... 92.16
- Key Position ..... 92.17
- Litigation Consulting Services ..... 101.05
- Litigation Services ..... 101.05
- Loan ..... 92.18
- Management Participation Threat ..... 100.01.19
- Manager ..... 92.19
- Member ..... 92.20
- Normal Lending Procedures, Terms, and Requirements ..... 92.21
- Office ..... 92.22
- Partner ..... 92.23
- Period of Professional Engagement ..... 92.24
- Practice of Public Accounting ..... 92.25
- Professional Services ..... 92.26
- Receipt of Contingent Fee or Commission ..... 391.033-034; ..... 591.367-368
- Responsible Party ..... 101.13

References are to ET section and paragraph numbers.

**TERMINOLOGY**—continued

- Safeguards ..... 100.01.20
- Self-Review Threat ..... 100.01.13
- Significant Influence ..... 92.27; 101.16
- Subject Matter of an Attest Engagement ..... 101.13
- Tax Compliance Services ..... 101.05
- Tax Return ..... 101.05
- Threats ..... 100.01.10
- Undue Influence Threat ..... 100.01.17

**THIRD-PARTY SERVICE PROVIDERS**

- Applicability of General and Technical Standards When Using ..... 291.023-.024
- Professional Services ..... 191.224-225; ..... 391.001-.002

**THREATS TO INDEPENDENCE**

- Adverse Interest ..... 100.01.15
- Advocacy ..... 100.01.14
- Familiarity ..... 100.01.16
- Financial Self-Interest ..... 100.01.18
- Management Participation ..... 100.01.19
- Self-Review ..... 100.01.13
- Undue Influence ..... 100.01.17

**TIMESHARE DEVELOPMENTS**—See Common Interest Realty Association

**TITLES, PROFESSIONAL**

- Associated Firms Not Partnership ..... 591.269-270; ..... 591.357-358
- Controller's Use of CPA Designation ..... 591.075-.076
- CPA in Partnership With Non-CPAs ..... 591.379-380
- CPA Title by Employee ..... 191.130-.131
- Former Partner in Firm Name ..... 591.279-.280; ..... 591.289-.290
- Letterhead of Lawyer/CPA ..... 591.155-.156

**TITLES, PROFESSIONAL**—continued

- Nonproprietary Partners ..... 591.273-274
- Partner's Roster Differs by States ..... 591.287-288
- Personal Financial Specialist Designation ..... 591.365-366

**TRADE ASSOCIATIONS**

- Request for Information ..... 391.003-004

**TRUST FUNDS**

- Member Co-Fiduciary With Client Bank ..... 191.075-.076

**TRUST INVESTMENTS**

- Financial Relationships ..... 101.17

**TRUSTEES**

- Charitable Organization ..... 191.023-024
- Estate of Majority Stockholder ..... 191.021-022
- Honorary Directorships of Not-for-Profit Organizations ..... 101.06; ..... 191.128-129
- Independence With Respect to Alternative Practice Structures ..... 101.16
- Prohibited Relationship ..... 101.02

**TRUSTS**

- Member as Director and Auditor ..... 191.041-.042

**U**

**UNDERWRITERS**

- Independence With Respect to Alternative Practice Structures ..... 101.16

**W**

**WORKING PAPERS**

- Response to Requests by Clients for Records ..... 501.02

# Bylaws of the American Institute of Certified Public Accountants

As Amended October 28, 1997, unless otherwise indicated

## DEFINITIONS

As used in these bylaws, implementing resolutions of Council thereunder, or the Code of Professional Conduct, masculine terms shall be understood to include the feminine; "state" shall be understood to include the District of Columbia, Puerto Rico, and the territories, or territorial possessions of the United States of America; "firm" shall be understood to mean any organization permitted by law or regulation; "owner" shall be understood to include partners, partner equivalents, shareholders, or other owners of a firm; "official records of the Institute" shall be understood to mean the records of the membership department; and "committee" shall be understood to include any board (except the AICPA Board of Directors), division, task force, or any subdivision thereof.

[As revised May 15, 2000; revised November 6, 2007.]

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# BL Section 100

## 1. NAME AND PURPOSE

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### TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
101	Name and Purpose .....	.01

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**BL Section 101*****Name and Purpose***

**As amended  
January 12, 1988**

**.01** The name of this organization shall be the American Institute of Certified Public Accountants. In keeping with the Institute's certificate of incorporation, its objectives shall be to unite certified public accountants in the United States; to promote and maintain high professional standards of practice; to assist in the maintenance of standards for entry to the profession; to promote the interests of CPAs; to develop and improve accounting education; and to encourage cordial relations between CPAs and professional accountants in other countries.

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**BL Section 200****2. ADMISSION TO, AND RETENTION OF,  
MEMBERSHIP AND ASSOCIATION**

## TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
210	Members .....	.01
220	Requirements for Admission to Membership .....	.01
220R	Implementing Resolution Under Section 2.2 Requirements for Admission to Membership.....	.01-[.03]
230	Requirements for Retention of Membership .....	.01
230R	Implementing Resolutions Under Section 2.3 Requirements for Retention of Membership.....	[.01]-[.08]
240	Certificate of Membership .....	.01
250	Right of Members to Describe Themselves as Such.....	.01
260	International Associates.....	.01
260R	Implementing Resolution Under Section 2.6 International Associates...	.01



## **BL Section 210**

### ***2.1 Members***

**As amended  
January 12, 1988**

**.01** Members of the Institute shall be

**2.1.1** Members of the Institute at the effective date of these bylaws,  
and

**2.1.2** Persons who shall qualify for admission as provided in section 2.2  
of this article and who shall be admitted under procedures adopted by the  
Board of Directors.

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**BL Section 220****2.2 Requirements for Admission to Membership**

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** Persons may qualify for admission as members of the Institute if they satisfy the criteria listed below:

**2.2.1** They are in possession of a valid and unrevoked certified public accountant certificate issued by a legally constituted authority,

**2.2.2** They have passed an examination in accounting and other related subjects satisfactory to the Board of Directors, and

**2.2.3** With respect to those persons who are engaged in the practice of public accounting as an owner or as an employee who has been licensed as a CPA for more than two years, either they are practicing in a firm that is enrolled in an Institute-approved practice-monitoring program if the services performed by such a firm are within the scope of the AICPA's practice-monitoring standards and the firm issues reports purporting to be in accordance with AICPA professional standards, or if authorized by Council, are themselves enrolled in such a program.

[As amended October 28, 1997 and May 15, 2000.]

(See section 220R.)

**2.2.4** With respect to persons who first become eligible to take the examination required by section 2.2.2 after the year 2012, they shall have obtained 150 semester hours of education at an accredited college or university including a bachelor's degree or its equivalent. After 2012, a person who does not meet the educational requirement set out in this section shall, nonetheless, be eligible for membership upon enactment (regardless of the effective date) of the education requirement set out in this section by the state which grants the certificate required under section 2.2.1.

[As revised May 15, 2000; revised November 6, 2007.]



**BL Section 220R*****Implementing Resolution Under Section 2.2  
Requirements for Admission to Membership***

As amended  
October 24, 1994,  
unless otherwise  
indicated

**Under Sections 2.2.3 and 2.3.4 to Implement the  
Practice-Monitoring Requirement*****Resolved:***

.01 That the Board of Directors is authorized to establish within the Institute a peer review division governed by an executive committee named the "peer review board" having senior status with authority to carry out the activities of the division. The primary activities of the division will be to establish and conduct, in cooperation with state CPA societies, practice-monitoring programs for AICPA and state society members engaged in the practice of public accounting. Such activities shall not conflict with the policies and standards of the AICPA and shall be subject to the oversight of the Board of Directors. The nominees to serve on the peer review board shall be selected by the AICPA nominations committee and elected by Council.

[As revised by Council May 15, 2000.]

***Further Resolved:***

.02 A firm within the description of subparagraph A of Council Resolution Concerning Rule 505 shall be required to enroll in an Institute-approved practice-monitoring program. An individual engaged in the practice of public accounting in a firm not within the description of Subparagraph A of Council Resolution Concerning Rule 505, but who performs compilations of financial statements in accordance with the Statements on Standards for Accounting and Review Services shall be enrolled in an Institute-approved practice-monitoring program. A firm or individual enrolled in a practice-monitoring program established herein shall be deemed to be enrolled in an approved practice-monitoring program under sections 2.2.3 and 2.3.4 of the bylaws. A firm or individual which is dropped for disciplinary reasons from enrollment in a practice-monitoring program established herein is ineligible to enroll in another Institute-approved practice-monitoring program until the cause of the disciplinary action is removed.

[As amended by Council October 28, 1997; revised May 15, 2000; revised November 6, 2007.]

***Further Resolved:***

[.03] [Deleted May 15, 2000.]



**BL Section 230*****2.3 Requirements for Retention of Membership***

**As amended  
January 8, 1990,  
unless otherwise  
indicated**

**.01** Members of the Institute shall

**2.3.1** Pay dues as established by Council.

**2.3.2** Conform with these bylaws and the Rules of the Code of Professional Conduct.

**2.3.3** Complete continuing professional education requirements established by Council.

(See section 230R.)

**2.3.4** Engage in the practice of public accounting with a firm that is enrolled in an Institute-approved practice-monitoring program if the services performed by such a firm are within the scope of the AICPA's practice-monitoring standards and the firm issues reports purporting to be in accordance with AICPA professional standards or, if authorized by Council, themselves enroll in such a program.

[As amended October 28, 1997; revised May 15, 2000.]

(See section 220R, as amended October 24, 1994.)

**2.3.5**

[Deleted November 6, 2007.]

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**BL Section 230R*****Implementing Resolutions Under Section 2.3  
Requirements for Retention of Membership***

As amended  
January 12, 1988,  
unless otherwise indicated

**Under Sections 2.2.3 and 2.3.4 to Implement the  
Practice-Monitoring Requirement**

[.01-.03] [Deleted March 1995. See section 220R.]

**Under Section 2.3.3 Continuing Professional Education  
for Members*****Resolved:***

.04 That pursuant to section 2.3.3 of the bylaws the continuing professional education requirement for membership in the American Institute of Certified Public Accountants shall be as follows:

From January 1, 2001, forward and for each three-year reporting period thereafter, all AICPA members shall complete 120 hours, or its equivalent, of continuing professional education. Compliance can be achieved either by a formal program of education or by any other means, however measured, that would be reasonably expected to maintain professional competencies in the member's area of practice or employment. Members shall report compliance with such requirement to the AICPA each year and shall keep appropriate records and submit copies of such on request of the Institute.

[As amended by Council September 23, 1989 and May 7, 1997.]

[.05-.06] [Deleted January 1, 2001.]

***Further Resolved:***

.07 That the Board of Directors, or a body designated or appointed by it, shall have the power and authority to

- a. Identify and accept methods of learning to meet and measure this continuing professional education requirement.
- b. Grant exceptions for reasons such as retirement, inactive dues status, health, military service, foreign residency, or any other reason it deems appropriate.

[As amended by Council May 7, 1997.]

**Under Section 2.3.5, Definition of "SEC Client"**

[.08] [Deleted November 6, 2007.]





**BL Section 240*****2.4 Certificate of Membership***

**As amended  
January 12, 1988**

.01 Upon admission each member shall be entitled to a certificate setting forth that the person is a member of the Institute, but no certificate shall be issued until receipt of dues for the current year. Certificates of membership shall be returned upon the demand of the secretary of the Institute in the event of suspension or termination of membership.

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## **BL Section 250**

### ***2.5 Right of Members to Describe Themselves as Such***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** A member of the Institute shall be entitled to use the designation "Member of the American Institute of Certified Public Accountants." A firm shall be entitled to use the designation "Members of the American Institute of Certified Public Accountants" only if all of its CPA owners are members.

[As revised May 15, 2000.]

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**BL Section 260*****2.6 International Associates***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** International associates shall include those who were international associates on or before January 12, 1988. Thereafter, citizens of other countries who shall satisfy such requirements as the Council may prescribe may be admitted as international associates. The Council shall adopt rules governing such association and indications thereof.

[As revised May 15, 2000.]

(See section 260R.)

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**BL Section 260R*****Implementing Resolution Under Section 2.6  
International Associates***

**As adopted  
May 7, 1997**

***Resolved:***

**.01** That a new category of nonvoting international associate be created pursuant to bylaw section 2.6 and made available to all certified public accountants or chartered accountants, or their equivalents, who are members of associations belonging to the International Federation of Accountants (IFAC) and who are of good moral character and do not hold a CPA certificate issued by a U.S. jurisdiction. If reasonably practicable and appropriate, except for voting, eligibility for a seat on Council or as a nonpublic member of the Board of Directors, all other member benefits will be made available to international associates.

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**BL Section 300**

**3. ORGANIZATION AND PROCEDURE**

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TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
310	General .....	.01-.02
320	Membership .....	.01
320R	Implementing Resolution Under Section 3.2 Membership .....	.01-.02
330	Council .....	.01
340	Board of Directors .....	.01
340R	Implementing Resolution Under Section 3.4 Board of Directors .....	.01
350	Officers Elected by Council .....	.01
350R	Implementing Resolution Under Section 3.5 Officers Elected by Council .....	.01-.05
360	Committees .....	.01
360R	Implementing Resolutions Under Section 3.6 Committees .....	.01-.13

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## BL Section 310

### 3.1 General

As amended  
January 12, 1988,  
unless otherwise  
indicated

.01 The organization of the Institute shall include the members, the Council, the Board of Directors, officers, and committees.

.02 The Board of Directors may from time to time organize the committees and staff of the Institute into divisions and, subject to section 3.6, may adopt rules of procedure and operating policies for such divisions.

#### 3.1.1 Communications With Members

Any communication, notification or other action required by these by-laws to be provided or undertaken by mail or in writing, to or from the members, may be provided or undertaken by any means including but not limited to electronic or telephonic means, as authorized by Council. Except for determining a member's residence for voting purposes under section 3.2.3, a member's mailing address for purposes of these bylaws may be an electronic or other form of address, in lieu of a postal address.

[As adopted May 15, 2000.]

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## BL Section 320

### 3.2 Membership

As amended  
June 17, 1996,  
unless otherwise  
indicated

.01 The rights and powers of the membership of the Institute shall be as defined herein.

#### 3.2.1 Attendance at Meetings

Every member and international associate of the Institute shall be entitled to attend all meetings of the Institute.

#### 3.2.2 Voting Rights

Every member, but no international associate, shall be entitled to vote in person, when in attendance, upon all questions brought before duly called meetings of the Institute, and by mail ballot for the election of Council members pursuant to sections 6.1 through 6.1.6, on proposed amendments to these bylaws or to the Code of Professional Conduct as provided in article 8, and upon proposed resolutions of the membership as provided in section 5.1.4.

#### 3.2.3 Residence for Voting Purposes

The state from which a member may vote shall be that indicated by the member's mailing address as carried in the official records of the Institute, and may be either the state in which the member resides or that in which the member's office is located.

#### 3.2.4 Resolutions of the Membership

As provided in section 5.1.4, the members by mail ballot may enact resolutions of the membership, not inconsistent with these bylaws, which shall be binding upon the membership, the Council, the Board of Directors, officers, committees, and staff.

#### 3.2.5 Certain Positions to Be Held Only by Members

With the exceptions noted below, only members of the Institute, as defined in section 2.1, may serve as members of the Council, the Board of Directors, or any committee or board designated as "senior" by the Council (see section 3.6.1) or as "permanent" by these bylaws (see section 3.6.2). Exceptions to this rule are as follows:

1. Three representatives of the public, none of whom shall be members of the Institute, shall be members of the Board of Directors and Council.
2. Council may authorize the appointment of persons who are not Institute members to any senior or permanent committee or board provided the non-Institute members do not constitute more than twenty-five percent of its membership.

[As revised May 15, 2000.]



**BL Section 320R*****Implementing Resolution Under Section  
3.2 Membership***

**As adopted  
May 15, 2000,  
unless otherwise  
indicated**

**Under Section 3.2.5 Certain Positions to Be Held  
Only by Members*****Resolved:***

**.01** That pursuant to bylaw section 3.2.5, persons who are not Institute members may be appointed to the following senior or permanent committees or boards:

- Board of Examiners
- Professional Ethics Executive Committee
- Auditing Standards Board
- Accounting Standards Executive Committee
- Center for Audit Quality Governing Board
- Peer Review Board

[As revised by Council October 21, 2003; revised October 24, 2005; revised May 21, 2006.]

***Further Resolved:***

**.02** That except as otherwise provided by Council, and except for committees of the Board of Directors, such as the Committee on Audit, no public member on a senior or permanent committee or board may serve as its chair.

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## BL Section 330

### 3.3 Council

As amended  
January 12, 1988

.01 The governing body of the Institute shall be the Council.

#### **3.3.1 Composition**

The Council shall be composed of

**3.3.1.1** Members of the Institute directly elected by the membership in each state in accordance with sections 6.1.1 through 6.1.6;

**3.3.1.2** Representatives of the recognized state societies of certified public accountants selected in accordance with section 6.2;

**3.3.1.3** Twenty-one members-at-large selected in accordance with section 6.3;

**3.3.1.4** All members of the Board of Directors of the Institute;

**3.3.1.5** All past presidents of the American Institute of Certified Public Accountants who served prior to December 31, 1973, and are members of the Institute;

**3.3.1.6** All past chairmen of the board of the American Institute of Certified Public Accountants who are members of the Institute.

#### **3.3.2 Powers**

The Council may exercise all powers requisite for the purposes of the Institute, not inconsistent with these bylaws or with duly enacted resolutions of the membership, including but not limited to the authority to prescribe the policies and procedures of the Institute and to enact resolutions binding upon the Board of Directors, the officers, committees, and staff.

#### **3.3.3 Reports to Membership**

The actions of the Council shall be reported to the membership at least annually.

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## BL Section 340

### *3.4 Board of Directors*

**As amended  
January 12, 1988**

**.01** Between meetings of the Council, the activities of the Institute shall be directed by the Board of Directors, the composition of which shall be prescribed by the Council.

(See section 340R.)

#### **3.4.1 Powers**

The Board of Directors shall act as the executive committee of Council between meetings of Council, shall control and manage the property, business, and activities of the Institute, and shall take whatever action it deems desirable including the establishment of policies for the conduct of the affairs of the Institute consistent with the provisions of these bylaws, resolutions of the membership, or actions of the Council.

#### **3.4.2 Reports to Council**

The actions of the Board of Directors shall be reported to the Council at least semiannually.

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## **BL Section 340R**

# ***Implementing Resolution Under Section 3.4 Board of Directors***

**As amended  
May 23, 1994**

***Resolved:***

- .01** That the Board of Directors shall be composed of
- (a) The chairman, the vice chairman, and the immediate past chairman of the Board of Directors;
  - (b) The president of the Institute;
  - (c) Sixteen present or former members of the Council elected pursuant to section 6.3 to serve for three years or until the election of their successors; and
  - (d) Three representatives of the public, who are not members of the Institute.
-



**BL Section 350*****3.5 Officers Elected by Council***

**As amended  
June 17, 1996**

**.01** The officers of the Institute elected by the Council shall be a chairman of the Board of Directors and a vice chairman of the board, who shall be the chairman of the board nominee, both of whom shall be members possessing valid and unrevoked certified public accountant certificates. The chairman and the vice chairman of the board shall have such terms of office, powers, and privileges as the Council may prescribe.

(See section 350R.)

**3.5.1 Officers Appointed by the Board of Directors**

The officers of the Institute appointed by the Board of Directors shall be a president, who shall be a full-time employee of the Institute and who shall be a member possessing a valid and unrevoked certified public accountant certificate, and a secretary, who shall be a full-time employee of the Institute, but need not be a member of the Institute. The president and the secretary shall have such terms of office, powers, and privileges as the Board of Directors may prescribe. The Board of Directors may also appoint staff vice presidents who shall be neither members of the board nor of the Council and who shall perform such duties as may be assigned to them by the president.

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**BL Section 350R*****Implementing Resolution Under Section  
3.5 Officers Elected by Council***

As amended  
January 14, 1992

***Resolved:*****Term of Office**

.01 That the chairman and the vice chairman of the Board of Directors shall each be elected annually by the Council for a term of one year or until the election of that person's successor. Neither may succeed oneself in the same office after serving a full term of one year. The term of the president and the secretary shall be determined by the Board of Directors.

**Chairman of the Board**

.02 That the chairman of the Board of Directors shall preside at meetings of members of the Institute, the Council, and the Board of Directors. The chairman shall appoint committees and boards as provided in section 3.6 of the bylaws. The chairman shall act as a spokesperson for the Institute and appear on its behalf before other organizations.

**Vice Chairman of the Board**

.03 That the vice chairman shall be chairman-nominee of the Board of Directors and shall preside in the absence of the chairman at meetings of the Institute, the Council, and the Board of Directors. The vice chairman shall familiarize oneself with the duties of the office of chairman and shall perform such other related duties as may be assigned to the vice chairman by the chairman.

**President**

.04 That the president shall have full responsibility for the execution of the policies and programs of the Institute, act as a spokesperson for the Institute, and perform such other services as may be assigned to the president by the Council and the Board of Directors.

**Secretary**

.05 That the secretary of the Institute shall have the usual duties of a corporate secretary and shall perform such other related duties as may be assigned to the secretary by the president. An assistant secretary to serve in the secretary's absence, who need not be a member of the Institute, may be appointed by the Board of Directors.

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## BL Section 360

### 3.6 Committees

**As amended  
June 17, 1996,  
unless otherwise indicated**

**.01** Except as otherwise provided by these bylaws or the Council (see section 3.6.1), the chairman of the Board of Directors, or the chairman's delegate, may appoint committees and boards with such duties, powers, responsibilities, and procedures as the chairman may prescribe. The chairman of the board and the president shall have the privilege of the floor at meetings of all committees.

(See section 360R.)

#### **3.6.1 Senior Committees**

The Council may designate any committee as a "senior" committee. The appointment by the chairman of the Board of Directors of members and any appointed pursuant to bylaw 3.2.5, to senior committees shall require the approval of the Board of Directors. The scope of responsibility of senior committees shall be as the Council may prescribe consistent with the specific provisions of these bylaws. The Board of Directors shall prescribe the duties, powers, and procedures of such committees.

[As revised November 6, 2007.]

(See section 360R.)

#### **3.6.2 Permanent Committees, Boards, and Divisions**

The following shall be permanent committees, boards, or divisions of the Institute: the nominations committee (see section 3.6.2.1); the professional ethics division (see section 3.6.2.2); the trial board (see section 3.6.2.3); and the board of examiners (see section 3.6.2.4).

(See section 360R.)

##### **3.6.2.1 Nominations Committee**

There shall be a nominations committee composed of eleven persons, including any appointed pursuant to bylaw 3.2.5 and members of the Institute, elected by the Council in such manner as the Council shall prescribe. It shall be the responsibility of the committee to make nominations for the offices of chairman of the Board of Directors, vice chairman of the Board of Directors, the elected members of the Board of Directors, the joint trial board, the peer review board, and the Council, as elsewhere provided in these bylaws, and to apportion among the states directly elected Council seats pursuant to section 6.1.2.

(See section 360R.)

##### **3.6.2.2 Professional Ethics Division**

The executive committee of the professional ethics division, including any appointed pursuant to bylaw 3.2.5, shall serve as the ethics committee of the Institute, and there shall be such other committees

within the division as the Board of Directors shall authorize. The executive committee shall (1) subject to amendment, suspension, or revocation by the Board of Directors, adopt rules governing procedures consistent with these bylaws or actions of Council to investigate potential disciplinary matters involving members, (2) arrange for presentation of a case before the trial board where the committee finds prima facie evidence of infraction of these bylaws or of the Code of Professional Conduct, (3) interpret the Code of Professional Conduct, (4) propose amendments thereto, and (5) perform such related services as the Council may prescribe.

(See section 360R.)

### **3.6.2.3 Joint Trial Board**

There shall be a trial board that, in addition to any appointed pursuant to bylaw 3.2.5, shall consist of members possessing a valid and unrevoked certified public accountant certificate, each of whom shall have been a member for at least five consecutive years prior to that person's appointment to the joint trial board, to adjudicate disciplinary charges against members of the Institute pursuant to section 7.4. Members of the trial board shall be elected by the Council for such terms as the Council may prescribe.

The trial board is empowered to adopt rules, consistent with these bylaws or actions of the Council, governing procedure in cases heard by any hearing panel, and in connection with any application for review of a decision of a hearing panel.

Decisions of any hearing panel shall be subject to review only by the trial board.

(See section 360R.)

### **3.6.2.4 Board of Examiners**

There shall be a board of examiners, that, in addition to any appointed pursuant to bylaw 3.2.5, shall consist of persons who have passed the Uniform CPA Examination and who possess valid and unrevoked certified public accountant certificates, appointed by the chairman of the Board of Directors subject to the approval of the Board of Directors. It shall supervise the preparation of a uniform examination which may be adopted by the legally constituted authorities of the states in examining candidates for the certified public accountant certificate and the conduct of the grading service offered by the Institute. The board of examiners shall formulate the necessary rules and regulations for the conduct of its work, but all such rules and regulations may be amended, suspended, or revoked by the Board of Directors. The board of examiners may delegate to members of the Institute's staff or other duly qualified persons the preparation of examination questions and the operation of the grading service conducted by the Institute.

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**BL Section 360R*****Implementing Resolutions Under  
Section 3.6 Committees***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

***Resolved:***

**.01** (1) That the following be designated as senior committees and boards: \*

- Accounting and review services committee<sup>e</sup>
- Accounting standards executive committee<sup>e</sup>
- Assurance services executive committee<sup>e</sup>
- Auditing standards board<sup>d</sup>
- Board of examiners
- Center for audit quality governing board<sup>d</sup>
- Employee benefit plans audit quality center executive committee
- Forensic and valuation services executive committee<sup>e</sup>
- Government audit quality center executive committee
- Information technology executive committee
- Management consulting services executive committee<sup>e</sup>
- National Accreditation Commission
- Peer review board<sup>d</sup>
- Personal financial planning executive committee<sup>e</sup>
- Private companies practice executive committee<sup>e</sup>
- Professional ethics executive committee<sup>e</sup>
- Tax executive committee<sup>e</sup>

[As amended by Council May, 1988 and May, 1991; revised April, 1992; amended October, 1994; revised June, 1996; revised May, 1997; revised October 21, 2003; revised October 24, 2005; revised October, 2007.]

**[.02]**

[As amended by Council May, 1988 and May, 1991; revised April, 1992; amended October 24, 1994; revised May, 1997; revised October 21, 2003; revised October 24, 2005; deleted October 2007.]

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\* Note: \* Indicates a senior committee which is authorized to make statements, without clearance with the Council or the Board of Directors, in matters related to its area of practice.

### Under Section 3.6.2.1 Nominations Committee

**Resolved:**

.03 That the nominations committee shall be chaired by the immediate past chairman of the Board and shall consist of ten additional members serving two-year terms. At the Council meeting held in conjunction with the annual meeting, the Board of Directors, after having considered at least ten candidates, shall recommend five members for election to the nominations committee, each for a two-year term. At any one time, no more than seven members shall be members of Council, and none except the chairman shall be a member of the Board of Directors. Other nominations from the floor shall be permitted. Voting shall be by voice vote of the incoming Council, or, if requested by a majority of those present, by written ballot. A majority vote shall elect. With the exception of its chairman, no member, having served on the nominations committee, shall be eligible again to serve on the nominations committee until the passage of five years.

[As amended by Council May, 1991; revised May 15, 2000.]

**Further Resolved:**

.04 That the nominations committee shall not select any of its members for positions to be filled by the committee.

### Under Section 3.6.2.2 Professional Ethics Division

**Resolved:**

.05 That in cases where the professional ethics executive committee concludes that a prima facie violation of the Code of Professional Conduct or by-laws is not of sufficient gravity to warrant further formal action, the committee may direct the member or members concerned to complete specified continuing professional education courses, or to take other remedial or corrective action, provided, however, that there will be no publication of such action in the Institute's principal membership periodical and the member concerned is notified of his right to reject such direction. In the case of such a rejection, the professional ethics executive committee shall determine whether to bring the matter to a hearing panel of the trial board for a hearing.

**Further Resolved:**

.06 That in cases where there is prima facie evidence of one or more actions by or with respect to a member as described in subparagraphs 7.4.1 through and including 7.4.6 of bylaw section 7.4, the professional ethics executive committee may decide to offer the member or members concerned the opportunity to avoid further investigation and a possible hearing before the trial board by entering into a settlement agreement under such terms and conditions as the committee deems appropriate including but not limited to agreement by the member or members (a) to resign from membership or (b) to complete specified continuing professional education courses and/or to submit to independent preissuance review of some or all financial statements and accountant's reports and/or submit to an accelerated practice-monitoring review, and/or to perform other remedial or corrective action as the committee may determine and/or (c) to submit to disciplinary action with publication by the Institute as provided in Council resolutions under bylaw section 7.6. The committee shall monitor compliance with the settlement agreement and may initiate an investigation where it finds there has been noncompliance.

[As revised by Council April 28, 2003; revised November 6, 2007.]

.07 A member's rejection of the terms and conditions of a proposed settlement agreement will not in any way affect the rights of a member under the bylaws and implementing resolutions in any subsequent investigation by the professional ethics executive committee in a hearing before the trial board.

[As adopted by Council May 26, 1993.]

### **Under Section 3.6.2.3 Joint Trial Board**

***Resolved:***

.08 That the joint trial board shall consist of at least thirty-six members elected for a three-year term by Council on a staggered basis on nomination of the nominations committee. No member shall serve more than two full successive terms. The size of the trial board shall be determined by the Board of Directors. No member of the Institute's professional ethics division, of a state society ethics committee, or of a state board of accountancy shall be a member of the trial board.

[As revised by Council June 17, 1996.]

.09 The trial board shall elect from its membership a chairman and a vice chairman, the vice chairman to serve as chairman during any period of unavailability of the chairman. It shall also elect a secretary who need not be a member.

.10 The chairman or vice chairman, when acting as chairman, pursuant to the trial board rules of practice and procedure, may appoint from the members of the trial board a panel consisting of not less than three members, which may, but need not, include the chairman to sit as a hearing panel and hear and adjudicate charges against members, or an ad hoc committee consisting of not less than three members of the trial board to consider requests for nonapplication of sections 7.2 and 7.3. Decisions of hearing panels shall be reviewable by the trial board under the conditions and procedures as provided for in Council resolution under section 7.4 of the bylaws.

[As revised by Council May 15, 2000.]

***Resolved:***

.11 That the trial board is authorized to receive and act on petitions requesting review of a decision of the peer review board terminating a firm's or an individual's enrollment in the practice-monitoring program or of an AICPA peer review committee's decision terminating a firm's or an individual's enrollment in another Institute-approved practice-monitoring program. Following such review, the trial board may affirm, modify, or reverse all or any part of the peer review board's or an AICPA peer review committee's decision, but it may not increase the severity of the peer review board's or an AICPA peer review committee's sanction.

[As revised by Council June 17, 1996; revised October 24, 2005; revised November 6, 2007.]

***Resolved:***

.12 That the trial board is authorized to receive and act on petitions requesting review of a decision by the Center for Audit Quality Governing Board which imposed a sanction upon, or denied a reinstatement request by, a member or associate member of the Center for Audit Quality. Following such review, the trial board may affirm or reverse the Board's decision.

[As adopted by Council October 24, 2005.]



***Resolved:***

**.13** That the trial board may hear and adjudicate charges involving alleged violations of a state CPA society's bylaws or code of professional conduct when there is in force a written agreement for such procedure between the Institute and the state CPA society concerned.

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**BL Section 400****4. FINANCIAL MANAGEMENT AND CONTROLS**

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## TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
401	Financial Management and Controls .....	.01
401R	Implementing Resolution Under Article 4 Financial Management and Controls .....	.01
410	Audit .....	.01
420	Committee on Audit .....	.01
430	Execution of Instruments on Behalf of the Institute .....	.01
440	Indemnification .....	.01-.02
450	Dues .....	.01-.03
460	Fiscal Year .....	.01
460R	Implementing Resolution Under Section 4.6 Fiscal Year .....	.01

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**BL Section 401**

***Financial Management and Controls***

**As amended  
January 12, 1988**

**.01** The Council shall have authority to prescribe such procedures as it deems appropriate to assure adequate budgetary and financial controls. Budgets shall be prepared and presented as the Council shall prescribe.

(See section 401R.)

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**BL Section 401R*****Implementing Resolution Under Article 4  
Financial Management and Controls***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

***Resolved:***

**.01** That annual budget of revenues and expenditures for the succeeding fiscal year shall be prepared by the Institute's staff, reviewed and approved by the Board of Directors, and presented to Council for approval; such budgets shall be in a form indicating the costs of the principal programs and activities of the Institute; material variations from the annual budget shall be reported to the Council by the Board of Directors; receipt of such report without rejection shall constitute authority to continue expenditures for purposes indicated in the annual budget, as modified and presented to Council, until a new budget for the following fiscal year is approved by the Council. However, the Board of Directors may, between meetings of Council, authorize additional expenditures in total not to exceed 5 percent of budgeted revenues from all sources.

[As revised by Council May 15, 2000.]

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## **BL Section 410**

### ***4.1 Audit***

**As amended  
January 12, 1988**

**.01** The Council shall, for each fiscal year, appoint a certified public accountant or certified public accountants to express an opinion on the financial statements of the Institute and its affiliated organizations. The financial statements of the Institute and the report of the auditor or auditors for each fiscal year shall be published for the information of the membership.

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**BL Section 420****4.2 Committee on Audit**

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** The chairman of the board shall appoint from among the members of the Board of Directors, other than the officers, a committee on audit to make arrangements with the auditor or auditors for their examination, to review the audit report, and to perform such other duties appropriate for such a committee as directed by the Board of Directors.

[As revised May 15, 2000.]

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**BL Section 430*****4.3 Execution of Instruments on Behalf  
of the Institute***

**As amended  
January 12, 1988**

**.01** All checks, drafts, deeds, mortgages, bonds, contracts, reports, proxies, and other instruments may be executed on behalf of the Institute by such officers or employees as the Council or the Board of Directors may from time to time designate, either generally or in specific instances.

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**BL Section 440****4.4 Indemnification**

**As amended  
January 12, 1988**

**.01** The Institute shall indemnify to the full extent authorized by law for the good faith exercise of judgment in the performance of assigned duties any person made or threatened to be made a party to any action, suit, or proceeding, whether criminal, civil, administrative, or investigative, by reason of the fact that the person, the person's testator, or intestate is or was a member of Council, the Board of Directors, or any committee, trustee, officer, employee, or agent of the Institute or any affiliated entity or serves or served any other enterprise as a director, trustee, officer, employee, or agent at the request of the Institute.

**.02** Without limiting the generality of the foregoing, the Institute may contract for insurance against all or a portion of any liabilities and expenses, if any, resulting from the indemnification of any of the foregoing persons pursuant to this section or otherwise as permitted by law, and may also contract for companion insurance directly insuring any or all of such persons against liabilities and expenses.

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## BL Section 450

### 4.5 Dues

**As amended  
January 14, 1992**

**.01** The Council shall determine the annual dues which shall be paid by each member and international associate in accordance with such classifications as it deems appropriate, and may require dues of a different amount for each class so created.

**.02** Dues shall be payable on or before the first day of each fiscal year of the Institute or in such other manner as the Council shall prescribe. For new members or international associates, dues shall be apportioned to the end of the fiscal year.

**.03** No dues shall be paid by members or international associates of the Institute while they are engaged in military service of the United States or its allies during war. Individual members or international associates may be excused from payment of dues for reasonable cause by the chairman of the Finance Committee.

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## **BL Section 460**

### ***4.6 Fiscal Year***

**As amended  
January 12, 1988**

**.01** The fiscal year of the Institute shall be as the Council shall prescribe.

(See section 460R.)

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**BL Section 460R**

***Implementing Resolution Under Section 4.6  
Fiscal Year***

**As amended  
January 12, 1988**

***Resolved:***

**.01** That the fiscal year of the Institute shall be the twelve months beginning August 1 and ending July 31.

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**BL Section 500**

**5. MEETINGS OF THE INSTITUTE AND THE COUNCIL**

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TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
501	Meetings of the Institute and the Council .....	.01
510	Meetings of the Institute .....	.01
520	Meetings of Council .....	.01
530	General Provisions Governing Meetings .....	.01

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**BL Section 501**

***Meetings of the Institute and the Council***

**As amended  
January 12, 1988**

**.01** This article shall govern meetings of the Institute and of the Council. The Board of Directors shall determine the dates of meetings of Council and the matters to be presented for action.

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## BL Section 510

### *5.1 Meetings of the Institute*

As amended  
January 12, 1988

.01 The membership shall meet pursuant to sections 5.1.1 through 5.1.3, conduct its business pursuant to section 5.1.3, and may adopt resolutions pursuant to section 5.1.4. Meetings of the membership shall be known as meetings of the Institute.

#### **5.1.1 Regular Meetings of the Institute**

There shall be a regular meeting of the Institute within three months after the close of the fiscal year, on a date to be fixed by the Board of Directors. This meeting shall also be known as the annual meeting of the Institute.

#### **5.1.2 Special Meetings of the Institute**

The chairman of the board shall call special meetings of the Institute when so requested by the Council or the Board of Directors, or upon the written request of at least 5 percent of the membership of the Institute or any thirty members of Council. Special meetings of the Institute shall be held at places designated by the Board of Directors. No business shall be transacted at a special meeting of the Institute other than that for which the meeting shall have been convened.

#### **5.1.3 Notice of Meetings of the Institute**

Notice of each meeting of the Institute, whether regular or special, shall be mailed to each member of the Institute, at the member's mailing address as shown on the official records of the Institute, at least thirty days prior to the date of such meeting.

#### **5.1.4 Resolution of the Membership by Mail Ballot**

A majority of the members of the Institute, assembled at any duly called corporate meeting of the Institute at which a quorum is present, may direct that the chairman of the board submit any question to the entire membership for a vote by mail. Any resolution enacted in such a mail ballot by two-thirds of the members voting shall be declared by the chairman of the board a resolution of the membership and shall be binding, if consistent with these bylaws, upon the Council, the Board of Directors, committees, officers, and staff. Mail ballots shall be valid and counted only if received within sixty days after the date of the mailing of ballot forms.

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## BL Section 520

### *5.2 Meetings of Council*

As amended  
January 12, 1988,  
unless otherwise  
indicated

.01 Meetings of the Council shall be governed by sections 5.2.1 through 5.2.5, section 5.3, and section 6.6.

#### **5.2.1 Regular Meetings of Council**

A regular meeting of the Council shall be held in conjunction with the annual meeting of the Institute and on such other dates as the Council or the Board of Directors may designate.

[As revised May 15, 2000.]

#### **5.2.2 Special Meetings of Council**

The chairman of the board shall call special meetings of the Council when requested to do so by the Board of Directors or when requested in writing by at least thirty members of the Council. Special meetings of the Council shall be held at places designated by the Board of Directors.

#### **5.2.3 Mail Ballot in Lieu of Special Meeting of Council**

In lieu of a special meeting of the Council, the chairman of the board, with the approval of the Board of Directors, may submit any question to the Council for a vote by mail, and any action therein approved in writing by not less than two-thirds of those voting shall be declared by the chairman of the board an act of the Council and shall be recorded in the minutes of the Council provided, however, that at least a majority of the Council must have cast ballots on the question.

[As revised November 6, 2007.]

#### **5.2.4 Notice**

Notice of each meeting of the Council shall be sent to each member of the Council, at the member's mailing address as shown in the official records of the Institute, at least twenty-one days before such meeting. Such notice, as far as practicable, shall contain a statement of the business to be transacted.

#### **5.2.5 Minutes**

A copy of the minutes of each meeting of the Council shall be forwarded to each member of the Council within forty-five days after such meeting.



**BL Section 530****5.3 General Provisions Governing Meetings**

As amended  
January 12, 1988

.01 The following general provisions shall govern quorum and parliamentary procedure.

**5.3.1 Meetings—Quorum**

Five hundred members of the Institute shall constitute a quorum for the transaction of any business duly presented at any meeting of the Institute. Thirty members of Council shall constitute a quorum of the Council at any duly called meeting of the Council. Eleven members of the Board of Directors shall constitute a quorum of the board.

**5.3.2 Meetings—Rules of Parliamentary Procedure Applicable**

The rules of parliamentary procedure contained in *Robert's Rules of Order Revised* shall govern all meetings of the Institute and of the Council.

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**BL Section 600**

**6. ELECTION OF COUNCIL, BOARD OF DIRECTORS, AND OFFICERS OF THE INSTITUTE**

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TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
601	Election of Council, Board of Directors, and Officers of the Institute . . .	.01
610	Members of Council Directly Elected by Members of the Institute . . . . .	.01
610R	Implementing Resolution Under Section 6.1 Members of Council Directly Elected by Members of the Institute . . . . .	.01
620	Selection of Members of Council to Represent State Societies . . . . .	.01
630	Election of Members-at-Large of Council, Board of Directors, Chairman of the Board, and Vice Chairman of the Board . . . . .	.01-.02
640	Forfeiture of Office for Nonattendance . . . . .	.01
650	Vacancies . . . . .	.01-.02
650R	Implementing Resolution Under Section 6.5 Vacancies . . . . .	.01
660	Election Meeting of Council . . . . .	.01
670	Term Limit . . . . .	.01

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**BL Section 601**

***Election of Council, Board of Directors, and  
Officers of the Institute***

**As amended  
January 12, 1988**

**.01** Except for ex officio members of Council (see sections 3.3.1.4 through 3.3.1.6), the election of members of the Council, the Board of Directors, and officers of the Institute shall be in accordance with the provisions of this article.

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## BL Section 610

# ***6.1 Members of Council Directly Elected by Members of the Institute***

As amended  
June 17, 1996,  
unless otherwise  
indicated

.01 Members of Council directly elected by the membership in the respective states (see section 3.3.1.1) shall be elected in accordance with sections 6.1.1 through 6.1.6 as supplemented by Council resolution.

### **6.1.1 At Least One Member of Council Directly Elected by Membership of Each State**

There shall be at least one member of Council directly elected by the members of the Institute in each state having one or more persons enrolled upon the membership lists of the Institute.

### **6.1.2 Number and Allocation of Directly Elected Council Seats Among the States**

The total number of directly elected members of Council, in addition to those provided for by section 6.1.1, shall be eighty-five except as modified by section 6.1.2.1. The number of seats, excluding those extended by section 6.1.2.1, shall be equitably allocated among the states in direct proportion to the number of Institute members enrolled from each state.

#### **6.1.2.1 Unexpired Terms Unaffected by Reduced Allocation**

No member of Council directly elected by the membership in any state shall lose the member's seat for the term the member then serves should the allocation of that state be diminished by virtue of section 6.1.2; but, no state's allocation of directly elected Council seats shall be extended by this section beyond the natural expiration of a seat's full term or its vacation by the member filling it, whichever first occurs.

#### **6.1.2.2 Allocation to Be Made by Nominations Committee**

The nominations committee shall make the allocation provided in section 6.1.2. It shall be made at five-year intervals, at least nine months prior to annual meetings to be held each calendar year which ends in one and in six, and shall govern the five annual elections immediately following. It shall be based upon the membership figures and addresses carried on the books of the Institute the last day of the fiscal year immediately preceding the date of such determination.

If a state gains an additional seat from such allocation, the state society may request the nominations committee to authorize election for an initial term of less than three years in order to promote orderly rotation of Council members from that state. Upon receipt of such request, the nominations committee may authorize such shortened term. Following the expiration of such shortened term, subsequent terms for the seat shall be for three years, as provided in section 6.1.3.

In the event that a state has three or more directly elected members whose terms are not evenly staggered over a three-year cycle, the state society may request the nominations committee, for the election following the year these bylaws are adopted and thereafter in calendar years ending in one and in six, to approve the election of a nominee to fill a vacancy for a term of less than three years in order to effect a more orderly rotation of the Council members from that state. The nominations committee may authorize such shortened term. Subsequent terms for such a seat shall be three years, as provided in section 6.1.3.

### **6.1.3 Term of Office**

Except as specified by this section 6.1.3, the term of office of a directly elected member of the Council shall commence when the member's election is announced by the chairman of the Board of Directors at the meeting of the Council held in conjunction with the annual meeting of the Institute, as prescribed by section 6.6, and shall run until the announcement of the election of new directly elected members of the Council at the meeting of the Council held in conjunction with the annual meeting of the Institute three years after the member's election. If any such member of the Council shall not serve that member's full term, the vacancy so created may be filled pursuant to section 6.5. The term of office of any member directly elected by the members in that member's state to fill such vacancy shall be the remainder of the three-year term with respect to which the vacancy occurred.

No member having served for two consecutive full terms as a directly elected member of the Council shall be eligible to serve another such term until at least one year after the completion of the member's second consecutive full term.

### **6.1.4 Number of Council Seats to Be Filled by Election**

The number of Council seats to be filled in a state's quota of directly elected members of the Council for any given year shall be the number of its allocation of directly elected Council seats less the number of members of the Council from that state filling such seats for terms running through that year.

### **6.1.5 Nominations**

At least eight months prior to the annual meeting of the Institute, the nominations committee shall request, from the recognized society of certified public accountants in each state for which any vacancies (see section 6.1.4) will arise in the coming year, the names of suggested candidates from the state represented by such society to fill each such vacancy. The committee shall give due consideration to the names so submitted, but shall not be required to select its nominees from among such names. In the absence of a satisfactory response from any such state society, the nominations committee shall select the nominees from such state.

The nominations committee shall make its nominations for directly elected members of the Council at least six months prior to the annual meeting of the Institute. Notice of such nominations shall be published to the membership by the secretary at least five months prior to the annual meeting of the Institute. Five percent, but in no event less than twenty members of the Institute from any given state for which a vacancy shall arise, may submit to the secretary independent nominations for directly

elected members of the Council from that state provided that such nominations be filed with the secretary at least four months prior to the annual meeting of the Institute.

[As revised November 6, 2007.]

#### **6.1.6 Election**

The nominees of the nominations committee for directly elected seats on Council shall be declared elected by the secretary if no independent nominations are filed for such seats as required by section 6.1.5.

If independent nominations are received, the secretary shall mail to all members of the Institute in each state in which there is a contest for a directly elected seat on Council, at least ninety days prior to the annual meeting of the Institute, mail ballots containing the names and relevant background information of nominees from that state nominated by the nominations committee and the names and relevant background information of nominees independently nominated. Each ballot shall contain an announcement that votes will be counted only if received by the secretary at least forty-five days before the annual meeting of the Institute. Election to contested seats on Council shall be determined by a plurality of the votes received from each jurisdiction by that date. Mail ballots shall be counted by the secretary, who shall certify the results for publication to the membership. Newly elected members shall be notified promptly and advised to attend the meeting of Council held in conjunction with the annual meeting of the Institute. They shall take office as provided in section 6.6.

[As revised May 15, 2000; revised November 6, 2007]

(See section 610R.)

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## **BL Section 610R**

# ***Implementing Resolution Under Section 6.1 Members of Council Directly Elected by Members of the Institute***

**As amended  
January 12, 1988**

## **Under Section 6.1.6 Election**

### ***Resolved:***

**.01** That the withdrawal of a nomination for whatever reason after the balloting has commenced will not be acted upon until the certification of election has been completed. Vacancies then arising will be filled in accordance with section 6.5 of the bylaws, except that in states where the number of nominees exceeds the number of vacancies, the vacancy created by any withdrawal will be filled by that nominee having the highest number of votes after all other vacancies have been filled.

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**BL Section 620*****6.2 Selection of Members of Council to Represent State Societies***

**As amended  
June 17, 1996,  
unless otherwise  
indicated**

**.01** Each recognized state society of certified public accountants shall designate, in a manner it deems appropriate, an Institute member to represent it on the Council. The term of each member of the Council so designated shall commence at the meeting of Council held in conjunction with the annual meeting of the Institute after notification to the secretary by the society designating the member. The term shall run for one year or until the commencement of the successor's term, provided that no such member of the Council shall represent a state society for more than six consecutive years.

[As revised May 15, 2000.]

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**BL Section 630*****6.3 Election of Members-at-Large of Council, Board of Directors, Chairman of the Board, and Vice Chairman of the Board***

**As amended  
January 14, 1992,  
unless otherwise  
indicated**

.01 At the meeting of the Council held in conjunction with the annual meeting of the Institute, following the completion of such other business as the Council may transact, seven Institute members, without regard to the states in which they reside, shall be elected annually by the Council as members-at-large of the Council. This election shall occur prior to the installation of the members of the Council newly elected under section 6.1. The at-large members shall serve for a term of three years or until the election of their successors. At the same meeting, but after all newly elected and designated Council members have been installed, the Council shall elect the chairman of the board, the vice chairman of the board, one-third (or as near to one-third as mathematically possible) of the elected members of the Board of Directors. The elected members of the Board of Directors shall serve for a term of three years or until election of their successors. The Council shall also elect one representative of the public, who is not a member of the Institute, to the Board of Directors for a term of three years, or until election of a successor. Nominations for all these positions on the Board of Directors shall be made by the nominations committee at least six months prior to the annual meeting of the Institute. Notice of those nominations shall be published to the membership of the Institute at least five months prior to such annual meeting. Independent nominations may be made by any twenty members of the Council if filed with the secretary at least four months prior to the annual meeting of the Institute. No nominations from the floor will be recognized. A majority of votes shall elect. Nominees may be invited to the meeting at which the election is to be held, and those elected shall take office as prescribed in section 6.6.

[As amended June 17, 1996; revised May 15, 2000.]

.02 No member having served for two consecutive full terms as a member-at-large of the Council shall be eligible to serve another such term until at least one year after the completion of the member's second consecutive full term.

**6.3.1. Re-election to Board of Directors**

No elected member of the Board of Directors who has served a full three-year term shall be eligible for re-election to such a term until the meeting of the Council one year after the completion of the member's full three-year term, provided, however, that a public member may be elected to serve a second three-year term.



## **BL Section 640**

### ***6.4 Forfeiture of Office for Nonattendance***

**As amended  
January 12, 1988**

**.01** Any directly elected member or member-at-large of Council who shall be absent from three consecutive meetings shall forfeit that member's seat.

[Section renumbered as a result of the deletion of the former sections 640 and 640R on June 17, 1996.]

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**BL Section 650****6.5 Vacancies**

**As amended  
June 17, 1996**

**.01** Vacancies in the membership of Council, or in the Board of Directors, or in any of the offices of the Institute elected by the Council, occurring between annual meetings of the Institute, may be filled by election of replacements by the Council, either at a meeting of Council or by mail ballot, under such conditions as the Council may prescribe. If the Council should so replace a directly elected member of the Council, such interim appointment will run only until the member's seat is filled by direct election of the membership of that member's state as provided in these bylaws.

**.02** Pending action by the Council to fill a vacancy among any of the officers of the Institute who are elected by the Council, the Board of Directors may appoint a temporary successor to act in the capacity indicated.

(See section 650R.)

[Section renumbered as a result of the deletion of the former sections 640 and 640R on June 17, 1996.]

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**BL Section 650R*****Implementing Resolution Under Section 6.5  
Vacancies***

**As amended  
June 17, 1996**

***Resolved:***

.01 That if a vacancy occurs in the membership of Council, or in the Board of Directors, or in any of the offices of the Institute elected by the Council between annual meetings of the Institute, the Board of Directors shall recommend replacements for election by Council. Voting on such replacement may be conducted by mail ballot, in which case provision shall be made for write-in votes, or at the next meeting of Council, as may appear most desirable in the circumstances. If the voting takes place at a Council meeting, nominations from the floor shall be permitted; voting may be by voice vote, or, at the request of a majority of those present, by written ballot. A majority vote shall elect. In any event, persons elected to fill vacancies in the Board of Directors, in the Council, or in any of the offices of the Institute elected by the Council shall serve only for the remainder of the unexpired term of the previous incumbent or until a successor is elected.

[Section renumbered as a result of the deletion of the former sections 640 and 640R on June 17, 1996.]

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**BL Section 660*****6.6 Election Meeting of Council***

**As amended  
June 17, 1996,  
unless otherwise  
indicated**

**.01** New members-at-large of Council elected pursuant to section 6.3 shall take office as soon as their election is completed, replacing those members-at-large whose terms shall have expired. Then the presiding officer shall announce the installation of members of the Council newly elected under section 6.1, at which time they shall take office, replacing those directly elected members of Council whose terms shall have expired. Election of officers who are elected by the Council, new members of the Board of Directors, and others shall then be held, and each officer or member of the Board of Directors so elected shall replace that person's predecessor upon such election, provided, however, that the retiring chairman of the board shall continue in office through the end of the annual meeting of the Institute.

[Section renumbered as a result of the deletion of the former sections 640 and 640R on June 17, 1996; as revised May 15, 2000.]

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**BL Section 670****6.7 Term Limit**

**As adopted  
November 6, 2007**

.01 Regardless of whether a member has served as a designated, directly elected, or at-large member of Council, no Council member who has served in any, or all, of the foregoing categories may serve more than seven consecutive years. A member who has served seven consecutive years shall not be eligible to serve on Council as a designated, directly elected, or at-large member of the Council until at least one year after the seventh consecutive year the member last served on the Council. Notwithstanding anything to the contrary in any section of these bylaws, any period during which an individual served as an ex officio Council member, such as president or a member of the Board of Directors, shall not be included in any determination of eligibility under this section.

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**BL Section 700****7. TERMINATION OF MEMBERSHIP AND DISCIPLINARY SANCTIONS**

## TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
701	Termination of Membership and Disciplinary Sanctions .....	.01
710	Resignation of Membership .....	.01
710R	Implementing Resolution Under Section 7.1 Resignation of Membership .....	.01
720	Termination of Membership for Nonpayment of Financial Obligation or for Failure to Comply With Membership-Retention Requirements .....	.01
720R	Implementing Resolution Under Section 7.2 Termination of Membership for Nonpayment of Financial Obligation or for Failure to Comply With Membership-Retention Requirements .....	.01-.04
730	Disciplinary Action Without a Hearing .....	.01
730R	Implementing Resolution Under Section 7.3 Disciplinary Action Without a Hearing .....	.01-.07
740	Disciplining of Member by Trial Board .....	.01-.02
740R	Implementing Resolution Under Section 7.4 Disciplining of Member by Trial Board .....	.01-.04
750	Reinstatement .....	.01
750R	Implementing Resolution Under Section 7.5 Reinstatement .....	.01-.02
760	Publication of Disciplinary Action .....	.01
760R	Implementing Resolution Under Section 7.6 Publication of Disciplinary Action .....	.01
770	Disciplinary Sections Not to Be Applied Retroactively .....	.01





**BL Section 701*****Termination of Membership and Disciplinary Sanctions***

**As amended  
January 12, 1988**

.01 This article shall govern the termination or suspension of membership in the Institute, whether imposed as a matter of discipline or voluntarily sought, and the imposition of any other disciplinary sanction, or administrative reprimand, whether public or private, or imposition of conditions for retention of membership.

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**BL Section 710*****7.1 Resignation of Membership***

**As amended  
January 12, 1988,  
unless otherwise indicated**

**.01** Resignations of members shall be in writing and may be offered at any time. Actions on such resignations and applications for reinstatement of resigned members shall be taken by the Board of Directors under such provisions as the Council may prescribe. Council may make separate provision for action on resignations of members not in good standing or against whom disciplinary proceedings or investigations are pending or as to whom or to whose firm a practice-monitoring review has begun but has not been completed, and the resignation or resignations would make the firm or member ineligible to enroll in an Institute-approved practice-monitoring program, and on applications for reinstatement of persons whose resignation was accepted when in such classification.

[As revised November 6, 2007]

(See section 710R.)

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**BL Section 710R*****Implementing Resolution Under Section 7.1  
Resignation of Membership***

**As amended,  
January 12, 1988,  
unless otherwise indicated**

***Resolved:***

.01 That the Board of Directors shall act upon resignation of members, which shall become effective on the date of acceptance, but no action shall be taken on the resignation of a member with respect to whom charges are under investigation by the professional ethics division, or against whom a complaint is pending before the trial board, or as to whom or whose firm a practice-monitoring review has begun but has not been completed, and the resignation or resignations would make the firm or member ineligible to enroll in an Institute-approved practice-monitoring program unless the division, the trial board, or the Peer Review Board or peer review committee, as the case may be, recommends that such resignation be accepted. If a person whose resignation was accepted when that person was under investigation or the object of a complaint or during the pendency of a practice-monitoring review when that resignation or resignations would make the firm or member ineligible to enroll in an Institute-approved practice-monitoring program, should subsequently apply for reinstatement, the Board of Directors shall not reinstate such person without the consent of the division or the trial board, or the Peer Review Board or committee as the case may be.

[As revised November 6, 2007.]

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**BL Section 720*****7.2 Termination of Membership for  
Nonpayment of Financial Obligation  
or for Failure to Comply With  
Membership-Retention Requirements***

As amended  
January 12, 1988,  
unless otherwise  
indicated

**.01** The Board of Directors may, in its discretion, terminate the membership of a member who fails to pay dues or any other obligation to the Institute within five months after such debt has become due and terminate the membership of a member who fails to comply with the practice-monitoring or continuing education membership-retention requirements. The Council shall provide for consideration and disposition by the trial board, with or without hearing, of a timely written petition that membership should not be terminated pursuant to this section. Any membership so terminated may be reinstated by the Board of Directors, under such conditions and procedures as the Council may prescribe.

(See section 720R.)

**7.2.1 Termination of Association of International Associate**

The Board of Directors may terminate the affiliation of an international associate at its discretion.

[As revised May 15, 2000.]

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**BL Section 720R*****Implementing Resolution Under  
Section 7.2 Termination of Membership  
for Nonpayment of Financial Obligation  
or for Failure to Comply With  
Membership-Retention Requirements***

As amended  
January 12, 1988

***Resolved:***

.01 That if a person whose membership has terminated for nonpayment of dues or other financial obligation shall apply for reinstatement, the Board of Directors, in its discretion, may reinstate the member, provided that all dues and other obligations owing to the Institute at the time membership was terminated shall have been paid.

***Further Resolved:***

.02 That if a person whose membership has terminated for failure to comply with membership-retention requirements relating to CPE or practice-monitoring shall apply for reinstatement, the Board of Directors, in its discretion, may reinstate the person as a member provided the person shall have satisfactorily demonstrated that the failure to comply with the CPE or practice-monitoring requirements has been rectified.

***Further Resolved:***

.03 That no person shall be considered to have resigned in good standing if at the time of resignation the person was in debt to the Institute for dues or other obligations. A member submitting a resignation after the beginning of the fiscal year, but before expiration of the time limit for payment of dues or other obligations, may attain good standing by paying dues prorated according to the portion of the fiscal year which has elapsed, provided obligations other than dues shall have been paid in full.

.04 A member who has resigned or whose membership has terminated in any manner may not file a new application for admission but may apply for reinstatement under this resolution or applicable provisions of the bylaws.

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**BL Section 730****7.3 Disciplinary Action Without a Hearing**

As amended  
January 12, 1988,  
unless otherwise indicated

**.01** Membership in the Institute shall be suspended or terminated without a hearing for disciplinary purposes, or a member may be subjected to other disciplinary actions, as provided in sections 7.3.1 and 7.3.2, under such conditions and by such procedure as shall be prescribed by the Council.

[As revised October 18, 2003.]

(See section 730R.)

**7.3.1 Criminal Conviction of Member**

Membership in the Institute shall be suspended without a hearing should there be filed with the secretary of the Institute a judgment of conviction imposed upon any member for

**7.3.1.1** A crime punishable by imprisonment for more than one year;

**7.3.1.2** The willful failure to file any income tax return which the member, as an individual taxpayer, is required by law to file;

**7.3.1.3** The filing of a false or fraudulent income tax return on the member's or a client's behalf; or

**7.3.1.4** The willful aiding in the preparation and presentation of a false and fraudulent income tax return of a client; and

shall be terminated in like manner upon the similar filing of a final judgment of conviction; however, the Council shall provide for the consideration and disposition by the trial board, with or without hearing, of a timely written petition of any member that the member's membership should not be suspended or terminated pursuant to section 7.3.1.1, herein.

**7.3.2 Other Disciplinary Action**

**7.3.2.1** Membership in the Institute shall be suspended without a hearing should a member's certificate as a certified public accountant or license or permit to practice as such or to practice public accounting be suspended as a disciplinary measure; however, such suspension of membership shall terminate upon reinstatement of the certificate, license or permit. Membership in the Institute shall be terminated without a hearing should such certificate, license, or permit be revoked, withdrawn, surrendered, indefinitely suspended, or cancelled as a disciplinary measure or in connection therewith.

[As revised October 18, 2003.]

**7.3.2.2** The professional ethics executive committee and the Board of Directors may jointly approve certain governmental agencies and other organizations whose disciplinary actions against a member will permit the Institute to take disciplinary action against that member without a hearing. To be eligible for approval, the governmental

agency must be one which has the authority to prohibit a member from either practicing before it or serving as a director, officer or trustee of an entity. To be eligible for approval, an organization other than a governmental agency must be one which has been granted the authority by statute or regulation to regulate accountants. If such approved governmental agency or organization temporarily suspends, prohibits or restricts a member from practicing before it or another governmental agency, or from serving as a director, officer or trustee of any entity, the member's membership in the Institute shall be suspended; however, such suspension of membership shall terminate upon such agency's or organization's termination of the suspension, prohibition or restriction. If such approved governmental agency or organization bars or permanently or indefinitely suspends, prohibits or restricts a member from practicing before it or another governmental agency, or from serving as a director, officer or trustee of any entity, the member's membership in the Institute shall be terminated.

[As adopted October 18, 2003.]

**7.3.2.3** A member who has been subjected to any sanction as a disciplinary measure other than or in addition to those sanctions addressed above, by an authority covered in section 7.3.2.1 or section 7.3.2.2, may also be subjected to discipline by the Institute without a hearing pursuant to guidelines established by the professional ethics executive committee and approved by the Board of Directors.

[As adopted October 18, 2003.]

**7.3.2.4** Council shall permit the trial board, with or without a hearing, to consider a timely written petition by the professional ethics executive committee or the member that the member should not be disciplined pursuant to this section 7.3.2.

[As revised October 18, 2003.]

### **7.3.3 Trial Board Disciplining Not Precluded**

Application of the provisions of section 7.3.1 and section 7.3.2 shall not preclude the summoning of the member concerned to appear before a hearing panel of the trial board pursuant to section 7.4.

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**BL Section 730R****Implementing Resolution Under Section 7.3  
Disciplinary Action Without a Hearing**

As amended  
January 12, 1988,  
unless otherwise  
indicated

***Resolved:***

**.01** (1) That the membership of a member who is convicted by a court of any of the criminal offenses enumerated in section 7.3.1 of the bylaws shall become automatically suspended upon the mailing of a notice of such suspension, as provided in paragraph (6) of this resolution. Such notice shall be mailed within a reasonable time after a certified copy of a judgment of conviction of such criminal offense has been filed with the secretary of the Institute.

[As revised by Council October 18, 2003.]

**.02** (2) That the membership of a member who has been convicted by a court of any of the offenses enumerated in section 7.3.1 of the bylaws, and which conviction has become final, shall become automatically terminated upon the mailing of a notice of such termination, as provided in paragraph (6) of this resolution. Such notice shall be mailed within a reasonable time after a certified copy of such conviction and evidence that it has become final has been filed with the secretary of the Institute.

[As revised by Council October 18, 2003.]

**.03** (3) That the membership of a member (*a*) whose certificate, license or permit to practice public accounting or as a certified public accountant has been suspended as a disciplinary measure or (*b*) who is subject to a temporary suspension, prohibition or restriction by an approved governmental agency or organization covered in section 7.3.2 as a disciplinary measure shall, except as provided in paragraph (7) of this resolution, become automatically suspended upon the expiration of thirty days after the mailing of a notice of such suspension, as provided in paragraph (6) of this resolution. Such notice shall be mailed within a reasonable time after a statement by such authority showing the suspension, prohibition or restriction and specifying the cause and duration of such authority's action has been filed with the secretary of the Institute. Such automatic suspension shall cease upon the expiration of the period of suspension, prohibition or restriction so specified.

[As revised by Council October 18, 2003.]

**.04** (4) That the membership of a member (*a*) whose certificate, license or permit to practice public accounting or as a certified public accountant has been revoked, withdrawn, indefinitely suspended, surrendered or cancelled as a disciplinary measure, or (*b*) who has been subjected to a bar, to a permanent or indefinite suspension, prohibition or restriction by an approved governmental agency or organization covered in section 7.3.2 shall, except as provided in paragraph (7) of this resolution, become automatically terminated upon the expiration of thirty days after the mailing of a notice of such termination, as provided in paragraph (6) of this resolution. Such notice shall be mailed within

a reasonable time after a statement by such authority showing the revocation, withdrawal, surrender, cancellation, bar, permanent or indefinite suspension, prohibition or restriction and specifying the cause of such authority's action, has been filed with the secretary of the Institute.

[As revised by Council October 18, 2003.]

**.05** (5) That, if a member has been subjected to any sanction as a disciplinary measure, other than or in addition to those set out in paragraph (1), (2), (3) or (4), the member shall, except as provided in paragraph (7), have their membership suspended or terminated or be otherwise disciplined upon the expiration of thirty days after the mailing of a notice of such disciplinary action taken pursuant to guidelines developed by the professional ethics executive committee and approved by the Board of Directors, under section 7.3.2.

[As adopted by Council October 18, 2003.]

**.06** (6) That notices of disciplinary action pursuant to paragraph (1), (2), (3), (4) or (5) of this resolution shall be signed by the secretary of the Institute and mailed by registered or certified mail, postage prepaid, addressed to the member concerned at the member's last known address according to the official records of the Institute, which are the records of the membership department.

[As revised by Council June 17, 1996; revised October 18, 2003.]

**.07** (7) That the operation of paragraph (1), (2), (3), (4) or (5) of this resolution shall become postponed if, before the expiration of thirty days after mailing the notice of disciplinary action, the secretary of the Institute receives a written petition from either the member concerned or the professional ethics executive committee that the pertinent provision not become operative. The petition shall state briefly the facts and reasons relied upon. All such petitions shall be referred to the trial board for action thereon by a panel of the trial board consisting of at least three members appointed by the chairman of the trial board or vice chairman, when acting as chairman. If the petition is denied, the disciplinary action shall become effective upon such denial, and the party that made the petition shall be so notified in writing by the secretary of the Institute. No appeal shall be allowable with respect to a denial of such a petition. If the petition is granted, the disciplinary action shall not become effective. In such event, the secretary shall transmit the matter to the professional ethics division to take whatever action it considers proper in the circumstances. A determination that paragraph (1), (2), (3), (4) or (5) of this resolution shall not become operative shall be made only when it clearly appears that, because of exceptional or unusual circumstances, it would be inequitable to permit such automatic disciplinary action.

[As revised by Council May 15, 2000; revised October 18, 2003.]

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**BL Section 740*****7.4 Disciplining of Member by Trial Board***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** Under such conditions and by such procedure as the Council may prescribe, a hearing panel of the trial board, by a two-thirds vote of the members present and voting, may expel a member (except as otherwise provided in section 7.4.3), or by a majority vote of the members present and voting, may suspend a member for a period not to exceed two years not counting any suspension imposed under sections 7.3.1 and 7.3.2, or may impose such lesser sanctions as the Council may prescribe on any member if the member

**7.4.1** Infringes any of these bylaws or any rule of the Code of Professional Conduct;

**7.4.2** Is declared by a court of competent jurisdiction to have committed any fraud;

**7.4.3** Is held by a hearing panel of the trial board to have been guilty of an act discreditable to the profession, or to have been convicted of a criminal offense which tends to discredit the profession; provided that should a hearing panel of the trial board find by a majority vote that the member has been convicted by a criminal court of an offense involving moral turpitude, or any of the offenses enumerated in section 7.3.1, the penalty shall be expulsion;

**7.4.4** Is declared by any competent court to be insane or otherwise incompetent;

**7.4.5** Is subject to a disciplinary action by an authority covered in section 7.3.2 that could result in automatic discipline under section 7.3.2; or

[As revised October 18, 2003.]

**7.4.6** Fails to cooperate with the professional ethics division in any disciplinary investigation of the member, owner or employee of the firm by not making a substantive response to interrogatories or a request for documents from a committee of the professional ethics division or by not complying with the educational and remedial or corrective action determined to be necessary by the professional ethics executive committee, within thirty days after the posting of notice of such interrogatories, or a request for documents, or directive to take CPE or corrective action by registered or certified mail, postage prepaid, to the member at the member's last known address shown in the official records of the Institute.

[As revised May 15, 2000.]

**.02** With respect to a member residing in a state in which the state society has entered into an agreement approved by the Institute's Board of Directors



to deal with complaints against society members in cooperation with the professional ethics division, disciplinary hearings shall be conducted before a hearing panel of the joint trial board.

(See section 740R.)

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**BL Section 740R*****Implementing Resolution Under Section 7.4  
Disciplining of Member by Trial Board***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

***Resolved:***

**.01** (1) Any complaint preferred against a member under section 7.4 of the bylaws shall be submitted to the professional ethics division, which in turn may refer the complaint for investigation and recommendation to an ethics committee (or its equivalent) of a state society of certified public accountants that has made an agreement with the Institute of the type authorized in section 7.4 of the bylaws. If, upon consideration of the complaint, investigation and/or recommendation thereon, it appears that a prima facie case is established showing a violation of any applicable bylaws or any rule of the Code of Professional Conduct of the Institute or any state society making an agreement with the Institute referred to above or showing any conduct discreditable to a certified public accountant, the professional ethics division or the ethics committee of such state society, except as provided in the implementing resolution under section 3.6.2.2 of the bylaws, shall report the matter to the secretary of the joint trial board who shall summon the member involved to respond to the charges preferred against the member, which response may include the entering of a plea of guilty without a hearing, in accordance with rules established by the trial board, provided, however, that with respect to a case in which the trial board has granted a petition that automatic discipline shall not become operative under the provisions of paragraph (7) in the implementing resolution under section 7.3.2 of the bylaws, the division or such state society ethics committee shall have discretion as to whether and when to report the matter to the secretary for such summoning.

[As revised by Council October 18, 2003.]

**.02** (2)

- (a) If the professional ethics division or state society ethics committee dismisses any complaint preferred against a member or shall fail to initiate its inquiry within ninety days after such complaint is presented to it in writing, the member preferring the complaint may present the complaint in writing to the trial board, provided, however, that this provision shall not apply to a case falling within the scope of section 7.3.
- (b) The chairman of the trial board shall cause such investigation to be made of the matter as the chairman may deem necessary, and shall either dismiss the complaint or refer it to the secretary of the trial board who shall summon the member to answer the complaint in accordance with the provisions in paragraph (1) hereof.
- (c) Prior to causing the investigation referred to in paragraph (b), the chairman of the trial board shall designate six members of the trial

board who shall not be involved in such investigation in order that not less than three of them may be appointed to an independent hearing panel if necessary. The chairman shall report the names of such members to the secretary of the trial board prior to any action under paragraph (b).

[As revised by Council May 15, 2000.]

**.03** (3) For the purpose of adjudicating charges against members of the Institute, as provided in the foregoing paragraphs of this resolution, the following must take place:

- (a) The secretary shall mail to the member concerned, at least thirty days prior to the proposed meeting of a panel appointed to hear the case, written notice of the charges to be adjudicated. Such notice, when mailed by registered or certified mail, postage prepaid, addressed to the member concerned at the member's last known address according to the official records of the Institute, which are the records of the membership department, shall be deemed properly served.
- (b) After considering the evidence presented by the professional ethics division or other complainant and by the defense, the panel hearing the case, a quorum present, by vote of the members present and voting, may, in a manner consistent with section 7.4 of the bylaws, admonish, suspend for a period of not more than two years, or expel the member against whom the complaint is made and take such other disciplinary, remedial or corrective action as the panel deems appropriate.
- (c) In a case decided by a panel, the member concerned may request a review by the trial board of the decision of the panel, provided such a request for review is filed with the secretary of the trial board within thirty days after the decision of the panel, and that such information as may be required by the rules of the trial board shall be filed with such request. Such a review shall not be a matter of right. Each such request for a review shall be considered by an ad hoc committee to be appointed by the chairman of the trial board, or its vice chairman in the event of the chairman's unavailability, and to consist of not less than three members of the trial board who did not participate in the prior proceedings in the case. The ad hoc committee shall have power to decide whether such request for review by the trial board shall be granted, and such committee's decision that such request shall not be granted shall be final and subject to no further review. A quorum of such ad hoc committee shall consist of a majority of the appointed. If such request for review is granted, the trial board shall review the decision of the panel in accordance with its rules of practice and procedure. On review of such decision, the trial board may affirm, modify, or reverse all or any part of such decision or make such other disposition of the case as it deems appropriate. The trial board may, by general rule, indicate the character of reasons that may be considered to be of sufficient importance to warrant an ad hoc committee granting a request for review of a decision of a panel.

[As revised by Council May 15, 2000.]

- (d) Any decision of the trial board, including any decision reviewing a decision of a panel, shall become effective when made, unless the trial board's decision indicates otherwise, in which latter event it shall become effective at the time determined by the trial board. Any decision of a panel shall become effective as follows:
- (i) Upon the expiration of thirty days after it is made, if no request for review is properly filed within such thirty-day period.
  - (ii) Upon the denial of a request for review, if such request has been properly filed within such thirty-day period and is denied by an ad hoc committee.
  - (iii) Upon the date of a decision of a review panel affirming the decision of a hearing panel in cases where a review has been granted by an ad hoc committee.
- (e) A plea of guilty, if it conforms to the rules and procedures of the trial board, shall become effective upon acceptance by the trial board.

[As revised by Council June 17, 1996.]

**.04** (4) In the case of a settlement agreement between a member and the professional ethics executive committee that provides for disciplinary action pursuant to the Council resolution implementing bylaw section 3.6.2.2, the matter shall be referred to a panel of the trial board which, upon finding that there has been a waiver of the member's rights under Article 7.4, shall recognize such settlement agreement and arrange for publication of such disciplinary action under section 7.6 of the bylaws.

[As revised by Council May 26, 1993; revised April 28, 2003.]

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## **BL Section 750**

### ***7.5 Reinstatement***

**As amended  
January 12, 1988**

**.01** The Council may prescribe the conditions and procedures under which members suspended or terminated under sections 7.3 and 7.4 may be reinstated.

(See section 750R.)

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**BL Section 750R*****Implementing Resolution Under  
Section 7.5 Reinstatement***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

***Resolved:***

**.01** (1) That at any time after the publication by the Institute of a statement of a case and decision, including cases in which a guilty plea was entered without a hearing, on application of the member concerned to the secretary of the trial board, the appropriate panel of the trial board that last heard the case and whose decision provided the basis for the publication or, where the original panel cannot be reappointed, or in the case of a guilty plea, a newly formed panel, may, by a two-thirds vote of the members present and voting, rescind or modify such decision. Any such action shall be published by the Institute. The denial of an application under this section shall not be published and shall not prevent the member concerned from applying for reinstatement under section (2) hereof.

[As revised by Council May 26, 1993; revised May 15, 2000.]

**.02** (2) That

- (a) Should an order, judgment of conviction, decision or action on which the suspension or termination of membership was based under section 7.3 of the bylaws be reversed or otherwise set aside or invalidated, such suspension shall terminate or such member shall become reinstated when a certified copy of the order reversing or otherwise setting aside or invalidating such order, conviction, decision or action is filed with the secretary of the joint trial board, who shall refer the matter to the professional ethics division for whatever action it deems appropriate.

[As revised by Council October 18, 2003.]

- (b) A member who has been suspended or expelled by the trial board pursuant to section 7.4 of the bylaws may request that the suspension terminate or may request reinstatement if an order, judgment of conviction, decision or action on which the suspension or termination was based has been reversed or otherwise set aside or invalidated. Such request shall be referred to the trial board whereupon a hearing panel composed of five members designated by the chairman of the trial board may, after investigating all related circumstances, terminate the suspension or reinstate the member concerned by a majority vote of the members present and entitled to vote.

[As revised by Council October 18, 2003.]

- (c) Except as provided in subparagraphs (a) and (b) of this paragraph (2), a member whose membership has been automatically terminated



under section 7.3, or who has been expelled by or had the member's resignation accepted by a panel of the trial board may, at any time after three years from the effective date of such termination, expulsion, or acceptance of resignation, request reinstatement of their membership. Such request shall be referred to the trial board, whereupon the chairman shall designate five members of the board to a hearing panel which may, after investigation, reinstate such member on such terms and conditions as it shall determine to be appropriate. If an application for reinstatement under this subparagraph is denied, the member concerned may again apply for reinstatement at any time after two years from the date of such denial.

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**BL Section 760*****7.6 Publication of Disciplinary Action***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** Notice of disciplinary action pursuant to section 7.3 or 7.4 or of termination of enrollment of a member or a member's firm in an Institute-approved practice-monitoring program, together with a statement of the reasons therefore, shall be published in such form and manner as the Council may prescribe. Council also may prescribe any additional disclosures regarding any matter within the jurisdiction of the professional ethics executive committee.

[As revised May 15, 2000; revised October 18, 2003; revised November 6, 2007.]

(See section 760R.)

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**BL Section 760R*****Implementing Resolution Under Section 7.6  
Publication of Disciplinary Action***

**As amended  
May 26, 1993,  
unless otherwise  
indicated**

***Resolved:***

.01 That notice of disciplinary action taken under section 7.3 or 7.4 of the bylaws or of termination of enrollment of a member or a member's firm in an Institute-approved practice monitoring program, and the basis therefore shall be published by the Institute and that the professional ethics division, the Peer Review Board or peer review committee as appropriate shall maintain a record of such information and disclose that information upon request. In the case of disciplinary action pursuant to section 7.3 of the bylaws, such notice shall be in a form approved by the chairman of the trial board and consistent with this Council resolution. In any action pursuant to section 7.4 of the bylaws in which the member is found guilty or has entered into a settlement agreement with the professional ethics executive committee, the trial board or panel hearing the case shall decide on the form of the notice of the case and the decision to be published. All notices shall disclose, at least, the name of the member involved and, when appropriate, the terms and conditions of any settlement agreement and the nature of the violation. The statement and decision, as released by the chairman, trial board, or hearing panel, shall be published by the Institute. No such publication shall be made until such decision has become effective. The professional ethics executive committee may inform the complainant of the outcome of its investigation without regard to whether the action taken results in publication under section 7.6 of the bylaws.

[As revised by Council May 15, 2000; revised October 18, 2003; revised November 6, 2007.]

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## **BL Section 770**

### ***7.7 Disciplinary Sections Not to Be Applied Retroactively***

**As amended  
January 12, 1988**

**.01** Sections 7.3 and 7.4 shall not be applied to offenses of wrongful conduct occurring prior to their effective dates, but such offenses shall be subject to discipline under the bylaws of the Institute in effect at the time of their occurrence.

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## BL Section 800

### 8. AMENDMENTS

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#### TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
801	Amendments .....	.01
810	Proposals to Amend the Bylaws .....	.01
820	Proposals to Amend the Code of Professional Conduct .....	.01
830	Submission to Council via Board of Directors .....	.01
840	Submission to Membership by Mail Ballot .....	.01

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**BL Section 801**  
***Amendments***

**As amended**  
**January 12, 1988**

**.01** Amendments to these bylaws and the Code of Professional Conduct shall be accomplished in a manner consistent with this article.

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**BL Section 810*****8.1 Proposals to Amend the Bylaws***

**As amended  
June 17, 1996**

.01 Proposals to amend the bylaws may be made by any thirty members of the Council, by any two hundred or more members of the Institute in good standing, by the Board of Directors, or by petition of 5 percent of the membership as of the end of the prior fiscal year. Any such petition shall include the member's name (typed or printed), membership number and the date it is signed, and the signature of a member on such a petition shall be valid for one year from the date thereof. The changes to this provision will not apply to petitions, regardless of when they are signed, submitted pursuant to efforts to gather such petitions which were ongoing as of July 13, 1995.

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**BL Section 820*****8.2 Proposals to Amend the Code of Professional Conduct***

**As amended  
June 17, 1996**

**.01** Proposals to amend the Code of Professional Conduct may be made by any thirty members of the Council, by any two hundred or more members of the Institute in good standing, by the Board of Directors, by the professional ethics division, or by petition of 5 percent of the membership as of the end of the prior fiscal year. Any such petition shall include the member's name (typed or printed), membership number and the date it is signed, and the signature of a member on such a petition shall be valid for one year from the date thereof. The changes to this provision will not apply to petitions, regardless of when they are signed, submitted pursuant to efforts to gather such petitions which were ongoing as of July 13, 1995.

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**BL Section 830*****8.3 Submission to Council via  
Board of Directors***

**As amended  
January 12, 1988**

.01 All such proposals to amend the bylaws or the Code of Professional Conduct, unless made at a meeting of the Council or the Board of Directors, shall be submitted in writing to the Board of Directors. The Board of Directors shall submit all such proposals, accompanied by its recommendation, to the Council for action.

**8.3.1 Proposals Not Requiring Council Approval**

Following discussion at a meeting of the Council, proposals sponsored by at least 5 percent of the membership shall be submitted to the membership of the Institute for vote by mail ballot pursuant to section 8.4.

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**BL Section 840*****8.4 Submission to Membership by Mail Ballot***

**As amended  
January 12, 1988,  
unless otherwise  
indicated**

**.01** Amendments proposed under section 8.3.1 and those authorized by the Council under section 8.3 shall be submitted to all of the members of the Institute for a vote by mail ballot no later than 180 days following discussion or authorization by the Council. If at least two-thirds of those voting approve such proposal, it shall become effective as an amendment to the bylaws or to the Code of Professional Conduct, as applicable. Mail ballots shall be considered valid and counted only if received as instructed by the Institute for the return of such votes within sixty days from the date of mailing the ballots to the members.

[As revised May 15, 2000; revised November 6, 2007.]

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# BL Section 900

## GENERAL

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### TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
911	AICPA Mission Statement .....	.01
921	A Description of the Professional Practice of Certified Public Accountants .....	.01-.15

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## BL Section 911

### ***AICPA Mission Statement***\*

.01 The American Institute of Certified Public Accountants is the national professional organization for all Certified Public Accountants. Its mission is to provide members with the resources, information, and leadership that enable them to provide valuable services in the highest professional manner to benefit the public as well as employers and clients.

In fulfilling its mission, the AICPA works with state CPA organizations and gives priority to those areas where public reliance on CPA skills is most significant.

To achieve its mission, the Institute:

#### *Advocacy*

- Serves as the national representative of CPAs before governments, regulatory bodies and other organizations in protecting and promoting members' interests.

#### *Certification and Licensing*

- Seeks the highest possible level of uniform certification and licensing standards and promotes and protects the CPA designation.

#### *Communications*

- Promotes public awareness and confidence in the integrity, objectivity, competence, and professionalism of CPAs and monitors the needs and views of CPAs.

#### *Recruiting and Education*

- Encourages highly qualified individuals to become CPAs and supports the development and outstanding academic programs.

#### *Standards and Performance*

- Establishes professional standards; assists members in continually improving their professional conduct, performance, and expertise; and monitors such performance to enforce current standards and requirements.

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\* **Note:** The Mission Statement, developed in 1986 by the Mission of AICPA Special Committee, was revised by the Strategic Planning Committee and approved by Council in May 1991. The Strategic Objectives were revised in November 1993 and again in November 1995.



## BL Section 921

### *A Description of the Professional Practice of Certified Public Accountants*

- .01** Certified public accountants practice in the broad field of accounting.
- .02** Accounting is a discipline which provides financial and other information essential to the efficient conduct and evaluation of the activities of any organization.
- .03** The information which accounting provides is essential for (1) effective planning, control, and decision-making by management, and (2) discharging the accountability of organizations to investors, creditors, government agencies, taxing authorities, association members, contributors to welfare institutions, and others.
- .04** Accounting includes the development and analysis of data, the testing of their validity and relevance, and the interpretation and communication of the resulting information to intended users. The data may be expressed in monetary or other quantitative terms, or in symbolic or verbal forms.
- .05** Some of the data with which accounting is concerned are not precisely measurable, but necessarily involve assumptions and estimates as to the present effect of future events and other uncertainties. Accordingly, accounting requires not only technical knowledge and skill, but even more important, disciplined judgment, perception, and objectivity.
- .06** Within this broad field of accounting, certified public accountants are the identified professional accountants. They provide leadership in accounting research and education. In the practice of public accounting CPAs bring competence of professional quality, independence, and a strong concern for the usefulness of the information and advice they provide, but they do not make management decisions.
- .07** The professional quality of their services is based upon experience and the requirements for the CPA certificate—education and examination—and upon the ethical and technical standards established and enforced by their profession.
- .08** CPAs have a distinctive role in auditing financial statements submitted to investors, creditors, and other interested parties, and in expressing independent opinions on the fairness of such statements. This distinctive role has inevitably encouraged a demand for the opinions of CPAs on a wide variety of other representations, such as compliance with rules and regulations of government agencies, sales statistics under lease and royalty agreements, and adherence to covenants in indentures. [Revised, July 1997, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 58.]
- .09** The audit of financial statements requires CPAs to review many aspects of an organization's activities and procedures. Consequently they can advise clients of needed improvements in internal control and make constructive suggestions on financial, tax, and other operating matters. [Revised, July 1997, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 58.]



**.10** In addition to furnishing advice in conjunction with their independent audits of financial statements, CPAs are engaged to provide objective advice and consultation on various management problems. Many of these involve information and control systems and techniques, such as budgeting, cost control, profit planning, internal reporting, automatic data processing, and quantitative analysis. CPAs also assist in the development and implementation of programs approved by management. [Revised, July 1997, to reflect conforming changes necessary due to the issuance of Statement on Auditing Standards No. 58.]

**.11** Among the major management problems depending on the accounting function is compliance with tax requirements. An important part of the practice of CPAs includes tax planning and advice, preparation of tax returns, and representation of clients before government agencies.

**.12** CPAs also participate in conferences with government agencies such as the Securities and Exchange Commission, and with other interested parties, such as bankers.

**.13** Like other professionals, CPAs are often consulted on business, civic, and other problems on which their judgment, experience, and professional standards permit them to provide helpful advice and assistance.

**.14** The complexities of an industrial society encourage a high degree of specialization in all professions. The accounting profession is no exception. Its scope is so wide and varied that many individual CPAs choose to specialize in particular types of service.

**.15** Although their activities may be diverse, all CPAs have demonstrated basic competence of professional quality in the discipline of accounting. It is this which unites them as members of one profession, and provides a foundation for extension of their services into new areas.

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# BL TOPICAL INDEX

References are to BL section and paragraph numbers.

## A

### ACCOUNTING

- Defined as a Discipline ..... 921.02
- Definition ..... 921.04

### ACCOUNTING AND REVIEW SERVICES

#### COMMITTEE

- Authority to Make Public  
Statements ..... 360R.01
- Designation as Senior Committee .... 360R.01

### ACCOUNTING STANDARDS EXECUTIVE

#### COMMITTEE

- Authority to Make Public  
Statements ..... 360R.01
- Designation as Senior Committee .... 360R.01
- Qualifications for Membership ..... 320.01

### ACTS DISCREDITABLE

- Disciplining of Member by Trial  
Board ..... 740.01-02; 740R.01

### ADMISSION TO ASSOCIATION—See

International Associates

### ADMISSION TO MEMBERSHIP—See

Membership

### ADVICE TO CLIENTS

- Description of Practice ..... 921.09-11;  
..... 921.13

### ADVOCACY

- Mission of the Institute ..... 911.01

### AMENDMENTS

- Bylaws ..... 801.01
- Code of Professional Conduct ..... 801.01
- Effective Date ..... 840.01
- Petition Contents and Validity ..... 810.01;  
..... 820.01
- Proposals to Amend Bylaws ..... 810.01;  
..... 830.01; 840.01
- Proposals to Amend Code of  
Conduct ..... 820.01; 830.01; 840.01
- Submission to Council ..... 830.01

### AMERICAN INSTITUTE OF CPAs

- Agreement With State Society ..... 740.02;  
..... 740R.01
- Audit of Financial Statements ..... 410.01
- Designation as Members ..... 250.01
- Fiscal Year ..... 460.01
- Governing Body—See Council of Institute
- Indemnification Provision ..... 440.01-02
- Membership Department Records ... 730R.06;  
..... 740R.03
- Mission Statement ..... 911.01
- Name ..... 101.01

### AMERICAN INSTITUTE OF CPAs—continued

- Objectives ..... 101.01
- Organization and Procedure—See  
Organization of Institute
- Past Presidents Eligible for Council ... 330.01

### ANNUAL MEETINGS—See Meetings of

Institute

### ASSOCIATES—See International Associates

### ASSURANCE SERVICES EXECUTIVE COMMITTEE

- Authority to Make Public  
Statements ..... 360R.01
- Designation as Senior Committee .... 360R.01

### ATTESTATION

- Description of Practice ..... 921.08

### AUDIT COMMITTEE

- Appointed by Board of Directors ..... 420.01
- Duties ..... 420.01

### AUDIT OF INSTITUTE

- Appointment of Auditor ..... 410.01
- Financial Statements ..... 410.01

### AUDITING STANDARDS BOARD

- Authority to Make Public  
Statements ..... 360R.01
- Designation as Senior Committee .... 360R.01
- Qualifications for Membership ..... 320.01

## B

### BALLOT—See Mail Ballot

### BOARD OF DIRECTORS

- Action of Admissions ..... 220.01
- Action on Admissions ..... 210.01
- Action on Amendments ..... 830.01
- Action on Resignations ..... 710.01;  
..... 710R.01
- Agenda for Council Meetings ..... 501.01
- Amendment Proposals ..... 810.01; 820.01
- Appointment of Board of Examiners ... 360.01
- Appointment of President ..... 350.01
- Appointment of Secretary ..... 350.01
- Appointment of Senior Committees ... 360.01
- Appointment of Staff Officers ..... 350.01
- Audit Committee ..... 420.01
- Authority for Additional  
Expenditures ..... 401R.01
- Budgetary Controls ..... 401R.01
- Composition Prescribed by Council ..... 340.01;  
..... 340R.01
- Dates for Meetings of Council ..... 501.01;  
..... 520.01

References are to BL section and paragraph numbers.

**BOARD OF DIRECTORS—continued**

- Dates for Meetings of Institute ..... 510.01
- Disciplinary Actions ..... 730.01; 730R.01-.07
- Election by Council ..... 350R.01
- Election Meeting ..... 660.01
- Election of Members ..... 601.01; 630.01-.02
- Election of Nominating Committee ..... 360R.03-.04
- Execution of Instruments ..... 430.01
- Indemnification Provision ..... 440.01
- Interim Appointments ..... 650.01; 650R.01
- Meetings—See Meetings of Board of Directors
- Meetings of Council ..... 501.01
- Membership of Council ..... 330.01
- Organization of Institute ..... 310.01-.02
- Powers of Board ..... 340.01
- Powers of Council ..... 330.01
- Prescription of Committee Duties, Powers, and Procedures ..... 360.01
- Proposals to Amend Bylaws ..... 810.01; ..... 830.01
- Proposals to Amend Code of Conduct ..... 820.01; 830.01
- Public Representatives ..... 320.01; 340R.01
- Qualifications for Membership ..... 320.01
- Re-election to Board ..... 630.02
- Reinstatement of Membership ..... 710.01; ..... 710R.01; 720.01; 720R.01-.02
- Reports to Council ..... 340.01
- Resolutions of Membership ..... 320.01
- Special Meetings of Council ..... 520.01
- Term Limit ..... 670.01
- Termination of Membership ..... 720.01
- Unexpired Terms ..... 650R.01
- Vacancies ..... 650.01-.02; 650R.01

**BOARD OF EXAMINERS**

- Designation as Senior Board ..... 360R.01
- Duties of Board ..... 360.01
- Method of Appointment ..... 360.01
- Qualifications for Membership ..... 320.01; ..... 320R.01-.02
- Supervision of CPA Examination ..... 360.01

**BOARD OF PUBLIC COMPANY AUDITOR'S FORUM**

- Authority to Make Public Statements ..... 360R.01
- Designation as Senior Committee .... 360R.01
- Joint Trial Board ..... 360R.12

**BOARDS OF INSTITUTE**

- Appointed by Chairman of Board of Directors ..... 360.01
- Board of Directors—See Board of Directors
- Board of Examiners—See Board of Examiners
- Resolutions of Membership ..... 320.01
- Trial Board—See Joint Trial Board

**BUDGETS**

- Prescribed by Council ..... 401.01

**BYLAWS OF INSTITUTE**

- Admission to Membership and Association ..... 210.01
- Amendment Petition's Contents and Validity ..... 810.01; 820.01
- Amendments ..... 801.01
- Council Resolutions—See Resolutions of Council
- Disciplinary Actions ..... 701.01; 740.01-.02
- Elections ..... 601.01
- Financial Management and Controls .... 401.01
- Infringement ..... 740.01; 740R.01
- Meetings of Institute and Council ..... 501.01
- Mission Statement of the Institute ..... 911.01
- Name and Purpose of Institute ..... 101.01
- Organization and Procedure ..... 310.01-.02
- Proposals for Amendment .... 320.01; 810.01
- Retention of Membership ..... 230.01
- Retroactivity of Disciplinary Sanctions ..... 770.01
- Termination of Membership ..... 701.01

**C**

**CENSURE**

- Public or Private ..... 701.01

**CERTIFICATE, CPA—See CPA Certificate**

**CERTIFICATE OF MEMBERSHIP**

- Dues Required for Certificate ..... 240.01
- Issuance ..... 240.01
- Requirement for Return ..... 240.01

**CERTIFIED PUBLIC ACCOUNTANTS**

- Audit of Institute ..... 410.01
- Description of Professional Practice ..... 921.01-.15
- Designation as Member ..... 250.01

**CHAIRMAN OF BOARD OF DIRECTORS**

- Appointment of Committees and Boards ..... 360.01; 420.01
- Attendance at Board Meetings ..... 360.01
- Attendance at Committee Meetings ... 360.01
- Audit Committee ..... 420.01
- Duties of Chairman ..... 350R.02
- Election by Council ..... 350.01; 350R.01
- Election to Board ..... 630.01
- Powers Prescribed by Council ..... 350.01
- Qualifications for Office ..... 350.01
- Special Meetings of Council ..... 520.01
- Term of Office ..... 350R.01; 660.01

**CODE OF CONDUCT—See Conduct, Code of Professional**

**COMMITTEE**

- Accounting and Review Services Committee ..... 360R.01
- Accounting Standards Executive Committee ..... 360R.01
- Appointment by Chairman of Board .... 360.01
- Audit—See Audit Committee
- Auditing Standards Board ..... 360R.01

References are to BL section and paragraph numbers.

**COMMITTEE**—continued

- Board of Examiners . . . . . 360.01; 360R.01
- Board of Public Company Auditor's Forum . . . . . 360R.01
- Eligibility for Service . . . . . 320.01
- Employee Benefit Plans Audit Quality Center Executive Committee . . . . . 360R.01
- Government Audit Quality Center Executive Committee . . . . . 360R.01
- Indemnification Provision . . . . . 440.01
- Information Technology Executive Committee . . . . . 360R.01
- Joint Trial Board . . . . . 360.01
- Management Consulting Services Executive Committee . . . . . 360R.01
- Nominations Committee . . . . . 360.01; 360R.03-04
- Organization of Institute . . . . . 310.01-02
- Organization Prescribed . . . . . 360.01
- Peer Review Board . . . . . 220R.01; 360R.01
- Peer Review Committee . . . . . 360R.11
- Permanent Committees, Boards, and Divisions . . . . . 360.01; 360R.03-04
- Personal Financial Planning Executive Committee . . . . . 360R.01
- Private Companies Practice Executive Committee . . . . . 360R.01
- Professional Ethics Executive Committee . . . . . 360.01; 360R.01
- Resolutions of Membership . . . . . 320.01
- Scope of Responsibility . . . . . 360.01
- Senior Committees and Boards . . . . . 220R.01; 360.01; 360R.01
- Tax Executive Committee . . . . . 360R.01

**COMMUNICATION**

- By Mail or in Writing . . . . . 310.02
- Electronic Notification . . . . . 310.02
- Mission of the Institute . . . . . 911.01
- To or From Members . . . . . 310.02

**COMPETENCE**

- Mission Statement of the Institute . . . . . 911.01

**COMPLAINTS AGAINST MEMBERS**

- Referred to Professional Ethics Division . . . . . 740R.01-04
- Referred to Trial Board . . . . . 740R.02
- Resignation or Reinstatement . . . . . 710R.01

**CONDUCT, CODE OF PROFESSIONAL**

- Amendments Petition's Contents and Validity . . . . . 810.01; 820.01
- Amendments . . . . . 801.01
- Disciplinary Actions . . . . . 360R.05-07; 730.01; 730R.01-07; 740.01; 740R.01-04
- Infringement . . . . . 740.01; 740R.01; 740R.03
- Interpretations and Amendments . . . . . 360.01
- Proposals to Amend . . . . . 320.01; 820.01; 830.01; 840.01
- Retention of Membership . . . . . 230.01

**CONTINUING PROFESSIONAL****EDUCATION**—See Training and Education**CONVICTION OF CRIME**—See

Criminal Conviction

**COUNCIL OF INSTITUTE**

- Action on Reinstatement . . . . . 710.01
- Action on Resignations . . . . . 710.01
- Admission of International Associates . . . . . 260.01; 260R.01
- Amendment Proposals . . . . . 810.01; 820.01; 830.01; 840.01
- Appointment of Auditor . . . . . 410.01
- Budgetary Controls . . . . . 401.01
- Composition of Council . . . . . 330.01
- Disciplining of Membership . . . . . 740.01-02
- Disclosures Regarding PEEC Matters . . . . . 760.01
- Dues Determination by Council . . . . . 450.01
- Election Meeting . . . . . 660.01
- Election of Members . . . . . 601.01; 610.01
- Election of Members-at-Large . . . . . 630.01-02
- Election of Nominating Committee . . . . . 360R.03-04
- Election of Officers . . . . . 350.01; 630.01-02
- Election of Public Representatives . . . . . 630.01
- Execution of Instruments . . . . . 430.01
- Financial Management and Controls . . . . . 401.01; 401R.01
- Fiscal Year Prescribed . . . . . 460.01; 460R.01
- Forfeiture of Office . . . . . 640.01
- Indemnification Provision . . . . . 440.01
- Interim Appointments . . . . . 650.01-02
- Joint Trial Board Election . . . . . 360R.08
- Meetings—See Meetings of Council
- Members-at-Large . . . . . 330.01; 630.01-02; 670.01
- Members Elected to Board of Directors . . . . . 340R.01
- Membership . . . . . 330.01
- Nomination . . . . . 610.01
- Notification of Nomination . . . . . 610.01
- Number of Council Members . . . . . 610.01
- Organization of Institute . . . . . 310.01
- Powers of Council . . . . . 330.01
- Proportional Representations of Members . . . . . 610.01
- Proposals to Amend Bylaws . . . . . 810.01; 830.01; 840.01
- Proposals to Amend Code of Conduct . . . . . 820.01; 830.01; 840.01
- Publication of Disciplinary Action . . . . . 760.01; 760R.01
- Publication of Termination of Practice-Monitoring Program Participation . . . . . 760.01
- Qualifications for Membership . . . . . 320.01
- Reinstatement of Membership . . . . . 710.01; 710R.01; 720.01; 750.01
- Reports From Board of Directors . . . . . 340.01
- Reports to Membership . . . . . 330.01
- Resolutions of Membership . . . . . 320.01

References are to BL section and paragraph numbers.

**COUNCIL OF INSTITUTE—continued**

- Rules Governing International Associates ..... 260.01; 260R.01
- Selection of Council Members ..... 330.01
- Senior Committees Designated ..... 360.01
- Special Meetings of Council ..... 520.01
- State Society Representatives ..... 620.01
- Term of Office ..... 610.01; 670.01
- Termination of International Associate Affiliation ..... 720.01
- Termination of Membership ..... 720.01
- Unexpired Terms ..... 610.01; 650R.01
- Vacancies ..... 610.01; 610R.01; 650.01-02; 650R.01

**COUNCIL RESOLUTIONS—See Resolutions of Council****CPA CERTIFICATE**

- Disciplinary Actions ..... 730.01; 730R.03-04; 740.01-02
- Joint Trial Board Members ..... 360.01
- Mission of the Institute ..... 911.01
- Officers Appointed by Board of Directors ..... 350.01
- Officers Elected by Council ..... 350.01
- Requirement for Membership ..... 220.01
- Requirements ..... 921.07

**CPA EXAMINATION—See Examination, Uniform CPA****CRIMINAL CONVICTION**

- Disciplinary Actions Without a Hearing ..... 730.01; 730R.01-02
- Disciplining of Member by Trial Board ..... 740.01-02
- Judgment Reversed ..... 750R.02

**D****DIRECTORS—See Board of Directors****DISCIPLINARY ACTIONS**

- Disciplining by Trial Board ..... 360R.05-07; 740.01-02; 740R.01-04
- Introduction ..... 701.01
- Maintaining Records ..... 760R.01
- Practice-Monitoring Programs ... 220R.01-02; 760.01
- Publication of Action ..... 740R.04; 750R.01; 760.01; 760R.01
- Reinstatement ..... 750R.01-02
- Retroactivity ..... 770.01
- Settlement Agreement ..... 360R.07; 740R.04; 760R.01
- Without a Hearing ..... 730.01

**DISCIPLINARY SUSPENSION—See Suspension of Membership****DISCREDITABLE ACTS—See Acts Discreditable****DIVISION FOR CPA FIRMS (AICPA)**

- Practice-Monitoring Programs ..... 220R.01-02
- Private Companies Practice Section ..... 220R.01

**DUES**

- Classifications ..... 450.01
- Date Payable ..... 450.02
- International Associates ..... 450.01-03
- Military Service ..... 450.03
- Nonpayment ..... 720.01; 720R.01-02
- Required for Certification of Membership ..... 240.01

**E****EDUCATION AND TRAINING—See Training and Education****ELECTIONS**

- Board of Directors ..... 630.01-02; 660.01
- Chairman of Board of Directors ..... 630.01
- Council Members ..... 610.01
- Introduction ..... 601.01
- Members-at-Large ..... 630.01; 660.01
- Notification of Election to Council ..... 610.01
- Notification of Nomination to Council ... 610.01
- Officers of Institute ..... 660.01
- Proportional Representation in Council ..... 610.01
- Public Representatives ..... 630.01
- Term of Office of Council Members ... 610.01
- Vacancies ..... 650.01-02; 650R.01
- Vice Chairman of Board of Directors ... 630.01
- Withdrawal of Nomination ..... 610R.01

**EMPLOYEE BENEFIT PLANS AUDIT QUALITY CENTER EXECUTIVE COMMITTEE**

- Designation as Senior Committee .... 360R.01

**ETHICS DIVISION—See Professional Ethics Division****EXAMINATION, UNIFORM CPA**

- Requirement for Membership ..... 220.01
- Supervision by Board of Examiners ... 360.01

**EXAMINERS—See Board of Examiners****EXECUTION OF INSTRUMENTS**

- Designation of Officers or Employees ..... 430.01

**EXPENSES**

- Indemnification Provision ..... 440.02

**F****FELONY—See Criminal Conviction****FINANCIAL REPORTING**

- Description of Practice ..... 921.02-03; 921.08-10

**FINANCIAL STATEMENTS OF INSTITUTE**

- Audit Committee ..... 420.01
- Fiscal Year ..... 460R.01
- Publication for Membership ..... 410.01

**FIRM**

- Designation as Member ..... 250.01

References are to BL section and paragraph numbers.

**FISCAL PERIOD**

- Prescribed by Council ..... 460.01; 460R.01

**FOREIGN CITIZENSHIP**—See International

Associates

**G****GOVERNMENT AUDIT QUALITY CENTER****EXECUTIVE COMMITTEE**

- Designation as Senior Committee .... 360R.01

**GOVERNMENTAL AGENCIES**

- Compliance With Rules and Regulations ..... 921.08

**I****INCOME TAX RETURNS**—See Tax Returns**INCOMPETENCE**

- Disciplining by Trial Board ..... 740.01-02

**INDEPENDENCE**

- Description of Practice ..... 921.06

**INFORMATION TECHNOLOGY EXECUTIVE COMMITTEE**

- Designation as Senior Committee .... 360R.01

**INSTITUTE**—See American Institute of CPAs**INSTRUMENTS**—See Execution of Instruments**INSURANCE**

- Indemnification Provision ..... 440.02

**INTERNATIONAL ASSOCIATE**

- Admission ..... 260.01; 260R.01
- Attendance at Meetings ..... 320.01
- Dues ..... 450.01-03
- Member Benefits ..... 260R.01
- Termination of Association ..... 720.01
- Voting Rights ..... 260R.01; 320.01
- Waiver of Dues ..... 450.03

**J****JOINT TRIAL BOARD**

- Board of Public Company Auditor's Forum ..... 360R.11
- Complaints Against Members ..... 740R.02
- Composition ..... 360.01; 360R.08-10
- Disciplining of Member .... 730.01; 730R.07; ..... 740.01-02; 740R.01-04
- Duties and Powers ..... 360.01
- Effective Date of Decision ..... 740R.03
- Expulsion of Member ..... 740.01
- Membership Requirements ..... 360.01
- Notification to Member ..... 740R.03
- Panel ..... 740R.03
- Powers ..... 360R.10-12
- Peer Review Board ..... 360R.11
- Peer Review Committee ..... 360R.11
- Practice-Monitoring Program ..... 360R.11
- Publication of Disciplinary Action .... 760R.01
- Publication of Reinstatement ..... 750R.01

**JOINT TRIAL BOARD**—continued

- Reinstatement of Membership ..... 710R.01; ..... 750R.01-02
- Request for Trial ..... 740R.03
- Resignation of Membership ..... 710R.01
- Review Procedure ..... 740R.03; 750R.01-02
- State Societies, CPA ..... 360R.13
- Sub-Board ..... 360R.10
- Summoning of Member ..... 730.01

**L****LAWSUITS**—See Litigation**LIABILITIES**

- Indemnification Provision ..... 440.02

**LITIGATION**

- Indemnification Provision ..... 440.01-02

**M****MAIL BALLOT**

- Council Vote ..... 520.01
- Proposed Amendments ..... 830.01; 840.01
- Resolutions of Membership ..... 510.01
- Vacancies ..... 650.01; 650R.01
- Voting for Council Members ..... 610.01
- Voting Rights ..... 320.01

**MANAGEMENT**

- Audit Committee ..... 420.01
- Audit of Institute ..... 410.01
- Authority of Council ..... 401.01
- Budgets of Institute ..... 401.01; 401R.01
- Dues ..... 450.01-03
- Fiscal Year ..... 460.01; 460R.01
- Implementing Resolutions of Council ..... 401R.01
- Indemnification Provision ..... 440.01

**MANAGEMENT CONSULTING SERVICES**

- Description of Practice ..... 921.10-11

**MANAGEMENT CONSULTING SERVICES EXECUTIVE COMMITTEE**

- Authority to Make Public Statements ..... 360R.01
- Designation as Senior Committee .... 360R.01

**MEETINGS, GENERAL PROVISIONS**

- Quorum ..... 530.01
- Rules of Procedure ..... 530.01

**MEETINGS OF BOARD OF DIRECTORS**

- Amendment Proposals ..... 830.01
- Quorum ..... 530.01

**MEETINGS OF COUNCIL**

- Agenda Determined by Board of Directors ..... 501.01
- Amendment Proposals ..... 830.01
- Dates Determined by Board of Directors ..... 501.01
- Dates of Meetings ..... 520.01
- Election Meeting ..... 660.01
- Elections ..... 650.01-02; 650R.01

References are to BL section and paragraph numbers.

**MEETINGS OF COUNCIL—continued**

- Mail Ballot in Lieu of Special Meeting ..... 520.01
- Minutes ..... 520.01
- Non-attendance ..... 640.01
- Notice of Meetings ..... 520.01
- Quorum ..... 530.01
- Regular Meetings ..... 520.01
- Rules of Procedure ..... 530.01
- Special Meetings ..... 520.01

**MEETINGS OF INSTITUTE**

- Council Meeting Held in Conjunction With ..... 660.01
- Notice of Meetings ..... 510.01
- Quorum ..... 510.01; 530.01
- Regular Meetings ..... 510.01
- Resolution of Membership ..... 510.01
- Rules of Procedure ..... 530.01
- Special Meetings ..... 510.01

**MEMBERS—See Membership**

**MEMBERS-AT-LARGE OF COUNCIL**

- Council Members ..... 330.01
- Elections ..... 630.01-02; 660.01
- Forfeiture of Office ..... 640.01
- Nonattendance at Council Meetings ..... 640.01
- Term of Office ..... 630.01; 670.01

**MEMBERSHIP**

- Administrative Reprimand ..... 360R.05-07; 701.01
- Admission to Membership ..... 220.01; 220R.02; 240.01
- Amendment Petition's Contents and Validity ..... 810.01; 820.01
- Amendment Proposals ..... 810.01; 820.01
- Attendance at Meetings ..... 320.01
- Certificate—See Certificate of Membership
- Communications With ..... 310.02
- Conditions for Retention ..... 701.01
- Continuing Professional Education ..... 720.01; 720R.02
- Designation as Member ..... 250.01
- Disciplinary Sanctions—See Disciplinary Sanctions
- Disciplining of Member by Trial Board ..... 740.01-02; 740R.01-04
- Dues ..... 230.01; 450.01-03
- Education Requirements ..... 220.01
- Elections—See Elections
- Financial Statements of Institute ..... 410.01
- International Associates—See International Associates
- Mail Ballot ..... 320.01; 510.01; 610.01; 830.01
- Meetings—See Meetings of Institute
- Members Defined ..... 210.01
- Mission of the Institute ..... 911.01
- Nonpayment of Dues ..... 720.01; 720R.01
- Notice of Meetings ..... 510.01
- Objectives of Institute ..... 101.01

**MEMBERSHIP—continued**

- Organization—See Organization of Institute
- Positions Held Only by Members ..... 320.01; 630.01-02; 660.01
- Positions That May Be Held by Non-Members ..... 320R.01-02
- Practice-Monitoring Programs ..... 220R.01-02; 710.01; 710R.01; 720.01; 720R.02
- Proposals to Amend Bylaws ..... 810.01; 830.01; 840.01
- Proposals to Amend Code of Conduct ..... 820.01; 830.01; 840.01
- Publication of Disciplinary Action ..... 760.01; 760R.01
- Publication of Termination of Practice-Monitoring Program Participation ..... 760.01
- Qualifications ..... 220.01; 220R.02
- Reinstatement—See Reinstatement of Membership
- Reports of Council Action ..... 330.01
- Requirements for Admission ..... 220.01; 220R.02
- Requirements for Joint Trial Board ..... 360.01
- Requirements for Retention ..... 230.01
- Residence for Voting Purposes ..... 320.01
- Resignation—See Resignation
- Resolutions—See Resolutions of Membership
- Retention of Membership ..... 230.01; 230R.04-07
- Rights and Powers ..... 320.01
- Settlement Agreement ..... 360R.07
- Suspension—See Suspension of Membership
- Term Limit ..... 670.01
- Termination—See Termination of Membership
- Unity of Profession ..... 921.15
- Voting on Amendments ..... 840.01
- Voting Rights ..... 320.01
- Waiver of Dues ..... 450.03

**MILITARY SERVICE**

- Dues ..... 450.03

**MINUTES OF MEETINGS**

- Meetings of Council ..... 520.01

**MISSION OF THE INSTITUTE**

- Advocacy ..... 911.01
- Certificate and Licensing ..... 911.01
- Communications ..... 911.01
- Mission Statement ..... 911.01
- Recruiting and Education ..... 911.01
- Standards and Performance ..... 911.01

**N**

**NOMINATIONS**

- Council Members ..... 610.01; 670.01
- Duties of Committee ..... 360.01; 610.01
- Election of Council Members ..... 610.01; 630.01; 670.01

References are to BL section and paragraph numbers.

**NOMINATIONS**—continued

- Election of Members ..... 360R.03-04
- Election of Officers ..... 630.01
- Floor Nominations ..... 630.01
- Vacancies ..... 650R.01
- Withdrawal ..... 610R.01

**NONPAYMENT OF FINANCIAL OBLIGATION**

- Termination of Membership ..... 720.01;  
..... 720R.01-02

**NOTIFICATION**

- Charges Against Members ..... 740R.03
- Disciplinary Actions ..... 730R.05;  
..... 760.01; 760R.01
- Notice of Meetings ..... 510.01; 520.01

**O****OBJECTIVES OF INSTITUTE**

- Certificate of Incorporation ..... 101.01
- Mission Statement—See Mission of the Institute

**OBJECTIVITY**

- Description of Practice ..... 921.05

**OFFICERS OF INSTITUTE**

- Appointed by Board of Directors ..... 350.01
- Chairman of Board—See Chairman of Board of Directors
- Election by Council ..... 350.01
- Election Meetings ..... 660.01
- Election of Members ..... 601.01
- Execution of Instruments ..... 430.01
- Indemnification Provision ..... 440.01
- Nominations Committee ..... 360.01
- Organization of Institute ..... 310.01
- Powers of Council ..... 330.01
- President—See President of Institute
- Resolutions of Membership ..... 320.01
- Secretary—See Secretary of Institute
- Term of Office ..... 350R.01
- Unexpired Terms ..... 650R.01
- Vacancies ..... 650.01-02;  
..... 650R.01
- Vice Chairman—See Vice Chairman of Board of Directors
- Vice President—See Vice Presidents of Institute (Appointed)

**ORGANIZATION OF INSTITUTE**

- Board of Directors ..... 340.01; 340R.01
- Committees and Boards ..... 360.01;  
..... 360R.01-12
- Council of Institute ..... 330.01
- General Structure ..... 310.01-02
- Membership ..... 320.01
- Officers Elected by Board of Directors ..... 350.01
- Officers Elected by Council ..... 350.01;  
..... 350R.01-05

**P****PEER REVIEW BOARD**

- Authority to Make Public Statements ..... 360R.01
- Designation as Senior Committee ..... 220R.01;  
..... 360R.01
- Disciplinary Action ..... 760.01
- Election of Members ..... 220R.01
- Joint Trial Board ..... 360R.11
- Practice-Monitoring Program ..... 710R.01
- Qualifications for Membership ..... 320R.01-02
- Selection of Nominees ..... 220R.01

**PEER REVIEW COMMITTEE**

- Disciplinary Action ..... 760R.01
- Joint Trial Board ..... 360R.11
- Practice-Monitoring Program ..... 710R.01

**PEER REVIEW DIVISION**

- Activities ..... 220R.01
- Agreements With State Societies ..... 220R.01

**PERMANENT COMMITTEES, BOARDS, AND DIVISIONS**

- Composition ..... 360.01

**PERSONAL FINANCIAL PLANNING EXECUTIVE COMMITTEE**

- Authority to Make Public Statements ..... 360R.01
- Designation as Senior Committee ..... 360R.01

**PRACTICE-MONITORING PROGRAMS**

- Disciplinary Sanctions ..... 220R.02
- Institute Approved ..... 710.01; 710R.01;  
..... 760.01
- Publication of Disciplinary Action ..... 760.01
- Reinstatement of Membership ..... 710.01;  
..... 710R.01; 720R.01
- Requirement for Membership ..... 220.01;  
..... 220R.01-02; 230.01
- Termination of Membership ..... 720.01

**PRACTICE OF PUBLIC ACCOUNTING**

- Description ..... 921.01-15
- Enrollment in Practice-Monitoring Program ..... 220R.01-02
- Requirements for Membership ..... 220.01;  
..... 220R.01-02; 230.01; 230R.04-07

**PRESIDENT OF INSTITUTE**

- Appointed by Board of Directors ..... 350.01
- Duties of President ..... 350R.04
- Powers Prescribed by Board of Directors ..... 350.01
- Qualifications for Office ..... 350.01

**PRIVATE COMPANIES PRACTICE EXECUTIVE COMMITTEE**

- Authority to Make Public Statements ..... 360R.01
- Designation as Senior Committee ..... 360R.01

**PROFESSIONAL DEVELOPMENT**—See Training and Education



References are to BL section and paragraph numbers.

**PROFESSIONAL ETHICS DIVISION**

- Action on Complaints ..... 740R.02
- Action on Reinstatement ..... 710R.01
- Action on Resignations ..... 710R.01
- Administrative Reprimand ..... 360R.05-07;  
..... 740R.04
- Amendment Proposals ..... 820.01
- Complaints Against Members ..... 740R.01-04
- Continuing Professional Education  
Prescribed ..... 360R.05-06
- Disciplinary Actions ..... 730.01; 730R.01-07;  
..... 740.01-02; 740R.01-04
- Failure to Cooperate ..... 740.01-02
- Proposals to Amend Code of  
Conduct ..... 820.01
- Record of Disciplinary Actions ..... 760R.01
- Reinstatement of Membership ..... 750R.02

**PROFESSIONAL ETHICS EXECUTIVE COMMITTEE**

- Administrative Reprimand ..... 360R.05-07
- Authority to Make Public  
Statements ..... 360R.01
- Designation as Senior Committee .... 360R.01
- Disciplinary Actions ..... 730.01; 730R.01-07
- Duties of Committee ..... 360.01
- Interpretations and Amendments  
of Code ..... 360.01
- Outcome of Investigation  
of Disciplinary Action ..... 760R.01
- Qualifications for Membership .... 320R.01-02
- Settlement Agreement .... 360R.07; 740R.04;  
..... 760R.01

**PUBLIC REPRESENTATIVES**

- Elected by Council ..... 630.01
- Members of Board of Directors ..... 320.01;  
..... 340R.01; 630.01-02

**PUBLIC STATEMENTS**

- Authority to Issue ..... 360R.02

**Q**

**QUORUM**

- Meetings of Boards of Directors ..... 530.01
- Meetings of Council ..... 530.01
- Meetings of Institute ..... 530.01

**R**

**REINSTATEMENT OF MEMBERSHIP**

- Application for Reinstatement ..... 710.01;  
..... 710R.01; 720R.01-02;  
..... 720R.04; 750R.01-02
- Conditions and Procedures ..... 750.01-02
- Continuing Professional Education .... 720R.02
- Payment of Dues ..... 720R.01
- Payment of Financial Obligations ..... 720R.01
- Practice-Monitoring Programs ..... 710.01;  
..... 710R.01; 720R.02

**REPORTS**

- Actions of Board of Directors ..... 340.01
- Actions of Council ..... 330.01
- Requirement for Membership ..... 220.01;  
..... 220R.02; 230.01

**RESEARCH**

- Description of Practice ..... 921.06

**RESIGNATION**

- Membership ..... 710.01; 710R.01;  
..... 720R.03-04
- Practice-Monitoring Review ..... 360R.06;  
..... 710.01; 710R.01

**RESOLUTIONS OF COUNCIL**

- Board of Directors ..... 340R.01
- Committees of Institute ..... 360R.01-12
- Disciplinary Actions ..... 730R.01-07
- Disciplining by Trial Board ..... 740R.01-04
- Election of Council Members ..... 610R.01
- Financial Management  
and Controls ..... 401R.01
- Fiscal Year ..... 460R.01
- International Associates ..... 260R.01
- Nonpayment of Financial  
Obligations ..... 720R.01-04
- Officers of Institute ..... 350R.01-05
- Publication of Disciplinary Action ..... 760R.01
- Reinstatement of Membership .... 750R.01-02
- Resignation of Membership ..... 710R.01
- Retention of Membership ..... 230R.04-07
- Term Limit ..... 670.01
- Vacancies ..... 650R.01

**RESOLUTIONS OF MEMBERSHIP**

- Positions That May Be Held by  
Non-Members ..... 320R.01-02
- Rights and Powers ..... 320.01; 510.01

**RETENTION OF MEMBERSHIP—See Membership**

**RETROACTIVITY**

- Disciplinary Sanctions ..... 770.01

**RIGHTS**

- Administrative Reprimand ..... 360R.05-07
- Attendance at Meetings ..... 320.01
- Designation as Members of Institute ... 250.01
- Resolutions ..... 320.01
- Settlement Agreement ..... 360R.07
- Voting—See Voting Rights

**RULES OF PROCEDURE**

- Meeting of Institute and Council ..... 530.01

**S**

**SANCTIONS—See Disciplinary Sanctions**

**SCOPE OF PRACTICE**

- Specialization of CPAs ..... 921.14

**SCOPE OF RESPONSIBILITY**

- Senior Committees ..... 360.01

References are to BL section and paragraph numbers.

**SECRETARY OF INSTITUTE**

- Appointed by Board of Directors ..... 350.01
- Duties of Secretary ..... 350R.05; 610.01
- Member of Board of Directors ..... 320.01
- Powers Prescribed by Board  
of Directors ..... 350.01
- Qualifications for Office ..... 350.01

**SECURITIES AND EXCHANGE COMMISSION**

- Description of Practice ..... 921.12

**SPECIALIZATION**

- Scope of Practice ..... 921.14

**STAFF MEMBERS**

- Organization of Institute ..... 310.02
- Resolutions Binding on Staff ..... 320.01

**STANDARDS OF PERFORMANCE**

- Description of Practice ..... 921.13
- Mission Statement of the Institute ..... 911.01

**STANDARDS, TECHNICAL**—See Technical Standards**STATE SOCIETIES, CPA**

- Agreement With Institute .... 360R.13; 740.02;  
..... 740R.01
- Disciplining of Member ..... 740R.01-04
- Joint Trial Board ..... 360R.13
- Notification to Member ..... 740R.03
- Representation on Council ..... 620.01
- Selection of Council Members ..... 330.01;  
..... 610.01

**SUSPENSION OF ASSOCIATION**

- Return of Certificate ..... 240.01

**SUSPENSION OF MEMBERSHIP**

- Criminal Conviction ..... 730.01; 730R.01
- Disciplinary Actions ..... 730.01; 730R.01-07;  
..... 740.01; 740R.03
- Introduction ..... 701.01
- Publication of Reinstatement ..... 750R.01
- Reinstatement ..... 750.01; 750R.01-02
- Return of Certificate ..... 240.01

**T****TAX EXECUTIVE COMMITTEE**

- Authority to Make Public Statements ..... 360R.01
- Designation as Senior Committee .... 360R.01

**TAX RETURNS**

- Description of Practice ..... 921.11
- Failure to File ..... 730.01
- False or Fraudulent Returns ..... 730.01

**TECHNICAL STANDARDS**

- Adopted by Profession ..... 921.07

**TERM OF OFFICE**

- Members of Council ..... 610.01; 630.01;  
..... 660.01
- Officers of Institute ..... 350R.01
- State Society Representatives  
on Council ..... 620.01
- Unexpired ..... 650.01-02; 650R.01

**TERMINATION OF AFFILIATION**

- International Associates ..... 720.01

**TERMINATION OF MEMBERSHIP**

- Continuing Professional Education ..... 720.01
- Criminal Conviction ..... 730.01; 730R.02
- Disciplinary Actions ..... 730.01; 730R.01-07  
..... 740.01; 740R.03
- Introduction ..... 701.01
- Nonpayment of Financial  
Obligations ..... 720.01; 720R.01-02
- Notification by Mail ..... 730R.01
- Practice-Monitoring Programs ..... 720.01
- Publication of Reinstatement ..... 750R.01
- Reinstatement ..... 750.01; 750R.01-02
- Reinstatement Application ..... 720R.04
- Return of Certificate ..... 240.01
- Voluntary ..... 701.01

**TRAINING AND EDUCATION**

- Continuing Professional Education ..... 230.01;  
..... 230R.04-07; 720.01;  
..... 720R.02
- Description of Practice ..... 921.06-07
- Mission Statement of the Institute ..... 911.01
- Reinstatement of Membership ..... 720R.02
- Required by Ethics Division ..... 360R.05-06
- Requirement for Membership ..... 220.01
- Retention of Membership ..... 230.01;  
..... 230R.04-07
- Termination of Membership ..... 720.01

**U****UNIFORM CPA EXAMINATION**—See

Examination, Uniform CPA

**V****VACANCIES**

- Board of Directors ..... 650.01-02; 650R.01
- Council of Institute ..... 610.01; 610R.01;  
..... 650.01-02; 650R.01
- Mail Ballot ..... 650.01; 650R.01
- Officers of Institute ..... 650.01-02; 650R.01

**VICE CHAIRMAN OF BOARD OF DIRECTORS**

- Duties ..... 350R.03
- Election by Council ..... 350.01;  
..... 350R.01
- Election to Board ..... 630.01
- Powers Prescribed by Council ..... 350.01
- Qualifications for Office ..... 350.01
- Term of Office ..... 350R.01

**VICE PRESIDENTS OF INSTITUTE  
(APPOINTED)**

- Appointed by Board of Directors ..... 350.01
- Duties Assigned by President ..... 350.01
- Term of Office ..... 350R.01

**VOTING RIGHTS**

- Amendments ..... 830.01; 840.01
- Entitlement to Vote ..... 320.01



**PC****PUBLIC COMPANY ACCOUNTING  
OVERSIGHT BOARD STANDARDS  
AND AUDITS OF PUBLIC COMPANIES**

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The full text of the PCAOB's releases can be found in the AICPA's *PCAOB Standards and Related Rules (Including Select SEC-Approved PCAOB Releases and Staff Guidance)*. The PCAOB releases are also available on *AICPA reSOURCE: Online Accounting and Auditing Literature*. For subscription information, visit [www.cpa2biz.com](http://www.cpa2biz.com)

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## VS Section

# STATEMENTS ON STANDARDS FOR VALUATION SERVICES

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## TABLE OF CONTENTS

<i>Section</i>	<i>Paragraph</i>
100	Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset
	Introduction and Scope ..... .01-.10
	Exceptions From This Statement ..... .05-.10
	Overall Engagement Considerations ..... .11-.20
	Professional Competence ..... .11-.12
	Nature and Risks of the Valuation Services and Expectations of the Client ..... .13
	Objectivity and Conflict of Interest ..... .14
	Independence and Valuation ..... .15
	Establishing an Understanding With the Client ..... .16-.18
	Scope Restrictions or Limitations ..... .19
	Using the Work of Specialists in the Engagement to Estimate Value ..... .20
	Development ..... .21-.46
	Types of Engagement ..... .21
	Hypothetical Conditions ..... .22
	Valuation Engagement ..... .23-.42
	Subsequent Events ..... .43
	Documentation ..... .44-.45
	Calculation Engagement ..... .46
	The Valuation Report ..... .47-.78
	Reporting Exemption for Certain Controversy Proceedings ..... .50
	Detailed Report ..... .51
	Introduction ..... .52-.70
	Summary Report ..... .71-.72
	Calculation Report ..... .73-.77
	Oral Report ..... .78
	Effective Date ..... .79
	Appendix A—Illustrative List of Assumptions and Limiting Conditions for a Business Valuation ..... .80
	Appendix B—International Glossary of Business Valuation Terms ..... .81
	Appendix C—Glossary of Additional Terms ..... .82

<i>Section</i>		<i>Paragraph</i>
9100	Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset: Valuation Services Interpretations of Section 100	
	Background .....	.01
	General Interpretation .....	.02-.04
	Specific Illustrations .....	.05
	Illustrations Relating to Litigation Engagements and Certain Controversy Proceedings .....	.06-.15
	Illustrations Relating to Tax Engagements .....	.16-.71
	Illustrations Relating to Other Engagements .....	.72-.81
	Illustrations for PFP-Specific Engagements .....	.82-.89

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## VS Section 100

# Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset

June 2007

## Foreword

### Why Issued

Valuations of businesses, business ownership interests, securities, or intangible assets (hereinafter collectively referred to in this Foreword as *business valuations*) may be performed for a wide variety of purposes including the following:

1. Transactions (or potential transactions), such as acquisitions, mergers, leveraged buyouts, initial public offerings, employee stock ownership plans and other share based plans, partner and shareholder buy-ins or buyouts, and stock redemptions.
2. Litigation (or pending litigation) relating to matters such as marital dissolution, bankruptcy, contractual disputes, owner disputes, dissenting shareholder and minority ownership oppression cases, and employment and intellectual property disputes.
3. Compliance-oriented engagements, including (a) financial reporting and (b) tax matters such as corporate reorganizations; S corporation conversions; income, estate, and gift tax compliance; purchase price allocations; and charitable contributions.
4. Planning oriented engagements for income tax, estate tax, gift tax, mergers and acquisitions, and personal financial planning.

In recent years, the need for business valuations has increased significantly. Performing an engagement to estimate value involves special knowledge and skill.

Given the increasing number of members of the AICPA who are performing business valuation engagements or some aspect thereof, the AICPA Consulting Services Executive Committee has written this standard to improve the consistency and quality of practice among AICPA members performing business valuations. AICPA members will be required to follow this standard when they perform engagements to estimate value that culminate in the expression of a conclusion of value or a calculated value.

The Consulting Services Executive Committee is a body designated by AICPA Council to promulgate technical standards under Rule 201, *General Standards* [ET section 201.01], and Rule 202, *Compliance With Standards* [ET section 202.01], of the AICPA *Code of Professional Conduct*.

## Introduction and Scope

.01 This Statement establishes standards for AICPA members (hereinafter referred to in this Statement as *members*) who are engaged to, or, as part of another engagement, estimate the value of a **business**,<sup>1</sup> *business ownership*

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<sup>1</sup> This Statement includes two glossaries. Appendix B [paragraph .81] is the International Glossary of Business Valuation Terms (IGBVT), jointly developed by the AICPA, the American Society of Appraisers (ASA), the Canadian Institute of Chartered Business Valuators, the National Association

(continued)



*interest, security, or intangible asset* (hereinafter collectively referred to in this Statement as **subject interest**). For purposes of this Statement, the definition of a business includes not-for-profit entities or activities.

**.02** As described in this Statement, the term **engagement to estimate value** refers to an engagement or any part of an engagement (for example, a tax, litigation, or acquisition-related engagement) that involves estimating the value of a subject interest. An engagement to estimate value culminates in the expression of either a **conclusion of value** or a **calculated value** (see paragraph .21). A member who performs an engagement to estimate value is referred to, in this Statement, as a **valuation analyst**.

**.03** Valuation analysts should be aware of any governmental regulations and other professional standards applicable to the engagement, including the AICPA *Code of Professional Conduct* and the Statement on Standards for Consulting Services (SSCS) No. 1, *Consulting Services: Definitions and Standards* [CS section 100], and the extent to which they apply to engagements to estimate value. Compliance is the responsibility of the valuation analyst.

**.04** In the process of estimating value as part of an engagement, the valuation analyst applies **valuation approaches** and **valuation methods**, as described in this Statement, and uses professional judgment. The use of professional judgment is an essential component of estimating value.

## Exceptions From This Statement

**.05** This Statement is not applicable to a member who participates in estimating the value of a subject interest as part of performing an attest engagement defined by Rule 101 of the AICPA *Code of Professional Conduct* [ET section 101.01] (for example, as part of an audit, review, or compilation engagement).

**.06** This Statement is not applicable when the value of a subject interest is provided to the member by the client or a third party, and the member does not apply valuation approaches and methods, as discussed in this Statement.

**.07** This Statement is not applicable to internal use assignments from employers to employee members not in the practice of public accounting, as that term is defined in the AICPA *Code of Professional Conduct* [ET section 92.25]. (Interpretation No. 1, "Scope of Applicable Services," [VS section 9100], Illustrations 24 and 25 [VS section 9100.78–.81].)

**.08** This Statement is not applicable to engagements that are exclusively for the purpose of determining economic damages (for example, lost profits) unless those determinations include an engagement to estimate value. See also Interpretation No. 1, Illustrations 1, 2, and 3 [VS section 9100.06–.11].

**.09 (a)** This Statement is not applicable to mechanical computations that do not rise to the level of an engagement to estimate value; that is, when the member does not apply valuation approaches and methods and does not use professional judgment. See Interpretation No. 1, Illustration 8 [VS section 9100.20–.23].

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*(footnote continued)*

of Certified Valuation Analysts, and the Institute of Business Appraisers. The IGBVT is reproduced verbatim in Appendix B, "International Glossary of Business Valuation Terms [paragraph .81]. Appendix C [paragraph .82] provides definitions for terms included in this Statement, but not defined in the IGBVT. The terms defined in Appendix B [paragraph .81] are in boldface type the first time they appear in this Statement; the terms defined in Appendix C [paragraph .82] are in italicized boldface type the first time they appear in this Statement.

(b) This Statement is not applicable when it is not practical or not reasonable to obtain or use relevant information; as a result, the member is unable to apply valuation approaches and methods that are described in this Statement.<sup>2</sup>

### ***Jurisdictional Exception***

.10 If any part of this Statement differs from published governmental, judicial, or accounting authority, or such authority specifies valuation development procedures or valuation reporting procedures, then the valuation analyst should follow the applicable published authority or stated procedures with respect to that part applicable to the valuation in which the member is engaged. The other parts of this Statement continue in full force and effect (Interpretation No. 1 [VS section 9100.01–.89]).

## **Overall Engagement Considerations**

### **Professional Competence**

.11 Rule 201A, *Professional Competence*, of the AICPA Code of Professional Conduct [ET section 201.01], states that a member shall "undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence." Performing a valuation engagement with professional competence involves special knowledge and skill. A valuation analyst should possess a level of knowledge of valuation principles and theory and a level of skill in the application of such principles that will enable him or her to identify, gather, and analyze data, consider and apply appropriate valuation approaches and methods, and use professional judgment in developing the estimate of value (whether a single amount or a range). An in-depth discussion of valuation theory and principles, and how and when to apply them, is not within the scope of this Statement.

.12 In determining whether he or she can reasonably expect to complete the valuation engagement with professional competence, the valuation analyst should consider, at a minimum, the following:

- a. Subject entity and its industry
- b. Subject interest
- c. **Valuation date**
- d. Scope of the valuation engagement
  - i. Purpose of the valuation engagement
  - ii. **Assumptions and limiting conditions** expected to apply to the valuation engagement (paragraph .18)
  - iii. Applicable **standard of value** (for example, *fair value* or **fair market value**), and the applicable **premise of value** (for example, going concern)
  - iv. Type of valuation report to be issued (paragraph .48), intended use and users of the report, and restrictions on the use of the report
- e. Governmental regulations or other professional standards that apply to the subject interest or to the valuation engagement

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<sup>2</sup> Unless prohibited by statute or by rule, a member may use the client's estimates for compliance reporting to a third party if the member determines that the estimates are reasonable (based on the facts and circumstances known to the member). See Interpretation No. 1 [VS section 9100.01–.89], and Statement for Standards on Tax Services No. 4, *Use of Estimates* [TS section 400].

## Nature and Risks of the Valuation Services and Expectations of the Client

.13 In understanding the nature and risks of the *valuation services* to be provided, and the expectations of the client, the valuation analyst should consider the matters in paragraph .12, and in addition, at a minimum, the following:

- a. The proposed terms of the valuation engagement
- b. The identity of the client
- c. The nature of the interest and ownership rights in the business, business interest, security, or intangible asset being valued, including **control** characteristics and the degree of **marketability** of the interest
- d. The procedural requirements of a valuation engagement and the extent, if any, to which procedures will be limited by either the client or circumstances beyond the client's or the valuation analyst's control
- e. The use of and limitations of the report, and the conclusion or calculated value
- f. Any obligation to update the valuation

## Objectivity and Conflict of Interest

.14 The AICPA *Code of Professional Conduct* requires objectivity in the performance of all professional services, including valuation engagements. Objectivity is a state of mind. The principle of objectivity imposes the obligation to be impartial, intellectually honest, disinterested, and free from conflicts of interest. If necessary, where a potential conflict of interest may exist, a valuation analyst should make the disclosures and obtain consent as required under Interpretation No. 102-2, "Conflicts of Interest," under Rule 102, *Integrity and Objectivity* [ET section 102.03].

## Independence and Valuation

.15 If valuation services are performed for a client for which the valuation analyst or valuation analyst's firm also performs an attest engagement (defined by Rule 101 of the AICPA *Code of Professional Conduct*), the valuation analyst should meet the requirements of Interpretation No. 101-3, "Performance of Nonattest Services," under Rule 101, *Independence* [ET section 101.05], so as not to impair the member's independence with respect to the client.

## Establishing an Understanding With the Client

.16 The valuation analyst should establish an understanding with the client, preferably in writing, regarding the engagement to be performed. If the understanding is oral, the valuation analyst should document that understanding by appropriate memoranda or notations in the working papers. (If the engagement is being performed for an attest client, AICPA Ethics Interpretation 101-3 requires the engagement understanding to be in writing.) Regardless of whether the understanding is written or oral, the valuation analyst should modify the understanding if he or she encounters circumstances during the engagement that make it appropriate to modify that understanding.

.17 The understanding with the client reduces the possibility that either the valuation analyst or the client may misinterpret the needs or expectations of the other party. The understanding should include, at a minimum, the nature,

purpose, and objective of the valuation engagement, the client's responsibilities, the valuation analyst's responsibilities, the applicable assumptions and limiting conditions, the type of report to be issued, and the standard of value to be used.

### **Assumptions and Limiting Conditions**

.18 Assumptions and limiting conditions are common to valuation engagements. Examples of typical assumptions and limiting conditions for a business valuation are provided in Appendix A, "Illustrative List of Assumptions and Limiting Conditions for a Business Valuation" [paragraph .80]. The assumptions and limiting conditions should be disclosed in the valuation report (paragraphs .52*l*, .68*g*, and .71*m*).

### **Scope Restrictions or Limitations**

.19 A restriction or limitation on the scope of the valuation analyst's work, or the data available for analysis, may be present and known to the valuation analyst at the outset of the valuation engagement or may arise during the course of a valuation engagement. Such a restriction or limitation should be disclosed in the valuation report (paragraphs .52*m*, .68*e*, and .71*n*).

### **Using the Work of Specialists in the Engagement to Estimate Value**

.20 In performing an engagement to estimate value, the valuation analyst may rely on the work of a third party specialist (for example, a real estate or equipment appraiser). The valuation analyst should note in the assumptions and limiting conditions the level of responsibility, if any, being assumed by the valuation analyst for the work of the third party specialist. At the option of the valuation analyst, the written report of the third party specialist may be included in the valuation analyst's report.

## **Development**

### **Types of Engagement**

.21 There are two types of engagements to estimate value—a **valuation engagement** and a **calculation engagement**. The valuation engagement requires more procedures than does the calculation engagement. The valuation engagement results in a conclusion of value. The calculation engagement results in a calculated value. The type of engagement is established in the understanding with the client (paragraphs .16 and .17):

- a. *Valuation engagement*—A valuation analyst performs a valuation engagement when (1) the engagement calls for the valuation analyst to estimate the value of a subject interest and (2) the valuation analyst estimates the value (as outlined in paragraphs .23–.45) and is free to apply the valuation approaches and methods he or she deems appropriate in the circumstances. The valuation analyst expresses the results of the valuation as a conclusion of value; the conclusion may be either a single amount or a range.
- b. *Calculation engagement*—A valuation analyst performs a calculation engagement when (1) the valuation analyst and the client agree on the valuation approaches and methods the valuation analyst will use and the extent of procedures the valuation analyst will perform in the

process of calculating the value of a subject interest (these procedures will be more limited than those of a valuation engagement) and (2) the valuation analyst calculates the value in compliance with the agreement. The valuation analyst expresses the results of these procedures as a calculated value. The calculated value is expressed as a range or as a single amount. A calculation engagement does not include all of the procedures required for a valuation engagement (paragraph .46).

## Hypothetical Conditions

.22 Hypothetical conditions affecting the subject interest may be required in some circumstances. When a valuation analyst uses hypothetical conditions during a valuation or calculation engagement, he or she should indicate the purpose for including the hypothetical conditions and disclose these conditions in the valuation or calculation report (paragraphs .52*n*, .71*o*, and .74).

## Valuation Engagement

.23 In performing a valuation engagement, the valuation analyst should:

- Analyze the subject interest (paragraphs .25–.30)
- Consider and apply appropriate valuation approaches and methods (paragraphs .31–.42)
- Prepare and maintain appropriate documentation (paragraphs .44–.45)

.24 Even though the list in paragraph .23 and some requirements and guidance in this Statement are presented in a manner that suggests a sequential valuation process, valuations involve an ongoing process of gathering, updating, and analyzing information. Accordingly, the sequence of the requirements and guidance in this Statement may be implemented differently at the option of the valuation analyst.

## *Analysis of the Subject Interest*

.25 The analysis of the subject interest will assist the valuation analyst in considering, evaluating, and applying the various valuation approaches and methods to the subject interest. The nature and extent of the information needed to perform the analysis will depend on, at a minimum, the following:

- Nature of the subject interest
- Scope of the valuation engagement
- Valuation date
- Intended use of the valuation
- Applicable standard of value
- Applicable **premise of value**
- Assumptions and limiting conditions
- Applicable governmental regulations or other professional standards

.26 In analyzing the subject interest, the valuation analyst should consider financial and nonfinancial information. The type, availability, and significance of such information vary with the subject interest.

*Nonfinancial information*

.27 The valuation analyst should, as available and applicable to the valuation engagement, obtain sufficient nonfinancial information to enable him or her to understand the subject entity, including its:

- Nature, background, and history
- Facilities
- Organizational structure
- Management team (which may include officers, directors, and key employees)
- Classes of **equity** ownership interests and rights attached thereto
- Products or services, or both
- Economic environment
- Geographical markets
- Industry markets
- Key customers and suppliers
- Competition
- **Business risks**
- Strategy and future plans
- Governmental or regulatory environment

***Ownership Information***

.28 The valuation analyst should obtain, where applicable and available, ownership information regarding the subject interest to enable him or her to:

- Determine the type of ownership interest being valued and ascertain whether that interest exhibits control characteristics
- Analyze the different ownership interests of other owners and assess the potential effect on the value of the subject interest
- Understand the classes of equity ownership interests and rights attached thereto
- Understand the rights included in, or excluded from, each intangible asset
- Understand other matters that may affect the value of the subject interest, such as:
  - *For a business, business ownership interest, or security:* shareholder agreements, partnership agreements, operating agreements, voting trust agreements, buy-sell agreements, loan covenants, restrictions, and other contractual obligations or restrictions affecting the owners and the subject interest
  - *For an intangible asset:* legal rights, licensing agreements, sublicense agreements, nondisclosure agreements, development rights, commercialization or exploitation rights, and other contractual obligations

***Financial Information***

.29 The valuation analyst should obtain, where applicable and available, financial information on the subject entity such as:

- Historical financial information (including annual and interim financial statements and key financial statement ratios and statistics) for an appropriate number of years
- Prospective financial information (for example, budgets, forecasts, and projections)
- Comparative summaries of financial statements or information covering a relevant time period
- Comparative common size financial statements for the subject entity for an appropriate number of years
- Comparative common size industry financial information for a relevant time period
- Income tax returns for an appropriate number of years
- Information on compensation for owners including benefits and personal expenses
- Information on key man or officers' life insurance
- Management's response to inquiry regarding:
  - Advantageous or disadvantageous contracts
  - Contingent or off-balance-sheet assets or liabilities
  - Information on prior sales of company stock

.30 The valuation analyst should read and evaluate the information to determine that it is reasonable for the purposes of the engagement.

### ***Valuation Approaches and Methods***

.31 In developing the valuation, the valuation analyst should consider the three most common valuation approaches:

- **Income (Income-based) approach**
- **Asset (Asset-based) approach** (used for businesses, business ownership interests, and securities) or **cost approach** (used for intangible assets)
- **Market (Market-based) approach**

.32 The valuation analyst should use the valuation approaches and methods that are appropriate for the valuation engagement. General guidance on the use of approaches and methods appears in paragraphs .33–.41, but detailed guidance on specific valuation approaches and methods and their applicability is outside the scope of this Statement.

.33 *Income Approach.* Two frequently used valuation methods under the income approach include the **capitalization of benefits method** (for example, earnings or cash flows) and the **discounted future benefits method** (for example, earnings or cash flows). When applying these methods, the valuation analyst should consider a variety of factors, including but not limited to, the following:

- a. *Capitalization of benefits (for example, earnings or cash flows) method.* The valuation analyst should consider the following:
  - **Normalization** adjustments
  - Nonrecurring revenue and expense items
  - Taxes
  - **Capital structure** and financing costs

- Appropriate capital investments
  - Noncash items
  - Qualitative judgments for risks used to compute discount and **capitalization rates**
  - Expected changes (growth or decline) in future benefits (for example, earnings or cash flows)
- b. *Discounted future benefits method (for example, earnings or cash flows).* In addition to the items in item a above, the valuation analyst should consider:
- Forecast/projection assumptions
  - Forecast/projected earnings or cash flows
  - **Terminal value**
- c. For an intangible asset, the valuation analyst should also consider, when relevant:
- Remaining useful life
  - Current and anticipated future use of the intangible asset
  - Rights attributable to the intangible asset
  - Position of intangible asset in its life cycle
  - Appropriate discount rate for the intangible asset
  - Appropriate **capital or contributory asset charge**, if any
  - Research and development or marketing expense needed to support the intangible asset in its existing state
  - Allocation of income (for example, **incremental income**, **residual income**, or **profit split income**) to intangible asset
  - Whether any tax amortization benefit would be included in the analysis
  - Discounted multi-year excess earnings
  - Market royalties
  - Relief from royalty

### **Asset Approach and Cost Approach**

**.34** A frequently used method under the asset approach is the adjusted net asset method. When using the adjusted net asset method in valuing a business, business ownership interest, or security, the valuation analyst should consider, as appropriate, the following information related to the premise of value:

- Identification of the assets and liabilities
- Value of the assets and liabilities (individually or in the aggregate)
- Liquidation costs (if applicable)

**.35** When using methods under the cost approach to value intangible assets, the valuation analyst should consider the type of cost to be used (for example, reproduction cost or replacement cost), and, where applicable, the appropriate forms of depreciation and obsolescence and the remaining useful life of the intangible asset.



### **Market Approach**

.36 Three frequently used valuation methods under the market approach for valuing a business, business ownership interest, or security are:

- **Guideline public company method**
- **Guideline company transactions method**
- Guideline sales of interests in the subject entity, such as business ownership interests or securities

Three frequently used market approach valuation methods for intangible assets are:

- Comparable uncontrolled transactions method (which is based on arm's-length sales or licenses of guideline intangible assets)
- Comparable profit margin method (which is based on comparison of the profit margin earned by the subject entity that owns or operates the intangible asset to profit margins earned by guideline companies)
- **Relief from royalty method** (which is based on the royalty rate, often expressed as a percentage of revenue that the subject entity that owns or operates the intangible asset would be obligated to pay to a hypothetical third-party licensor for the use of that intangible asset)

For the methods involving guideline intangible assets (for example, the comparable profit margin method), the valuation analyst should consider the subject intangible asset's remaining useful life relative to the remaining useful life of the guideline intangible assets, if available.

.37 In applying the methods listed in paragraph .36 or other methods to determine valuation pricing multiples or metrics, the valuation analyst should consider:

- Qualitative and quantitative comparisons
- Arm's-length transactions and prices
- The dates and, consequently, the relevance of the market data

.38 The valuation analyst should set forth in the report the rationale and support for the valuation methods used (paragraph .47).

.39 *Rules of Thumb*. Although technically not a valuation method, some valuation analysts use rules of thumb or industry benchmark indicators (hereinafter, collectively referred to as **rules of thumb**) in a valuation engagement. A rule of thumb is typically a reasonableness check against other methods used and should generally not be used as the only method to estimate the value of the subject interest.

### **Valuation Adjustments**

.40 During the course of a valuation engagement, the valuation analyst should consider whether valuation adjustments (discounts or premiums) should be made to a **pre-adjustment** value. Examples of valuation adjustments for valuation of a business, business ownership interest, or security include a **discount for lack of marketability or liquidity** and a **discount for lack of control**. An example of a valuation adjustment for valuation of an intangible asset is obsolescence.

.41 When valuing a controlling ownership interest under the income approach, the value of any **nonoperating assets**, nonoperating liabilities, or **excess or deficient operating assets** should be excluded from the computation of the value based on the operating assets and should be added to or

deleted from the value of the operating entity. When valuing a noncontrolling ownership interest under the income approach, the value of any nonoperating assets, nonoperating liabilities, or excess or deficient operating assets may or may not be used to adjust the value of the operating entity depending on the valuation analyst's assessment of the influence exercisable by the noncontrolling interest. In the asset-based or cost approach, it may not be necessary to separately consider nonoperating assets, nonoperating liabilities, or excess or deficient operating assets.

### **Conclusion of Value**

- .42** In arriving at a conclusion of value, the valuation analyst should:
- a. Correlate and reconcile the results obtained under the different approaches and methods used.
  - b. Assess the reliability of the results under the different approaches and methods using the information gathered during the valuation engagement.
  - c. Determine, based on items *a* and *b*, whether the conclusion of value should reflect (1) the results of one valuation approach and method or (2) a combination of the results of more than one valuation approach and method.

### **Subsequent Events**

**.43** The valuation date is the specific date at which the valuation analyst estimates the value of the subject interest and concludes on his or her estimation of value. Generally, the valuation analyst should consider only circumstances existing at the valuation date and events occurring up to the valuation date. An event that could affect the value may occur subsequent to the valuation date; such an occurrence is referred to as a **subsequent event**. Subsequent events are indicative of conditions that were not known or knowable at the valuation date, including conditions that arose subsequent to the valuation date. The valuation would not be updated to reflect those events or conditions. Moreover, the valuation report would typically not include a discussion of those events or conditions because a valuation is performed as of a point in time—the valuation date—and the events described in this subparagraph, occurring subsequent to that date, are not relevant to the value determined as of that date. In situations in which a valuation is meaningful to the intended user beyond the valuation date, the events may be of such nature and significance as to warrant disclosure (at the option of the valuation analyst) in a separate section of the report in order to keep users informed (paragraphs *.52p*, *.71r*, and *.74*). Such disclosure should clearly indicate that information regarding the events is provided for informational purposes only and does not affect the determination of value as of the specified valuation date.

### **Documentation**

**.44** Documentation is the principal record of information obtained and analyzed, procedures performed, valuation approaches and methods considered and used, and the conclusion of value. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment. Documentation may include:

- Information gathered and analyzed to obtain an understanding of matters that may affect the value of the subject interest (paragraphs *.25–.30*)

- Assumptions and limiting conditions (paragraph .18)
- Any restriction or limitation on the scope of the valuation analyst's work or the data available for analysis (paragraph .19)
- Basis for using any **valuation assumption** during the valuation engagement
- Valuation approaches and methods considered
- Valuation approaches and methods used including the rationale and support for their use
- If applicable, information relating to subsequent events considered by the valuation analyst (paragraph .43)
- For any rule of thumb used in the valuation, source(s) of data used, and how the rule of thumb was applied (paragraph .39)
- Other documentation considered relevant to the engagement by the valuation analyst

.45 The valuation analyst should retain the documentation for a period of time sufficient to meet the needs of applicable legal, regulatory, or other professional requirements for records retention.

## Calculation Engagement

.46 In performing a calculation engagement, the valuation analyst should consider, at a minimum, the following:

- a. Identity of the client
- b. Identity of the subject interest
- c. Whether or not a business interest has ownership control characteristics and its degree of marketability
- d. Purpose and intended use of the calculated value
- e. Intended users of the report and the limitations on its use
- f. Valuation date
- g. Applicable premise of value
- h. Applicable standard of value
- i. Sources of information used in the calculation engagement
- j. Valuation approaches or valuation methods agreed upon with the client
- k. Subsequent events, if applicable (paragraph .43)

In addition, the valuation analyst should comply with the documentation requirements listed in paragraphs .44 and .45. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment.

## The Valuation Report

.47 A valuation report is a written or oral communication to the client containing the conclusion of value or the calculated value of the subject interest. Reports issued for purposes of certain controversy proceedings are exempt from this reporting standard (paragraph .50).

.48 The three types of written reports that a valuation analyst may use to communicate the results of an engagement to estimate value are: for a valuation engagement, a detailed report or a summary report; and for a calculation engagement, a calculation report.

### For a Valuation Engagement

- a. *Detailed Report:* This report may be used only to communicate the results of a valuation engagement (conclusion of value); it should not be used to communicate the results of a calculation engagement (calculated value) (paragraph .51).
- b. *Summary Report:* This report may be used only to communicate the results of a valuation engagement (conclusion of value); it should not be used to communicate the results of a calculation engagement (calculated value) (paragraph .71).

For a valuation engagement, the determination of whether to prepare a detailed report or a summary report is based on the level of reporting detail agreed to by the valuation analyst and the client.

### For a Calculation Engagement

- c. *Calculation Report:* This type of report should be used only to communicate the results of a calculation engagement (calculated value); it should not be used to communicate the results of a valuation engagement (conclusion of value) (paragraph .73).

**.49** The valuation analyst should indicate in the valuation report the restrictions on the use of the report (which may include restrictions on the users of the report, the uses of the report by such users, or both) (paragraph .65d).

## Reporting Exemption for Certain Controversy Proceedings

**.50** A valuation performed for a matter before a court, an arbitrator, a mediator or other facilitator, or a matter in a governmental or administrative proceeding, is exempt from the reporting provisions of this Statement. The reporting exemption applies whether the matter proceeds to trial or settles. The exemption applies only to the reporting provisions of this Statement (paragraphs .47–.49 and .51–.78). The developmental provisions of the Statement (paragraphs .21–.46) still apply whenever the valuation analyst expresses a conclusion of value or a calculated value (Interpretation No. 1 [VS section 9100.01–.89]).

## Detailed Report

**.51** The *detailed report* is structured to provide sufficient information to permit intended users to understand the data, reasoning, and analyses underlying the valuation analyst's conclusion of value. A detailed report should include, as applicable, the following sections titled using wording similar in content to that shown:

- Letter of transmittal
- Table of contents
- Introduction
- Sources of information
- Analysis of the subject entity and related nonfinancial information
- Financial statement/information analysis
- Valuation approaches and methods considered
- Valuation approaches and methods used
- Valuation adjustments

- Nonoperating assets, nonoperating liabilities, and excess or deficient operating assets (if any)
- Representation of the valuation analyst
- Reconciliation of estimates and conclusion of value
- Qualifications of the valuation analyst
- Appendices and exhibits

The above listed report sections and the detailed information within the sections described in the following paragraphs .52–.77 may be positioned in the body of the report or elsewhere in the report at the discretion of the valuation analyst.

## Introduction

**.52** This section should provide an overall description of the valuation engagement. The information in the section should be sufficient to enable the intended user of the report to understand the nature and scope of the valuation engagement, as well as the work performed. The introduction section may include, among other things, the following information:

- a. Identity of the client
- b. Purpose and intended use of the valuation
- c. Intended users of the valuation
- d. Identity of the subject entity
- e. Description of the subject interest
- f. Whether the business interest has ownership control characteristics and its degree of marketability
- g. Valuation date
- h. Report date
- i. Type of report issued (namely, a detailed report) (paragraph .51)
- j. Applicable premise of value
- k. Applicable standard of value
- l. Assumptions and limiting conditions (alternatively, these often appear in an appendix) (paragraph .18)
- m. Any restrictions or limitations in the scope of work or data available for analysis (paragraph .19)
- n. Any hypothetical conditions used in the valuation engagement, including the basis for their use (paragraph .22)
- o. If the work of a specialist was used in the valuation engagement, a description of how the specialist's work was relied upon (paragraph .20)
- p. Disclosure of subsequent events in certain circumstances (paragraph .43)
- q. Any application of the jurisdictional exception (paragraph .10)
- r. Any additional information the valuation analyst deems useful to enable the user(s) of the report to understand the work performed

If the above items are not included in the introduction, they should be included elsewhere in the valuation report.

### **Sources of Information**

**.53** This section of the report should identify the relevant sources of information used in performing the valuation engagement. It may include, among other things, the following:

- a. For valuation of a business, business ownership interest, or security, whether and to what extent the subject entity's facilities were visited
- b. For valuation of an intangible asset, whether the legal registration, contractual documentation, or other tangible evidence of the asset was inspected
- c. Names, positions, and titles of persons interviewed and their relationships to the subject interest
- d. Financial information (paragraphs .54 and .56)
- e. Tax information (paragraph .55)
- f. Industry data
- g. Market data
- h. Economic data
- i. Other empirical information
- j. Relevant documents and other sources of information provided by or related to the entity

**.54** If the financial information includes financial statements that were reported on (audit, review, compilation, or attest engagement performed under the Statements on Standards for Attestation Engagements (SSAEs) [AT sections 20–701]) by the valuation analyst's firm, the valuation report should disclose this fact and the type of report issued. If the valuation analyst or the valuation analyst's firm did not audit, review, compile, or attest under the SSAs [AT sections 20–701] to the financial information, the valuation analyst should so state and should also state that the valuation analyst assumes no responsibility for the financial information.

**.55** The financial information may be derived from or may include information derived from tax returns. With regard to such derived information and other tax information (paragraph .53e), the valuation analyst should identify the tax returns used and any existing relationship between the valuation analyst and the tax preparer. If the valuation analyst or the valuation analyst's firm did not audit, review, compile, or attest under the SSAs [AT sections 20–701] to any financial information derived from tax returns that is used during the valuation engagement, the valuation analyst should so state and should also state that the valuation analyst assumes no responsibility for that derived information.

**.56** If the financial information used was derived from financial statements prepared by management that were not the subject of an audit, review, compilation, or attest engagement performed under the SSAs, the valuation report should:

- Identify the financial statements
- State that, as part of the valuation engagement, the valuation analyst did not audit, review, compile, or attest under the SSAs [AT sections 20–710] to the financial information and assumes no responsibility for that information

### ***Analysis of the Subject Entity and Related Nonfinancial Information***

.57 The valuation analyst should include a description of the relevant non-financial information listed and discussed in paragraph .27.

### ***Financial Statement/Information Analysis***

.58 This section should include a description of the relevant information listed in paragraph .29. Such description may include:

- a. The rationale underlying any normalization or ***control adjustments*** to financial information
- b. Comparison of current performance with historical performance
- c. Comparison of performance with industry trends and norms, where available

### ***Valuation Approaches and Methods Considered***

.59 This section should state that the valuation analyst has considered the valuation approaches discussed in paragraph .31.

### ***Valuation Approaches and Methods Used***

.60 In this section, the valuation analyst should identify the valuation methods used under each valuation approach and the rationale for their use.

.61 This section should also identify the following for each of the three approaches (if used):

- a. Income approach:
  - Composition of the representative benefit stream
  - Method(s) used, and a summary of the most relevant risk factors considered in selecting the appropriate **discount rate**, the capitalization rate, or both
  - Other factors as discussed in paragraph .33
- b. Asset-based approach or cost approach:
  - *Asset-based approach*: Any adjustments made by the valuation analyst to the relevant balance sheet data
  - *Cost approach*: The type of cost used, how this cost was estimated, and, if applicable, the forms of and costs associated with depreciation and obsolescence used under the approach and how those costs were estimated
- c. Market approach:
  - For the guideline public company method:
    - The selected guideline companies and the process used in their selection
    - The pricing multiples used, how they were used, and the rationale for their selection. If the pricing multiples were adjusted, the rationale for such adjustments
  - For the guideline company transactions method, the sales transactions and pricing multiples used, how they were used, and the rationale for their selection. If the pricing multiples were adjusted, the rationale for such adjustments

- For the guideline sales of interests in the subject entity method, the sales transactions used, how they were used, and the rationale for determining that these sales are representative of arm's length transactions

.62 When a rule of thumb is used in combination with other methods, the valuation report should disclose the source(s) of data used and how the rule of thumb was applied (paragraph .39).

### ***Valuation Adjustments***

.63 This section should (a) identify each valuation adjustment considered and determined to be applicable, for example, discount for lack of marketability, (b) describe the rationale for using the adjustment and the factors considered in selecting the amount or percentage used, and (c) describe the pre-adjustment value to which the adjustment was applied (paragraph .40).

### ***Nonoperating Assets and Excess Operating Assets***

.64 When the subject interest is a business, business ownership interest, or security, the valuation report should identify any related nonoperating assets, nonoperating liabilities, or excess or deficient operating assets and their effect on the valuation (paragraph .41).

### ***Representation of the Valuation Analyst***

.65 Each written report should contain the representation of the valuation analyst. The representation is the section of the report wherein the valuation analyst summarizes the factors that guided his or her work during the engagement. Examples of these factors include the following:

- a. The analyses, opinions, and conclusion of value included in the valuation report are subject to the specified assumptions and limiting conditions (see paragraph .18), and they are the personal analyses, opinions, and conclusion of value of the valuation analyst.
- b. The economic and industry data included in the valuation report have been obtained from various printed or electronic reference sources that the valuation analyst believes to be reliable (any exceptions should be noted). The valuation analyst has not performed any corroborating procedures to substantiate that data.
- c. The valuation engagement was performed in accordance with the American Institute of Certified Public Accountants Statement on Standards for Valuation Services.
- d. The parties for which the information and use of the valuation report is restricted are identified; the valuation report is not intended to be and should not be used by anyone other than such parties (paragraph .49).
- e. The analyst's compensation is fee-based or is contingent on the outcome of the valuation.
- f. The valuation analyst used the work of one or more outside specialists to assist during the valuation engagement. (An outside specialist is a specialist other than those employed in the valuation analyst's firm.) If the work of such a specialist was used, the specialist should be identified. The valuation report should include a statement identifying the level of responsibility, if any, the valuation analyst is assuming for the specialist's work.



- g.* The valuation analyst has no obligation to update the report or the opinion of value for information that comes to his or her attention after the date of the report.
- h.* The valuation analyst and the person(s) assuming responsibility for the valuation should sign the representation in their own name(s). The names of those providing significant professional assistance should be identified.

### **Representations Regarding Information Provided to the Valuation Analyst**

**.66** It may be appropriate for the valuation analyst to obtain written representations regarding information that the subject entity's management provides to the valuation analyst for purposes of his or her performing the valuation engagement. The decision whether to obtain a representation letter is a matter of judgment for the valuation analyst.

### **Qualifications of the Valuation Analyst**

**.67** The report should contain information regarding the qualifications of the valuation analyst.

### **Conclusion of Value**

**.68** This section should present a reconciliation of the valuation analyst's estimate or various estimates of the value of the subject interest. In addition to a discussion of the rationale underlying the conclusion of value, this section should include the following or similar statements:

- a.* A valuation engagement was performed, including the subject interest and the valuation date.
- b.* The analysis was performed solely for the purpose described in this report, and the resulting estimate of value should not be used for any other purpose.
- c.* The valuation engagement was conducted in accordance with the Statement(s) on Standards for Valuation Services of the American Institute of Certified Public Accountants.
- d.* A statement that the estimate of value resulting from a valuation engagement is expressed as a conclusion of value.
- e.* The scope of work or data available for analysis is explained, including any restrictions or limitations (paragraph .19).
- f.* A statement describing the conclusion of value, either a single amount or a range.
- g.* The conclusion of value is subject to the assumptions and limiting conditions (paragraph .18) and to the valuation analyst's representation (paragraph .65).
- h.* The report is signed in the name of the valuation analyst or the valuation analyst's firm.
- i.* The date of the valuation report is included.
- j.* The valuation analyst has no obligation to update the report or the conclusion of value for information that comes to his or her attention after the date of the report.

**.69** The following is an example of report language that could be used, but is not required, when reporting the results of a valuation engagement:

We have performed a *valuation engagement*, as that term is defined in the Statement on Standards for Valuation Services (SSVS) of the American Institute of

Certified Public Accountants, of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date]. This valuation was performed solely to assist in the matter of [purpose of the valuation]; the resulting estimate of value should not be used for any other purpose or by any other party for any purpose. This valuation engagement was conducted in accordance with the SSVS. The estimate of value that results from a valuation engagement is expressed as a conclusion of value.

[If applicable] We were restricted or limited in the scope of our work or data available for analysis as follows: [describe restrictions or limitations].

Based on our analysis, as described in this valuation report, the estimate of value of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date] was [value, either a single amount or a range]. This conclusion is subject to the Statement of Assumptions and Limiting Conditions found in [reference to applicable section of valuation report] and to the Valuation Analyst's Representation found in [reference to applicable section of valuation report]. We have no obligation to update this report or our conclusion of value for information that comes to our attention after the date of this report.

[Signature]

[Date]

## Appendixes and Exhibits

.70 Appendixes or exhibits may be used for required information or information that supplements the detailed report. Often, the assumptions and limiting conditions and the valuation analyst's representation are provided in appendixes to the detailed report.

## Summary Report

.71 A summary report is structured to provide an abridged version of the information that would be provided in a detailed report, and therefore, need not contain the same level of detail as a detailed report. However, a summary report should, at a minimum, include the following:

- a. Identity of the client
- b. Purpose and intended use of the valuation
- c. Intended users of the valuation
- d. Identity of the subject entity
- e. Description of the subject interest
- f. The business interest's ownership control characteristics, if any, and its degree of marketability
- g. Valuation date
- h. Valuation report date
- i. Type of report issued (namely, a summary report) (paragraph .48)
- j. Applicable premise of value
- k. Applicable standard of value
- l. Sources of information used in the valuation engagement
- m. Assumptions and limiting conditions of the valuation engagement (paragraph .18)

- n.* The scope of work or data available for analysis including any restrictions or limitations (paragraph .19)
- o.* Any hypothetical conditions used in the valuation engagement, including the basis for their use (paragraph .22)
- p.* If the work of a specialist was used in the valuation (paragraph .20), a description of how the specialist's work was used, and the level of responsibility, if any, the valuation analyst is assuming for the specialist's work
- q.* The valuation approaches and methods used
- r.* Disclosure of subsequent events in certain circumstances (paragraph .43)
- s.* Any application of the jurisdictional exception (paragraph .10)
- t.* Representation of the valuation analyst (paragraph .65)
- u.* The report is signed in the name of the valuation analyst or the valuation analyst's firm
- v.* A section summarizing the reconciliation of the estimates and the conclusion of value as discussed in paragraphs .68 and .69
- w.* A statement that the valuation analyst has no obligation to update the report or the calculation of value for information that comes to his or her attention after the date of the valuation report

**.72** Appendices or exhibits may be used for required information (paragraph .70) or information that supplements the summary report. Often, the assumptions, limiting conditions, and the valuation analyst's representation are provided in appendices to the summary report.

## Calculation Report

**.73** As indicated in paragraph .48, a calculation report is the only report that should be used to report the results of a calculation engagement. The report should state that it is a calculation report. The calculation report should include the representation of the valuation analyst similar to that in paragraph .65, but adapted for a calculation engagement.

**.74** The calculation report should identify any hypothetical conditions used in the calculation engagement, including the basis for their use (paragraph .22), any application of the jurisdictional exception (paragraph .10), and any assumptions and limiting conditions applicable to the engagement (paragraph .18). If the valuation analyst used the work of a specialist (paragraph .20), the valuation analyst should describe in the calculation report how the specialist's work was used and the level of responsibility, if any, the valuation analyst is assuming for the specialist's work. The calculation report may also include a disclosure of subsequent events in certain circumstances (paragraph .43).

**.75** Appendices or exhibits may be used for required information (paragraph .72) or information that supplements the calculation report. Often, the assumptions and limiting conditions and the valuation analyst's representation are provided in appendices to the calculation report.

**.76** The calculation report should include a section summarizing the calculated value. This section should include the following (or similar) statements:

- a.* Certain calculation procedures were performed; include the identity of the subject interest and the calculation date.

- b. Describe the calculation procedures and the scope of work performed or reference the section(s) of the calculation report in which the calculation procedures and scope of work are described.
- c. Describe the purpose of the calculation procedures, including that the calculation procedures were performed solely for that purpose and that the resulting calculated value should not be used for any other purpose or by any other party for any purpose.
- d. The calculation engagement was conducted in accordance with the Statement on Standards for Valuation Services of the American Institute of Certified Public Accountants.
- e. A description of the business interest's characteristics, including whether the subject interest exhibits control characteristics, and a statement about the marketability of the subject interest.
- f. The estimate of value resulting from a calculation engagement is expressed as a calculated value.
- g. A general description of a calculation engagement is given, including that (1) a calculation engagement does not include all of the procedures required for a valuation engagement and (2) had a valuation engagement been performed, the results may have been different.
- h. The calculated value, either a single amount or a range, is described.
- i. The report is signed in the name of the valuation analyst or the valuation analyst's firm.
- j. The date of the valuation report is given.
- k. The valuation analyst has no obligation to update the report or the calculation of value for information that comes to his or her attention after the date of the report.

.77 The following is an example of report language that could be used, but is not required, in reporting a calculation engagement:

We have performed a *calculation engagement*, as that term is defined in the Statement on Standards for Valuation Services (SSVS) of the American Institute of Certified Public Accountants. We performed certain calculation procedures on [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [calculation date]. The specific calculation procedures are detailed in paragraphs [reference to paragraph numbers] of our calculation report. The calculation procedures were performed solely to assist in the matter of [purpose of valuation procedures], and the resulting calculation of value should not be used for any other purpose or by any other party for any purpose. This calculation engagement was conducted in accordance with the SSVS. The estimate of value that results from a calculation engagement is expressed as a calculated value.

In a calculation engagement, the valuation analyst and the client agree on the specific valuation approaches and valuation methods the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of the subject interest. A calculation engagement does not include all of the procedures required in a *valuation engagement*, as that term is defined in the SVSS. Had a valuation engagement been performed, the results might have been different.

Based on our calculations, as described in this report, which are based solely on the procedures agreed upon as referred to above, the resulting calculated value of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date] was [calculated value, either a single amount or a range].

This calculated value is subject to the Statement of Assumptions and Limiting Conditions found in [*reference to applicable section of valuation report*] and to the Valuation Analyst's Representation found in [*reference to applicable section of valuation report*]. We have no obligation to update this report or our calculation of value for information that comes to our attention after the date of this report.

[*Signature*]

[*Date*]

## Oral Report

**.78** An oral report may be used in a valuation engagement or a calculation engagement. An oral report should include all information the valuation analyst believes necessary to relate the scope, assumptions, limitations, and the results of the engagement so as to limit any misunderstandings between the analyst and the recipient of the oral report. The member should document in the working papers the substance of the oral report communicated to the client.

## Effective Date

**.79** This Statement applies to engagements to estimate value accepted on or after January 1, 2008. Earlier application is encouraged.

## Appendix A

### Illustrative List of Assumptions and Limiting Conditions for a Business Valuation

The valuation report or calculation report should include a list of assumptions and limiting conditions under which the engagement was performed. This appendix includes an illustrative list of assumptions and limiting conditions that may apply to a business valuation.

#### Illustrative List of Assumptions and Limiting Conditions

1. The conclusion of value arrived at herein is valid only for the stated purpose as of the date of the valuation.
2. Financial statements and other related information provided by [ABC Company] or its representatives, in the course of this engagement, have been accepted without any verification as fully and correctly reflecting the enterprise's business conditions and operating results for the respective periods, except as specifically noted herein. [Valuation Firm] has not audited, reviewed, or compiled the financial information provided to us and, accordingly, we express no audit opinion or any other form of assurance on this information.
3. Public information and industry and statistical information have been obtained from sources we believe to be reliable. However, we make no representation as to the accuracy or completeness of such information and have performed no procedures to corroborate the information.
4. We do not provide assurance on the achievability of the results forecasted by [ABC Company] because events and circumstances frequently do not occur as expected; differences between actual and expected results may be material; and achievement of the forecasted results is dependent on actions, plans, and assumptions of management.
5. The conclusion of value arrived at herein is based on the assumption that the current level of management expertise and effectiveness would continue to be maintained, and that the character and integrity of the enterprise through any sale, reorganization, exchange, or diminution of the owners' participation would not be materially or significantly changed.
6. This report and the conclusion of value arrived at herein are for the exclusive use of our client for the sole and specific purposes as noted herein. They may not be used for any other purpose or by any other party for any purpose. Furthermore the report and conclusion of value are not intended by the author and should not be construed by the reader to be investment advice in any manner whatsoever. The conclusion of value represents the considered opinion of [Valuation Firm], based on information furnished to them by [ABC Company] and other sources.
7. Neither all nor any part of the contents of this report (especially the conclusion of value, the identity of any valuation specialist(s), or the firm with which such valuation specialists are connected or any reference to any of their professional designations) should be disseminated to the public through advertising media, public relations, news media,

sales media, mail, direct transmittal, or any other means of communication without the prior written consent and approval of [*Valuation Firm*].

8. Future services regarding the subject matter of this report, including, but not limited to testimony or attendance in court, shall not be required of [*Valuation Firm*] unless previous arrangements have been made in writing.
9. [*Valuation Firm*] is not an environmental consultant or auditor, and it takes no responsibility for any actual or potential environmental liabilities. Any person entitled to rely on this report, wishing to know whether such liabilities exist, or the scope and their effect on the value of the property, is encouraged to obtain a professional environmental assessment. [*Valuation Firm*] does not conduct or provide environmental assessments and has not performed one for the subject property.
10. [*Valuation Firm*] has not determined independently whether [*ABC Company*] is subject to any present or future liability relating to environmental matters (including, but not limited to CERCLA/Superfund liability) nor the scope of any such liabilities. [*Valuation Firm*]'s valuation takes no such liabilities into account, except as they have been reported to [*Valuation Firm*] by [*ABC Company*] or by an environmental consultant working for [*ABC Company*], and then only to the extent that the liability was reported to us in an actual or estimated dollar amount. Such matters, if any, are noted in the report. To the extent such information has been reported to us, [*Valuation Firm*] has relied on it without verification and offers no warranty or representation as to its accuracy or completeness.
11. [*Valuation Firm*] has not made a specific compliance survey or analysis of the subject property to determine whether it is subject to, or in compliance with, the American Disabilities Act of 1990, and this valuation does not consider the effect, if any, of noncompliance.
12. [*Sample wording for use if the jurisdictional exception is invoked.*] The conclusion of value (or the calculated value) in this report deviates from the Statement on Standards for Valuation Services as a result of published governmental, judicial, or accounting authority.
13. No change of any item in this appraisal report shall be made by anyone other than [*Valuation Firm*], and we shall have no responsibility for any such unauthorized change.
14. Unless otherwise stated, no effort has been made to determine the possible effect, if any, on the subject business due to future Federal, state, or local legislation, including any environmental or ecological matters or interpretations thereof.
15. If prospective financial information approved by management has been used in our work, we have not examined or compiled the prospective financial information and therefore, do not express an audit opinion or any other form of assurance on the prospective financial information or the related assumptions. Events and circumstances frequently do not occur as expected and there will usually be differences between prospective financial information and actual results, and those differences may be material.
16. We have conducted interviews with the current management of [*ABC Company*] concerning the past, present, and prospective operating results of the company.

17. Except as noted, we have relied on the representations of the owners, management, and other third parties concerning the value and useful condition of all equipment, real estate, investments used in the business, and any other assets or liabilities, except as specifically stated to the contrary in this report. We have not attempted to confirm whether or not all assets of the business are free and clear of liens and encumbrances or that the entity has good title to all assets.



## Appendix B

### International Glossary of Business Valuation Terms\*

To enhance and sustain the quality of business valuations for the benefit of the profession and its clientele, the below identified societies and organizations have adopted the definitions for the terms included in this glossary.

The performance of business valuation services requires a high degree of skill and imposes upon the valuation professional a duty to communicate the valuation process and conclusion in a manner that is clear and not misleading. This duty is advanced through the use of terms whose meanings are clearly established and consistently applied throughout the profession.

If, in the opinion of the business valuation professional, one or more of these terms needs to be used in a manner which materially departs from the enclosed definitions, it is recommended that the term be defined as used within that valuation engagement.

This glossary has been developed to provide guidance to business valuation practitioners by further memorializing the body of knowledge that constitutes the competent and careful determination of value and, more particularly, the communication of how that value was determined.

Departure from this glossary is not intended to provide a basis for civil liability and should not be presumed to create evidence that any duty has been breached.

**American Institute of Certified Public Accountants**

**American Society of Appraisers**

**Canadian Institute of Chartered Business Valuators**

**National Association of Certified Valuation Analysts**

**The Institute of Business Appraisers**

**Adjusted Book Value Method**—a method within the asset approach whereby all assets and liabilities (including off-balance sheet, intangible, and contingent) are adjusted to their fair market values. {NOTE: In Canada on a going concern basis}

**Adjusted Net Asset Method**—see **Adjusted Book Value Method**.

**Appraisal**—see **Valuation**.

**Appraisal Approach**—see **Valuation Approach**.

**Appraisal Date**—see **Valuation Date**.

**Appraisal Method**—see **Valuation Method**.

**Appraisal Procedure**—see **Valuation Procedure**.

**Arbitrage Pricing Theory**—a multivariate model for estimating the cost of equity capital, which incorporates several systematic risk factors.

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\* Reproduced verbatim from the International Glossary of Business Valuation Terms (the Glossary), which appears at <http://bvfls.aicpa.org/Resources/Business+Valuation/Tools+and+Aids/Definitions+and+Terms/International+Glossary+of+Business+Valuation+Terms.htm>. Note that the phrase, "we discourage the use of this term," that appears herein is also reproduced verbatim.

**Asset (Asset-Based) Approach**—a general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities.

**Beta**—a measure of systematic risk of a stock; the tendency of a stock's price to correlate with changes in a specific index.

**Blockage Discount**—an amount or percentage deducted from the current market price of a publicly traded stock to reflect the decrease in the per share value of a block of stock that is of a size that could not be sold in a reasonable period of time given normal trading volume.

**Book Value**—see **Net Book Value**.

**Business**—see **Business Enterprise**.

**Business Enterprise**—a commercial, industrial, service, or investment entity (or a combination thereof) pursuing an economic activity.

**Business Risk**—the degree of uncertainty of realizing expected future returns of the business resulting from factors other than financial leverage. See **Financial Risk**.

**Business Valuation**—the act or process of determining the value of a business enterprise or ownership interest therein.

**Capital Asset Pricing Model (CAPM)**—a model in which the cost of capital for any stock or portfolio of stocks equals a risk-free rate plus a risk premium that is proportionate to the systematic risk of the stock or portfolio.

**Capitalization**—a conversion of a single period of economic benefits into value.

**Capitalization Factor**—any multiple or divisor used to convert anticipated economic benefits of a single period into value.

**Capitalization of Earnings Method**—a method within the income approach whereby economic benefits for a representative single period are converted to value through division by a capitalization rate.

**Capitalization Rate**—any divisor (usually expressed as a percentage) used to convert anticipated economic benefits of a single period into value.

**Capital Structure**—the composition of the invested capital of a business enterprise; the mix of debt and equity financing.

**Cash Flow**—cash that is generated over a period of time by an asset, group of assets, or business enterprise. It may be used in a general sense to encompass various levels of specifically defined cash flows. When the term is used, it should be supplemented by a qualifier (for example, "discretionary" or "operating") and a specific definition in the given valuation context.

**Common Size Statements**—financial statements in which each line is expressed as a percentage of the total. On the balance sheet, each line item is shown as a percentage of total assets, and on the income statement, each item is expressed as a percentage of sales.

**Control**—the power to direct the management and policies of a business enterprise.

**Control Premium**—an amount or a percentage by which the pro rata value of a controlling interest exceeds the pro rata value of a noncontrolling interest in a business enterprise to reflect the power of control.

**Cost Approach**—a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.

**Cost of Capital**—the expected rate of return that the market requires in order to attract funds to a particular investment.

**Debt-Free**—*we discourage the use of this term.* See **Invested Capital**.

**Discount for Lack of Control**—an amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

**Discount for Lack of Marketability**—an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

**Discount for Lack of Voting Rights**—an amount or percentage deducted from the per share value of a minority interest voting share to reflect the absence of voting rights.

**Discount Rate**—a rate of return used to convert a future monetary sum into present value.

**Discounted Cash Flow Method**—a method within the income approach whereby the present value of future expected net cash flows is calculated using a discount rate.

**Discounted Future Earnings Method**—a method within the income approach whereby the present value of future expected economic benefits is calculated using a discount rate.

**Economic Benefits**—inflows such as revenues, net income, net cash flows, etc.

**Economic Life**—the period of time over which property may generate economic benefits.

**Effective Date**—see **Valuation Date**.

**Enterprise**—see **Business Enterprise**.

**Equity**—the owner's interest in property after deduction of all liabilities.

**Equity Net Cash Flows**—those cash flows available to pay out to equity holders (in the form of dividends) after funding operations of the business enterprise, making necessary capital investments, and increasing or decreasing debt financing.

**Equity Risk Premium**—a rate of return added to a risk-free rate to reflect the additional risk of equity instruments over risk free instruments (a component of the cost of equity capital or equity discount rate).

**Excess Earnings**—that amount of anticipated economic benefits that exceeds an appropriate rate of return on the value of a selected asset base (often net tangible assets) used to generate those anticipated economic benefits.

**Excess Earnings Method**—a specific way of determining a value indication of a business, business ownership interest, or security determined as the sum of a) the value of the assets derived by capitalizing excess earnings and b) the value of the selected asset base. Also frequently used to value intangible assets. See **Excess Earnings**.

**Fair Market Value**—the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. {NOTE: In Canada, the term "*price*" should be replaced with the term "*highest price*."}

**Fairness Opinion**—an opinion as to whether or not the consideration in a transaction is fair from a financial point of view.

**Financial Risk**—the degree of uncertainty of realizing expected future returns of the business resulting from financial leverage. See **Business Risk**.

**Forced Liquidation Value**—liquidation value, at which the asset or assets are sold as quickly as possible, such as at an auction.

**Free Cash Flow**—*we discourage the use of this term.* See **Net Cash Flow**.

**Going Concern**—an ongoing operating business enterprise.

**Going Concern Value**—the value of a business enterprise that is expected to continue to operate into the future. The intangible elements of Going Concern Value result from factors such as having a trained work force, an operational plant, and the necessary licenses, systems, and procedures in place.

**Goodwill**—that intangible asset arising as a result of name, reputation, customer loyalty, location, products, and similar factors not separately identified.

**Goodwill Value**—the value attributable to goodwill.

**Guideline Public Company Method**—a method within the market approach whereby market multiples are derived from market prices of stocks of companies that are engaged in the same or similar lines of business and that are actively traded on a free and open market.

**Income (Income-Based) Approach**—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.

**Intangible Assets**—nonphysical assets such as franchises, trademarks, patents, copyrights, goodwill, equities, mineral rights, securities, and contracts (as distinguished from physical assets) that grant rights and privileges and have value for the owner.

**Internal Rate of Return**—a discount rate at which the present value of the future cash flows of the investment equals the cost of the investment.

**Intrinsic Value**—the value that an investor considers, on the basis of an evaluation or available facts, to be the "true" or "real" value that will become the market value when other investors reach the same conclusion. When the term applies to options, it is the difference between the exercise price and strike price of an option and the market value of the underlying security.

**Invested Capital**—the sum of equity and debt in a business enterprise. Debt is typically (a) all interest-bearing debt or (b) long-term, interest-bearing debt. When the term is used, it should be supplemented by a specific definition in the given valuation context.

**Invested Capital Net Cash Flows**—those cash flows available to pay out to equity holders (in the form of dividends) and debt investors (in the form of principal and interest) after funding operations of the business enterprise and making necessary capital investments.

**Investment Risk**—the degree of uncertainty as to the realization of expected returns.

**Investment Value**—the value to a particular investor based on individual investment requirements and expectations. {NOTE: in Canada, the term used is "*Value to the Owner.*"}

**Key Person Discount**—an amount or percentage deducted from the value of an ownership interest to reflect the reduction in value resulting from the actual or potential loss of a key person in a business enterprise.

**Levered Beta**—the beta reflecting a capital structure that includes debt.

**Limited Appraisal**—the act or process of determining the value of a business, business ownership interest, security, or intangible asset with limitations in analyses, procedures, or scope.

**Liquidity**—the ability to quickly convert property to cash or pay a liability.

**Liquidation Value**—the net amount that would be realized if the business is terminated and the assets are sold piecemeal. Liquidation can be either "orderly" or "forced."

**Majority Control**—the degree of control provided by a majority position.

**Majority Interest**—an ownership interest greater than 50% of the voting interest in a business enterprise.

**Market (Market-Based) Approach**—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.

**Market Capitalization of Equity**—the share price of a publicly traded stock multiplied by the number of shares outstanding.

**Market Capitalization of Invested Capital**—the market capitalization of equity plus the market value of the debt component of invested capital.

**Market Multiple**—the market value of a company's stock or invested capital divided by a company measure (such as economic benefits, number of customers).

**Marketability**—the ability to quickly convert property to cash at minimal cost.

**Marketability Discount**—see **Discount for Lack of Marketability**.

**Merger and Acquisition Method**—a method within the market approach whereby pricing multiples are derived from transactions of significant interests in companies engaged in the same or similar lines of business.

**Mid-Year Discounting**—a convention used in the Discounted Future Earnings Method that reflects economic benefits being generated at midyear, approximating the effect of economic benefits being generated evenly throughout the year.

**Minority Discount**—a discount for lack of control applicable to a minority interest.

**Minority Interest**—an ownership interest less than 50% of the voting interest in a business enterprise.

**Multiple**—the inverse of the capitalization rate.

**Net Book Value**—with respect to a business enterprise, the difference between total assets (net of accumulated depreciation, depletion, and amortization) and total liabilities as they appear on the balance sheet (synonymous with Shareholder's Equity). With respect to a specific asset, the capitalized cost less accumulated amortization or depreciation as it appears on the books of account of the business enterprise.

**Net Cash Flows**—when the term is used, it should be supplemented by a qualifier. See **Equity Net Cash Flows** and **Invested Capital Net Cash Flows**.

**Net Present Value**—the value, as of a specified date, of future cash inflows less all cash outflows (including the cost of investment) calculated using an appropriate discount rate.

**Net Tangible Asset Value**—the value of the business enterprise's tangible assets (excluding excess assets and nonoperating assets) minus the value of its liabilities.

**Nonoperating Assets**—assets not necessary to ongoing operations of the business enterprise. {NOTE: in Canada, the term used is "*Redundant Assets*."}

**Normalized Earnings**—economic benefits adjusted for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

**Normalized Financial Statements**—financial statements adjusted for nonoperating assets and liabilities and/or for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

**Orderly Liquidation Value**—liquidation value at which the asset or assets are sold over a reasonable period of time to maximize proceeds received.

**Premise of Value**—an assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation; for example, going concern, liquidation.

**Present Value**—the value, as of a specified date, of future economic benefits and/or proceeds from sale, calculated using an appropriate discount rate.

**Portfolio Discount**—an amount or percentage deducted from the value of a business enterprise to reflect the fact that it owns dissimilar operations or assets that do not fit well together.

**Price/Earnings Multiple**—the price of a share of stock divided by its earnings per share.

**Rate of Return**—an amount of income (loss) and/or change in value realized or anticipated on an investment, expressed as a percentage of that investment.

**Redundant Assets**—see **Nonoperating Assets**.

**Report Date**—the date conclusions are transmitted to the client.

**Replacement Cost New**—the current cost of a similar new property having the nearest equivalent utility to the property being valued.

**Reproduction Cost New**—the current cost of an identical new property.

**Required Rate of Return**—the minimum rate of return acceptable by investors before they will commit money to an investment at a given level of risk.

**Residual Value**—the value as of the end of the discrete projection period in a discounted future earnings model.

**Return on Equity**—the amount, expressed as a percentage, earned on a company's common equity for a given period.

**Return on Investment**—See **Return on Invested Capital** and **Return on Equity**.

**Return on Invested Capital**—the amount, expressed as a percentage, earned on a company's total capital for a given period.

**Risk-Free Rate**—the rate of return available in the market on an investment free of default risk.

**Risk Premium**—a rate of return added to a risk-free rate to reflect risk.

**Rule of Thumb**—a mathematical formula developed from the relationship between price and certain variables based on experience, observation, hearsay, or a combination of these; usually industry specific.

**Special Interest Purchasers**—acquirers who believe they can enjoy post-acquisition economies of scale, synergies, or strategic advantages by combining the acquired business interest with their own.

**Standard of Value**—the identification of the type of value being utilized in a specific engagement; for example, fair market value, fair value, investment value.

**Sustaining Capital Reinvestment**—the periodic capital outlay required to maintain operations at existing levels, net of the tax shield available from such outlays.

**Systematic Risk**—the risk that is common to all risky securities and cannot be eliminated through diversification. The measure of systematic risk in stocks is the beta coefficient.

**Tangible Assets**—physical assets (such as cash, accounts receivable, inventory, property, plant and equipment, etc.).

**Terminal Value**—See **Residual Value**.

**Transaction Method**—See **Merger and Acquisition Method**.

**Unlevered Beta**—the beta reflecting a capital structure without debt.

**Unsystematic Risk**—the risk specific to an individual security that can be avoided through diversification.

**Valuation**—the act or process of determining the value of a business, business ownership interest, security, or intangible asset.

**Valuation Approach**—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more valuation methods.

**Valuation Date**—the specific point in time as of which the valuator's opinion of value applies (also referred to as "Effective Date" or "Appraisal Date").

**Valuation Method**—within approaches, a specific way to determine value.

**Valuation Procedure**—the act, manner, and technique of performing the steps of an appraisal method.

**Valuation Ratio**—a fraction in which a value or price serves as the numerator and financial, operating, or physical data serve as the denominator.

**Value to the Owner**—see **Investment Value**.

**Voting Control**—*de jure* control of a business enterprise.

**Weighted Average Cost of Capital (WACC)**—the cost of capital (discount rate) determined by the weighted average, at market value, of the cost of all financing sources in the business enterprise's capital structure.

## Appendix C

### Glossary of Additional Terms

**Assumptions and Limiting Conditions.** Parameters and boundaries under which a valuation is performed, as agreed upon by the valuation analyst and the client or as acknowledged or understood by the valuation analyst and the client as being due to existing circumstances. An example is the acceptance, without further verification, by the valuation analyst from the client of the client's financial statements and related information.

**Business Ownership Interest.** A designated share in the ownership of a business (business enterprise).

**Calculated Value.** An estimate as to the value of a business, business ownership interest, security, or intangible asset, arrived at by applying valuation procedures agreed upon with the client and using professional judgment as to the value or range of values based on those procedures.

**Calculation Engagement.** An engagement to estimate value wherein the valuation analyst and the client agree on the specific valuation approaches and valuation methods that the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of a subject interest. A calculation engagement generally does not include all of the valuation procedures required for a valuation engagement. If a valuation engagement had been performed, the results might have been different. The valuation analyst expresses the results of the calculation engagement as a calculated value, which may be either a single amount or a range.

**Capital or Contributory Asset Charge.** A fair return on an entity's *contributory assets*, which are tangible and intangible assets used in the production of income or cash flow associated with an intangible asset being valued. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as net income, or operating cash flow before taxes and capital expenditures. A capital charge may be expressed as a percentage return on an economic rent associated with, or a profit split related to, the contributory assets.

**Capitalization of Benefits Method.** A method within the income approach whereby expected future benefits (for example, earnings or cash flow) for a representative single period are converted to value through division by a capitalization rate.

**Comparable Profits Method.** A method of determining the value of intangible assets by comparing the profits of the subject entity with those of similar uncontrolled companies that have the same or similar complement of intangible assets as the subject company.

**Comparable Uncontrolled Transaction Method.** A method of determining the value of intangible assets by comparing the subject transaction to similar transactions in the market place made between independent (uncontrolled) parties.

**Conclusion of Value.** An estimate of the value of a business, business ownership interest, security, or intangible asset, arrived at by applying the valuation procedures appropriate for a valuation engagement and using professional judgment as to the value or range of values based on those procedures.



**Control Adjustment.** A valuation adjustment to financial statements to reflect the effect of a controlling interest in a business. An example would be an adjustment to owners' compensation that is in excess of market compensation.

**Engagement to Estimate Value.** An engagement, or any part of an engagement (for example, a tax, litigation, or acquisition-related engagement), that involves determining the value of a business, business ownership interest, security, or intangible asset. Also known as *valuation service*.

**Excess Operating Assets.** Operating assets in excess of those needed for the normal operation of a business.

**Fair Value.** In valuation applications, there are two commonly used definitions for fair value:

(1) For financial reporting purposes only, the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. *Source:* Financial Accounting Standards Board *Accounting Standards Codification* glossary.

(2) For state legal matters only, some states have laws that use the term *fair value* in shareholder and partner matters. For state legal matters only, therefore, the term may be defined by statute or case law in the particular jurisdiction.

**Guideline Company Transactions Method.** A method within the market approach whereby market multiples are derived from the sales of entire companies engaged in the same or similar lines of business.

**Hypothetical Condition.** That which is or may be contrary to what exists, but is supposed for the purpose of analysis.

**Incremental Income.** Additional income or cash flow attributable to an entity's ownership or operation of an intangible asset being valued, as determined by a comparison of the entity's income or cash flow with the intangible asset to the entity's income or cash flow without the intangible asset. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as license royalty income or operating cash flow before taxes and capital expenditures.

**Normalization.** See *Normalized Earnings* in Appendix B, "International Glossary of Business Valuation Terms." [paragraph .81].

**Pre-adjustment Value.** The value arrived at prior to the application, if appropriate, of valuation discounts or premiums.

**Profit Split Income.** With respect to the valuation of an intangible asset of an entity, a percentage allocation of the entity's income or cash flow whereby (1) a split (or percentage) is allocated to the subject intangible and (2) the remainder is allocated to all of the entity's tangible and other intangible assets. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as net income or operating cash flow before taxes and capital expenditures.

**Relief from Royalty Method.** A valuation method used to value certain intangible assets (for example, trademarks and trade names) based on the premise that the only value that a purchaser of the assets receives is the exemption from paying a royalty for its use. Application of this method usually involves estimating the fair market value of an intangible asset by quantifying the present value of the stream of market-derived royalty payments that the owner of the intangible asset is exempted from or "relieved" from paying.

**Residual Income.** For an entity that owns or operates an intangible asset being valued, the portion of the entity's income or cash flow remaining after

subtracting a capital charge on all of the entity's tangible and other intangible assets. *Income or cash flows* can refer to any appropriate measure of income or cash flow, such as net income or operating cash flow before taxes and capital expenditures.

**Security.** A certificate evidencing ownership or the rights to ownership in a business enterprise that (1) is represented by an instrument or by a book record or contractual agreement, (2) is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment, and (3) either one of a class or series or, by its terms, is divisible into a class or series of shares, participations, interests, rights, or interest-bearing obligations.

**Subject Interest.** A business, business ownership interest, security, or intangible asset that is the subject of a valuation engagement.

**Subsequent Event.** An event that occurs subsequent to the valuation date.

**Valuation Analyst.** For purposes of this Statement, an AICPA member who performs an engagement to estimate value that culminates in the expression of a conclusion of value or a calculated value.

**Valuation Assumptions.** Statements or inputs utilized in the performance of an engagement to estimate value that serve as a basis for the application of particular valuation methods.

**Valuation Engagement.** An engagement to estimate value in which a valuation analyst determines an estimate of the value of a subject interest by performing appropriate valuation procedures, as outlined in the AICPA Statement on Standards for Valuation Services, and is free to apply the valuation approaches and methods he or she deems appropriate in the circumstances. The valuation analyst expresses the results of the valuation engagement as a conclusion of value, which may be either a single amount or a range.

**Valuation Service.** See **Engagement to Estimate Value**.

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC.]

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## VS Section 9100

# ***Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset: Valuation Services Interpretations of Section 100***

### **1. Scope of Applicable Services**

#### **Background**

.01 The Statement on Standards for Valuation Services (SSVS) No. 1, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset* [VS section 100] establishes standards of performance and reporting for all AICPA members performing those valuation services that are within the scope of the Statement. When originally proposed on March 30, 2005, the Exposure Draft contained a list of questions and answers (Appendix A of the March 30, 2005 Exposure Draft) that were intended to assist members in determining if an engagement, particularly with regard to litigation or tax engagements, fell within the scope of the Statement. Through the Exposure Draft process, it was determined that the questions and answers were an integral part of the Statement and should be made authoritative. This Interpretation is part of the AICPA's continuing efforts at self-regulation of its members in valuation practice, and its desire to provide guidance to members when providing valuation services. The Interpretation does not change or elevate any level of conduct prescribed by any standard. Its goal is to clarify existing standards.

#### **General Interpretation**

.02 The SSVSs apply to an engagement to estimate value if, as all or as part of another engagement, a member determines the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraphs 1 and 2 [VS section 100.01–.02]). In the process of estimating value, professional judgment is used to apply valuation approaches and valuation methods as described in the SSVS No. 1, paragraph 4 [VS section 100.04].

.03 In determining whether a particular service falls within the scope of the Statement, a member should consider those services that are specifically excluded:

- Audit, review, and compilation engagements (SSVS No. 1, paragraph 5 [VS section 100.05])
- Use of values provided by the client or a third party (SSVS No. 1, paragraph 6 [VS section 100.06])
- Internal use assignments from employers to employee members not in the *practice of public accounting* (SSVS No. 1, paragraph 7 [VS section 100.07])
- Engagements that are exclusively for the purpose of determining economic damages (for example, lost profits) and that do not include an

engagement to estimate value (SSVS No. 1, paragraph 8 [VS section 100.08])

- Mechanical computations that do not rise to the level of an engagement to estimate value (SSVS No. 1, paragraph 9(a) [VS section 100.09a])
- Engagements where it is not practical or reasonable to obtain or use relevant information and, therefore, the member is unable to apply valuation approaches and methods described in this Statement. (SSVS No. 1, paragraph 9(b) [VS section 100.09b])
- Engagements meeting the jurisdictional exception (SSVS No. 1, paragraph 10 [VS section 100.10])

**.04** A member should be diligent in determining if an engagement falls within the scope of the Statement. Unless specifically excluded by the SSVS, if the engagement requires a member to apply valuation approaches and methods, and use professional judgment in applying those approaches and methods, the SSVS would apply. In determining the scope and requirements of the engagement, a member should consider the clients needs, or the requirements of a third party for which the valuation is intended, including governmental, judicial, and accounting authorities. In addition, a member should consider other professional standards that might apply.

### Specific Illustrations

**.05** The following illustrations address general fact patterns. Accordingly, the application of the guidance discussed in the "General Interpretation" section to variations in general facts, or to particular facts and circumstances, may lead to different conclusions. In each illustration, there is no authority other than that indicated.

### Illustrations Relating to Litigation Engagements and Certain Controversy Proceedings

**.06** *Illustration 1.* Do lost profits damage computations fall within the scope of the Statement?

**.07** *Conclusion.* No, unless the computations are undertaken as part of an engagement to estimate value (SSVS No. 1, paragraphs 1, 2, and 8 [VS section 100.01, .02, and .08]).

**.08** *Illustration 2.* Is an economic damages computation that incorporates a terminal value within the scope of the Statement?

**.09** *Conclusion.* The use of a terminal value exclusively for the determination of lost profits is not within the scope of this statement unless that determination will be used as part of an engagement to estimate value (*Illustration 1*).

**.10** *Illustration 3.* If a start-up business is destroyed, is the economic damages computation within the scope of the Statement?

**.11** *Conclusion.* There are two common measures of damages: lost profits and loss of value. If a valuation analyst performs an engagement to estimate value to determine the loss of value of a business or intangible asset, the Statement applies. Otherwise, the Statement does not apply (*Illustration 1*). In order to determine whether the Statement applies, a member acting as an expert witness should evaluate whether the particular damages calculation constitutes an engagement to estimate value with respect to the business, business interest, security, or intangible asset or whether it constitutes a lost-profits computation.

**.12 Illustration 4.** Does the Statement include any exceptions relating to litigation or controversy proceedings?

**.13 Conclusion.** Yes, the Statement includes a reporting exemption for certain controversy proceedings (SSVS No. 1, paragraph 50 [VS section 100.50]); however, there is no litigation or controversy proceeding exemption from the developmental provisions of the Statement (SSVS No. 1, paragraphs 21–46 [VS section 100.21–.46]) in circumstances in which an engagement to estimate value is performed (*Illustration 1*).

**.14 Illustration 5.** Is the Statements reporting exemption for litigation or controversy proceedings (see SSVS No. 1, paragraph 50 [VS section 100.50]) the same as the "litigation exemption" in the AICPA attestation standards?

**.15 Conclusion.** No, the so-called "litigation exemption" is provided for in the AICPA attestation standards and is further discussed in the attestation interpretations. The attestation standards do not apply to engagements in which a practitioner is engaged to testify as an expert witness in accounting, auditing, taxation, or other matters, given certain stipulated facts. This is clarified in the attestation interpretation, which states, in part, that the attestation standards do not apply to litigation services engagements when (among other requirements) the practitioner "has not been engaged to issue and does not issue an examination, a review, or an agreed-upon procedures report on the subject matter, or an assertion about the subject matter that is the responsibility of another party." (Interpretation No. 3, "Applicability of Attestation Standards to Litigation Services," of Chapter 1, "Attest Engagements," of Statement on Standards for Attestation Engagements No. 10, *Attestation Standards: Revision and Recodification*, as revised [AT section 9101.34–.42]. However, unlike the AICPA attestation standards, which do not apply in any capacity to litigation or controversy proceeding situations, as discussed above, the Statements exemption for litigation or certain controversy proceedings is an exemption from the reporting provisions of the Statement (SSVS No. 1, paragraphs 47–78 [VS section 100.47–.78]).

## Illustrations Relating to Tax Engagements

**.16 Illustration 6.** When does the Statement apply to members who determine values related to tax reporting and planning engagements?

**.17 Conclusion.** The Statement applies when the member is engaged to estimate the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraph 1 [VS section 100.01]). The application of valuation approaches and methods and the use of professional judgment (SSVS No. 1, paragraph 4 [VS section 100.04]) are required, unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]).

**.18 Illustration 7.** If the sole purpose of an engagement is reporting a value in a tax return and the Statement applies to this engagement, are any separate reports (specifically, valuation reports) required to be issued? To whom are those reports required to be provided? Is a report required to be attached to the tax return? Are any specific disclosures required?

**.19 Conclusion.** The Statement requires the preparation of a written or oral valuation report (SSVS No. 1, paragraphs 47–78 [VS section 100.47–.78]) that is communicated to the client (SSVS No. 1, paragraph 47 [VS section 100.47]) but does not require that any report be attached to the tax return or mandate any other tax-specific disclosures. In limited circumstances, a taxing authority may require its own report, which would obviate the need for a separate valuation report (SSVS No. 1, paragraph 10 [VS section 100.10] and *Illustration 18*).

There is also a reporting exemption for certain controversy proceedings (SSVS No. 1, paragraph 50 [VS section 100.50] and *Illustration 4*).

**.20 *Illustration 8.*** Are mechanical computations of value, for example, computations using actuarial tables, excluded from the Statement?

**.21 *Conclusion.*** Mechanical computations of value are excluded from the Statement if they do not rise to the level of an engagement to estimate value, that is, if the member does not apply valuation approaches and methods, and does not use professional judgment, as described in the Statement (SSVS No. 1, paragraph 9(a) [VS section 100.09a]).

**.22** Examples of services that do **not** rise to the level of an engagement to estimate value include: (a) computations of a remainder interest under a grantor retained annuity trust (GRAT) using actuarial tables; (b) determining the value of relatively small blocks (relative to the total amount of corporate stock outstanding) of publicly traded stock whose per share price is readily ascertainable; (c) preparing a tax return using the valuation of a business that was provided by a third-party appraiser, or by the client (SSVS No. 1, paragraph, [VS section 100.06]); and (d) calculating cash "hold back" requirements for tax contingencies (SSVS No. 1, paragraphs 4 and 9(a) [VS section 100.01, .04, and .09a]).

**.23** Examples of services that rise to the level of an engagement to estimate value include: (a) valuing a block of publicly traded stock, if the analysis includes consideration of a discount for blockage, lock-up, or other contractual or market restrictions such that valuation approaches and methods are applied, and professional judgment is used to determine the fair value, fair market value, or other applicable standard of value; (b) valuing stock that is not publicly traded; and (c) computing the fair market value of assets in a charitable remainder trust (CRT), if the engagement requires the application of valuation approaches and methods, and the use of professional judgment to estimate the fair market value.

**.24 *Illustration 9.*** Does the "jurisdictional exception" (SSVS No. 1, paragraph 10 [VS section 100.10]) provide that an engagement to estimate value is not subject to the Statement if a member determines and reports values using procedures mandated or allowed by the Internal Revenue Code (IRC), Internal Revenue Service (IRS) regulations, court cases, or other published guidance and other sources of federal, state, and local law solely for purposes of tax return preparation and other tax services using these methods?

**.25 *Conclusion.*** No, the "jurisdictional exception" would not exempt the engagement from this Statement, even if the engagements sole purpose was to value a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]) for tax reporting purposes. Only the portion of the Statement that differs from the published governmental or judicial authority is superseded for purposes of the engagement. The remainder of the Statement applies to the engagement.

**.26 *Illustration 10.*** Is an interest in a publicly traded partnership whose shares are frequently traded considered a "security" under the Statement? Is an interest in a family limited partnership (FLP), or in another nontraded partnership, considered a "security" under the Statement?

**.27 *Conclusion.*** Whether interest constitutes a "security" is a legal determination. However, where the value of a security is readily ascertainable, a valuation analyst does not need to apply valuation approaches and methods and use professional judgment. Accordingly, the valuation of such an interest would not be subject to the Statement (SSVS No. 1, paragraphs 1 and 9(a) [VS section 100.01 and .09a]). An interest in a nonpublicly traded partnership, such

as an FLP, whether considered a security or not, is a business ownership interest. The valuation of such nonpublicly traded interest requires the application of valuation approaches and methods and the use of professional judgment, and, accordingly, would be subject to the Statement (SSVS No. 1, paragraphs 1, 4, [VS section 100.01 and .04], and *Illustration 6*), unless the exception under SSVS No. 1, paragraph 9(b) [VS section 100.09b] applies (*Illustration 13e*). If the engagement requires the valuation analyst to consider and apply adjustments, for example, valuation discounts or premiums, then the engagement would be subject to the Statement.

**.28 *Illustration 11.*** A client engages a member to provide advice for planning purposes (such as estate planning, personal financial planning, or merger and acquisitions planning). The client holds an ownership interest in a family business being operated as a limited liability company, an interest in a private real estate limited partnership, publicly traded stock, a personal residence, and a retirement account (not an IRA). Is this a valuation engagement subject to the Statement?

**.29 *Conclusion.*** It depends. Providing technical advice, without reference to values for the various assets, is not subject to the Statement. However, if a member calculates a value to illustrate various planning options, he or she may fall under the Statement with regard to various assets. If one or more of the assets for which value is to be determined for purposes of the plan illustrations is a business, business ownership interest, security, or intangible asset, and the client or a third party does not provide the values for these assets, or the member does not use assumed or hypothetical values as part of the overall engagement, the member performing the valuation(s) is subject to the Statement with regard to these assets (SSVS No. 1, paragraph 1, [VS section 100.01] and *Illustration 6*). In this example, if the member applies valuation approaches and methods and uses professional judgment to determine the value of the ownership interest in the family business or the interest in the private real estate limited partnership in order to provide planning advice, the Statement would apply. In contrast, if the client or a third party provides the values for these assets, or the member uses assumed or hypothetical values, the Statement would not apply because the member would not be applying valuation approaches and methods and using professional judgment. In addition, the exception under SSVS No. 1, paragraph 9(b), [VS section 100.09b], where it is not practical or reasonable to obtain or use relevant information, could apply (see *Illustration 13e*). The computation of the "estimated estate tax" or other taxes once the values have been determined, assumed, or provided is not subject to the Statement, as the computation is a tax computation but would be subject to the Statements on Standards for Tax Services [TS sections 100–900] (*Illustration 10* at paragraph .27 of this Interpretation).

**.30 *Illustration 12.*** There are many instances where a tax engagement involves the need for a member to estimate value. The estimation of value may not be the primary purpose of the engagement, but rather a necessary task to perform or item to consider, when making a tax determination concerning the reporting of a transaction on a tax return. Consider the following practice situations:

**.31 *Illustration 12a.*** A member has been engaged to determine the deductibility of interest on a nonrecourse loan. Under applicable regulations, interest on a nonrecourse loan cannot be deducted if it is clear that the company will be unable to service the debt. For purposes of tax reporting, a conclusion must be reached concerning the ability of the company to service the debt. Is this considered a valuation engagement subject to the Statement?



**.32 Conclusion.** This is not a valuation engagement covered by the Statement because it is not the valuation of a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]). This example is a debt-service analysis.

**.33 Illustration 12b.** There are compliance filings that require an estimate of the value of a company. For example, the "market value" of "intangible personal property," as defined by a states taxing authority may need to be reported annually on an intangible personal property tax return. A client has a subject interest that is considered intangible personal property for purposes of the return. The member has been engaged to prepare the tax return. Is this a valuation engagement subject to the Statement?

**.34 Conclusion.** It depends. If the state requires an estimation of the value of a subject interest, and the estimation of value requires the application of valuation approaches and methods and the use of professional judgment (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]), the Statement applies. If, however, the client or a third-party appraiser provides the value of the subject interest to the member, the Statement does not apply (SSVS No. 1, paragraphs 1 and 6 [VS section 100.01 and .06]). In addition, the exception under SSVS No. 1, paragraph 9(b) [VS section 100.09b], where it is not practical or reasonable to obtain or use relevant information, could apply (*Illustration 13e*). Alternatively, if the state follows more informal rules where the application of valuation approaches or valuation methods are not necessary, the Statement does not apply (SSVS No. 1, paragraph 4 [VS section 100.04]).

**.35 Illustration 12c.** There are times when a member must allocate value among various assets. For example, IRC sections 1060 and 338 require the allocation to assets, based on relative values, of consideration paid. In partnership taxation, there may be allocations under IRC sections 754, 743, and 734 and special tax basis adjustments for partnerships (sales or exchanges and transfers at or upon death) may require an allocation of value among various partnership assets. Are these types of allocations engagements to estimate value subject to the Statement?

**.36 Conclusion.** It depends. If one or more of the assets to which value is to be allocated is a subject interest (that is, a business, business ownership interest, security, or intangible asset), and the client or a third party did not provide the member with a value for those assets, then the member performing the allocation would be subject to the Statement, and the member is required to apply valuation approaches and methods, and use professional judgment to value those assets (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*), unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]). For example, in an IRC section 1060 allocation, after the allocation of purchase price to cash, receivables, inventory, and depreciable tangible assets, there is a residual amount of value allocable to goodwill or going concern. The mechanical assignment of the residual amount to goodwill or going concern is not subject to the Statement. However, if the member allocates this residual amount to specific intangible assets (such as to various customer-based and supplier-based intangibles), such allocation is based on the assets relative values. Because the member applies valuation approaches and methods and uses professional judgment to value those specific intangible assets, the Statement applies.

**.37 Illustration 12d.** If the member does not apply any discount and simply computes the fair market value of an interest in a family limited partnership (FLP) for tax purposes, is this a valuation engagement subject to the Statement?

**.38 Conclusion.** Yes, the Statement applies if the member determines the value of the FLP or an interest in an FLP. The application of valuation

approaches and methods, and the use of professional judgment are required, unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]). The fact that the member does not apply a discount does not exempt the engagement from the Statement (SSVS No. 1, paragraphs 1–4 and 9(a) [VS section 100.01–.04 and .09a]).

**.39 Illustration 12e.** Would the Statement apply to the computation of the fair market value of assets in, or the computation of the required distribution of, a charitable remainder trust (CRT)?

**.40 Conclusion.** It depends on the underlying assets held by the CRT. The Statement would apply only if the member determines the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraph 1 [VS section 100.01]). To the extent that the CRT holds assets that, to be valued, require the application of valuation approaches and methods, and the use of professional judgment, such as an interest in a limited liability corporation (LLC), the Statement would apply. However, if the CRT only holds publicly traded stock with a readily ascertainable value, the Statement would not apply because valuation approaches and methods and professional judgment would not be needed in the computation (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*).

**.41 Illustration 12f.** In circumstances in which the value of assets contributed by partners to a partnership differ from their cost basis, each difference must be tracked for tax purposes under IRC section 704(c) so that amounts of gain or loss can be properly assigned to the contributing partners. Are these types of asset value assignments valuation engagements subject to the Statement?

**.42 Conclusion.** It depends. If one or more of the assets for which value is relevant under IRC section 704(c) is a subject interest that is, a business, business ownership interest, security, or intangible asset, and the client or a third party does not provide the valuation, and the member applies valuation approaches and methods and uses professional judgment to value these assets for IRC section 704(c) tax purposes, then the Statement applies (SSVS No. 1, paragraphs 1 and 6 [VS section 100.01 and .06], and *Illustration 6*).

**.43 Illustration 12g.** A member has been engaged to perform a cost segregation study. The study involves an analysis of the costs of building a structure and the allocation of such costs to the real and personal property components of the structure so that depreciation of those components may be properly computed. Is this a valuation engagement subject to the Statement?

**.44 Conclusion.** No, none of the assets constitutes a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]).

**.45 Illustration 12h.** A member has been engaged to provide advice to a company regarding the tax planning for income from discharge of indebtedness under IRC section 108. The company has advised the member that the company will be able to negotiate a settlement in complete satisfaction of an obligation at 30 cents on the dollar. Is this a valuation engagement subject to the Statement?

**.46 Conclusion.** It depends. Under IRC section 108(a), gross income of the company excludes income from discharge of indebtedness only under certain circumstances. One of those circumstances is the insolvency of the company. Under IRC section 108(d) (3), insolvency results from an excess of liabilities over the fair market value of assets. If (a) the company must rely on the insolvency provisions of IRC section 108; (b) one or more of the assets for which value is relevant under IRC section 108 is a subject interest (that is, a business, business ownership interest, security, or intangible asset); (c) the company or a third

party does not provide the valuation; and (d) the member applies valuation approaches and methods, and uses professional judgment to value the subject interest(s) for purposes of the IRC section 108(d)(3) insolvency determination, the Statement applies.

**.47 Illustration 13.** An executor has engaged a member to prepare an estate tax return, which requires determining values for the following estate assets: (a) shares in a publicly traded company, "TI Corporation," whose shares are infrequently traded; (b) a large block of stock in "LB Corporation," a publicly traded company; (c) a brokerage account consisting of shares in various publicly traded companies; (d) "CHB Corporation," a closely held business owned by the decedent and the decedent's family; and (e) a 5 percent interest in "RP," a privately held rental real estate partnership. Does the Statement apply to any of the following assets owned by the estate? (See *Illustration 10* at paragraph .27 of this Interpretation regarding the valuation of a security.)

**.48 Illustration 13a.** Does the Statement apply to shares in a publicly traded company, "TI Corporation," whose shares are traded infrequently?

**.49 Conclusion.** It depends; although the price of a share of publicly traded stock is ascertainable from published sources, there are no definitive criteria that would indicate when the Statement applies to shares that are infrequently traded. A key consideration is the average daily trading volume of TI Corporation stock on or around the valuation date. The concept of fair market value incorporates the notions that (1) cash could have been received for the stock at the valuation date, and (2) the share price of an infrequently traded stock could decrease if a relatively large block of the stock were to be put on the market on that date. If the subject shares held by the estate do not represent a significant percentage of the daily trading volume of TI stock on or around the valuation date, and the price of a share of the stock is readily ascertainable on the valuation date, then the resulting value (the quoted share price times the number of shares owned) represents a cash price that could have been received at the valuation date for the block, and the Statement does not apply because the calculation of value is mechanical (SSVS No. 1, paragraph 9(a) [VS section 100.09a]). If, however, the subject shares held by the estate represent a large percentage of the average daily trading volume of the stock, the quoted market price for a share may not be adequate for purposes of determining the fair market value of the block of shares on the valuation date. In that case, the Statement applies because valuation approaches and methods need to be applied, and professional judgment needs to be used in determining the value of the block (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]) (See *Illustration 10* at paragraph .27 of this Interpretation regarding the valuation of a security.)

**.50 Illustration 13b.** Does the Statement apply to a large block of stock in "LB Corporation," a publicly traded company?

**.51 Conclusion.** The answer depends on the amount of shares to be valued in relation to the average daily trading volume in LB Corporation on or around the valuation date. There are no definitive criteria that would indicate when the Statement applies to the valuation of a large block of publicly traded stock. The concept of fair market value incorporates the notion that cash could have been received from a sale of the block on the valuation date. A large block could decrease the share price if sold on the valuation date. The Statement would typically not apply to the valuation of a large block (for example, 200,000 shares) of a large and actively-traded public company. Even though the value of the estate's stock may be large in absolute terms, the daily trading volume in such stock on the valuation date may be sufficiently high that a sale of the block on the valuation date would not affect the market price of a company's

shares. In such a case, the quoted market price of a share times the number of shares held by the estate may be considered to reflect the fair market value of the subject block of stock, and because it would not be the case that valuation approaches and methods would need to be applied and professional judgment used, the Statement would not apply. If, however, the large block of publicly traded shares represents a significant percentage of the daily trading volume, the Statement would apply because valuation approaches and methods would need to be applied and professional judgment used to determine the value (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

**.52 *Illustration 13c.*** Does the Statement apply to a brokerage account consisting of shares in various publicly traded companies?

**.53 *Conclusion.*** The Statement would not apply to the determination of the value of a brokerage account consisting of publicly traded securities, except as discussed in paragraphs .49 and .51 of this Interpretation. Absent certain scenarios involving infrequently traded securities or large blocks of stock, the application of valuation approaches and methods and the use of professional judgment are not necessary in that determination (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

**.54 *Illustration 13d.*** Does the Statement apply to "CHB Corporation," a closely held business owned by the decedent and the decedent's family?

**.55 *Conclusion.*** The Statement would apply to the determination of value of CHB Corporation because valuation approaches and methods need to be applied, and professional judgment needs to be used to determine the fair market value of the ownership interest in CHB (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

**.56 *Illustration 13e.*** Does the Statement apply to a 5 percent interest in a privately held rental real estate partnership (RP)?

**.57 *Conclusion.*** The Statement would apply to the determination of value of the 5 percent interest in rental real estate partnership (RP) because valuation approaches and methods need to be applied and professional judgment needs to be used to determine the fair market value of the ownership of a fractional interest in a privately held partnership (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]). However, where it is not practical or not reasonable to obtain or use relevant information and, therefore, the member is unable to apply valuation approaches and methods, the Statement would not apply. For example, the member has requested from RP's general partner financial information the member needs in order to apply valuation approaches and methods. The general partner is not responsive to the member's requests, and the due date for filing the estate tax return is near. Given the small ownership interest, and given that RP is likely a relatively small percent of the total estate, unless prohibited by statute or by rule, the member may then use the taxpayer's estimates if the member determines that the estimates are reasonable (based on the facts and circumstances known to the member) (SSVS No. 1, paragraph 9(b) [VS section 100.09b]).

**.58 *Illustration 14.*** Would the answers to *Illustration 13* change if the values were provided by the client or a client-engaged third party?

**.59 *Conclusion.*** The Statement would not apply if the values were provided by the client or by a client-engaged third party because the member is not applying valuation approaches and methods and using professional judgment to determine value (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]). However, the member would be subject to Statement on Standards for Tax Services No. 3, *Certain Procedural Aspects of Preparing Returns* [TS section 300],

in providing appropriate due diligence with respect to the values provided to the member. It is also recommended that the understanding between member and client in these circumstances include documentation of the fact that the member is not determining but rather is being provided with the value of the subject interest.

**.60 *Illustration 15.*** Would the answers to *Illustration 13* change if the values were provided by an outside third-party specialist hired by the member?

**.61 *Conclusion.*** If the member engages an outside third-party specialist to assist with the member's work, and it is the member expressing a conclusion or calculated value, the member will be applying valuation approaches and methods and using professional judgment; thus, the Statement would apply (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]; SSVS No. 1, paragraph 20, "Using the Work of Specialists in the Valuation Engagement," [VS section 100.20]). If, however, the third-party specialist is determining the value in his or her own name and providing that value to the client, and the member will not be applying valuation approaches and methods or using professional judgment (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*), the Statement would not apply, but the member would be subject to Statement on Standards for Tax Services No. 3, *Certain Procedural Aspects of Preparing Returns* [TS section 300] in providing appropriate due diligence with respect to the values provided.

**.62 *Illustration 16.*** The client and the member agree that the member will value a partnership interest and then apply an "average" discount that the member is to determine (based on the results of various studies and case law). Does the Statement apply? If so, is this a valuation engagement or a calculation engagement?

**.63 *Conclusion.*** Yes, the Statement applies because the member determined the value of the partnership interest by applying valuation approaches and valuation methods and using professional judgment. This would be considered a calculation engagement because the member and the client have agreed on the specific valuation approaches or valuation methods the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform (SSVS No. 1, paragraph 21(b) [VS section 100.21b] and *Illustration 6*).

**.64 *Illustration 17.*** Would the Statement apply if a member has an informal conversation or communicates in writing with a client regarding the alternative tax consequences of gifting versus selling a business using a presumption of a specific value of the business?

**.65 *Conclusion.*** No, the Statement would not apply. The member is providing tax advice using an assumed or hypothetical value of a business and is not determining value, applying valuation approaches and methods, and using professional judgment to value a business (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*).

**.66 *Illustration 18.*** Would the Statement apply to a transfer pricing study (IRC section 482) that involves the use of specific methodologies, data, terminology, and documentation requirements that are provided in the IRS regulations and procedures, and whose methodologies and documentation requirements differ from those contained in the Statement?

**.67 *Conclusion.*** No. To the extent that the transfer pricing study applies, for example, to the valuation of inventory or services, the Statement would not apply (see SSVS No. 1, paragraph 1 [VS section 100.01] and *Illustration 6*). To the extent that the transfer pricing study applies to the valuation of intangible assets, the Statement would normally apply. However, because the

IRS regulations require that the taxpayer reasonably calculate an arm's-length price according to the best method that is determined using third-party comparable data under explicit IRS rules and documentation procedures, and to the extent these IRS rules and procedures differ from the Statement, the jurisdictional exception (SSVS No. 1, paragraph 10 [VS section 100.10]) would exempt the valuation of the intangible assets from the developmental provisions of the Statement (SSVS No. 1, paragraphs 25–48 [VS section 100.25–.48]). In addition, to the extent that the IRS regulations (such as IRS regulation section 1.6662-6(d) (2) (iii)) and procedures provide specific documentation requirements for avoiding potential penalties, and if a transfer pricing report is provided to a client according to such IRS documentation requirements, the jurisdictional exception would apply to the reporting provisions of the Statement (SSVS No. 1, paragraphs 50–78 [VS section 100.50–.78]) and thus a valuation report would not be necessary.

**.68 Illustration 19.** In a situation where the Statement applies to members who determine value as part of tax engagements, would the member also be required to be in compliance with the Statements on Standards for Tax Services (SSTSs) [TS sections 100–900]?

**.69 Conclusion.** Yes, the Statement would apply only to the valuation determination and reporting aspects of the engagement but the SSTSs would apply to all aspects of the engagement. For example, even though the Statement would govern the determination of value of an applicable asset reported on a tax return, the member would also have to be in compliance with SSTS No. 1, *Tax Return Positions*, [TS section 100], for that valuation.

**.70 Illustration 21.** Do settlements or negotiations of value in offers-in-compromise or tax disputes fall under the Statement?

**.71 Conclusion.** No, settlements or negotiations of value in offers-in-compromise or tax disputes are part of a tax process. However, if a member prepares a valuation in preparation for a settlement or negotiation of value, and the valuation involves the application of valuation approaches and methods and the use of professional judgment, the valuation would fall under the developmental aspects of the Statement. The settlement or negotiation process itself is not a valuation and would not fall under the Statement. In addition, the Statement's reporting exemption for certain controversy proceedings would apply as the valuation was performed specifically for the administrative matter (SSVS No. 1, paragraph 50 [VS section 100.50]).

## Illustrations Relating to Other Engagements

**.72 Illustration 20.** Does determining the value of accounts receivable fall under the Statement?

**.73 Conclusion.** No, accounts receivable constitute **tangible assets** under the Statement (SSVS No. 1, Appendix B [VS section 100.81], and do not constitute a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]).

**.74 Illustration 22.** In the course of performing a valuation under the Statement, if a valuation analyst prepares prospective financial information (for example, as part of a discounted cash flow or discounted earnings analysis within the income approach), does this require the valuation analyst to examine or compile such information in accordance with the Statements on Standards for Attestation Engagements (SSAEs) [AT sections 20–701]?

**.75 Conclusion.** No, Chapter 1, "Attest Engagements," of SSAE No. 10, *Attestation Standards: Revision and Recodification*, as amended [AT section 101.01] states that the attestation standards apply when a practitioner is "engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter..., that is the responsibility of another party." If the valuation analyst has not been engaged to examine, compile, assemble, review, or apply agreed-upon procedures to prospective financial information, and does not issue an examination, compilation, assembly, or agreed-upon report on prospective financial information, the SSAEs [AT sections 20–701] do not apply (SSARS 14 [AR section 120]).

**.76 Illustration 23.** Under a valuation engagement, a valuation analyst is free to select any and all valuation approaches and methods the valuation analyst deems appropriate in the circumstances. Under a calculation engagement, the valuation analyst and the client agree to the specific approaches or methods the valuation analyst will use or the extent of calculation procedures the valuation analyst will perform. (SSVS No. 1, paragraph 21 [VS section 100.21]) Under SSVS No. 1, paragraph 18 [VS section 100.18], a restriction or limitation on the scope of the valuation analyst's work, or the data available for analysis may be present and known to the valuation analyst at the outset of the engagement, or may arise during the course of an engagement (and such restriction or limitation should be disclosed in the report). Is it possible to have a restriction or limitation that is of such a degree that a valuation analyst engaged to perform a valuation engagement should propose altering the engagement to be a calculation engagement?

**.77 Conclusion.** Although the two engagements represent two different types of service performed by valuation analysts, the possibility exists. If, in the course of a valuation engagement, restrictions, or limitations on the scope of the valuation analyst's work or the data available for analysis are so significant that the valuation analyst believes that he or she cannot, even with disclosure in the valuation report of the restrictions or limitations, adequately perform a valuation engagement leading to a conclusion of value, the valuation analyst should determine whether he or she has the ability to adequately complete the engagement as a calculation engagement or should consider resigning from the engagement.

**.78 Illustration 24.** If a member employed in industry, government, or education "moonlights" doing engagements to estimate value, do the Standards apply?

**.79 Conclusion.** Yes, the Standard applies. By moonlighting, the member is holding him or herself out as a certified public accountant and as being in public practice. The Standard would apply just as it would to any other member in public practice unless one of the exceptions applies.

**.80 Illustration 25.** Does the Statement apply to an assignment from an employer to an employee member not in public practice to prepare a valuation for internal financial reporting purposes?

**.81 Conclusion.** No, SSVS No. 1, paragraph 7 [VS section 100.07] exempts internal use assignments from an employer to an employee member not in the practice of public accounting. However, if the valuation is to be used for financial reporting purposes, the employer and the employee may wish to consider whether the work will be accepted by the employer's outside auditors if the statement is not followed.

## Illustrations for PFP-Specific Engagements

*These illustrations assume the member has not been engaged to perform a business valuation.*

**.82 Illustration 26.** When does the Statement apply to members who determine values related to personal financial planning engagements?

**.83 Conclusion.** The Statement applies to personal financial planning engagements when the member determines the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraph 1 [VS section 100.01]) and in the process of determining the value applies valuation approaches and methods and uses professional judgment (SSVS No. 1, paragraph 4 [VS section 100.04]) unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]).

**.84 Illustration 27.** If a member is engaged to provide personal financial planning services to a client and, in the course of the engagement, estimates the proceeds from a hypothetical future sale of the client's business interest, does the Statement apply?

**.85 Conclusion.** No. The Statement does not apply because estimate of future sales proceeds does not in itself constitute a valuation engagement (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

**.86 Illustration 28.** A member is engaged to provide personal financial planning services to a client and, in the course of the engagement, estimates the proceeds from a hypothetical future sale of the client's business interest. As part of that engagement, the member shares general industry knowledge to assist the client in estimating the current value of the business interest. Does the Statement apply?

**.87 Conclusion:**

(a) If, in the process of determining the current value from which the member estimates future sales proceeds, the member applies valuation approaches and methods and uses professional judgment, the Statement applies to the determination of the current value (SSVS No. 1, paragraph 4 [VS section 100.04]). However, the Statement does not apply when the member shares general industry knowledge with the client instead of applying professional judgment.

(b) If the client or another party provides the current value, and the member does not apply valuation approaches and methods, the Statement does not apply (SSVS No. 1, paragraphs 4 and 6 [VS section 100.04 and .06]).

(c) If the member uses a hypothetical or assumed value as the starting point for the calculation of future sales proceeds and does not apply valuation approaches and methods, the Statement does not apply (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]). The Statement does not apply to a general discussion with the client of valuation concepts or industry price multiples based on the member's industry knowledge, which assists the client in determining a hypothetical or assumed value (SSVS No. 1, paragraphs 4 and 6 [VS section 100.04 and .06]).

**.88 Illustration 29.** The client has asked the member to prepare a personal financial plan that includes an estimate of future proceeds from a sale of the business interest at retirement. The member estimates the future proceeds based on an estimate of the business' current value by applying a rule of thumb for the business' industry, but the member does not consider the risk factors of the subject interest or exercise other professional judgment in applying the multiple. Does the Statement apply?



**.89 Conclusion.** No, the Statement does not apply because the member did not use professional judgment (SSVS No. 1, paragraph 4 [VS section 100.04]). If the member considers specific risk factors of the business interest in applying the price multiple, the Statement applies.

*This Statement titled Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset was unanimously adopted by the assenting votes of the AICPA Consulting Services Executive Committee.*

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## CS Section

# CONSULTING SERVICES

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### STATEMENT ON STANDARDS FOR CONSULTING SERVICES

Statements on Standards for Consulting Services are issued by the AICPA Management Consulting Services Executive Committee, the senior technical committee of the Institute designated to issue pronouncements in connection with consulting services. Council has designated the AICPA Management Consulting Services Executive Committee as a body to establish technical standards under *Rule 202* of the Institute's Code of Professional Conduct. Members should be prepared to justify departures from this Statement.

#### TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
100	Consulting Services: Definitions and Standards	.01-.10
	Introduction .....	.01-.04
	Definitions .....	.05
	Standards for Consulting Services .....	.06-.08
	Consulting Services for Attest Clients .....	.09
	Effective Date .....	.10

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## CS Section 100

# ***Consulting Services: Definitions and Standards***

Effective for engagements accepted on or after January 1, 1992, unless otherwise indicated.

## **Introduction**

**.01** Consulting services that CPAs provided to their clients have evolved from advice on accounting-related matters to a wide range of services involving diverse technical disciplines, industry knowledge, and consulting skills. Most practitioners, including those who provide audit and tax services, also provide business and management consulting services to their clients.

**.02** Consulting services differ fundamentally from the CPA's function of attesting to the assertions of other parties. In an attest service, the practitioner expresses a conclusion about the reliability of a written assertion that is the responsibility of another party, theasserter. In a consulting service, the practitioner develops the findings, conclusions, and recommendations presented. The nature and scope of work is determined solely by the agreement between the practitioner and the client. Generally, the work is performed only for the use and benefit of the client.

**.03** Historically, CPA consulting services have been commonly referred to as management consulting services, management advisory services, business advisory services, or management services. A series of Statements on Standards for Management Advisory Services (SSMASs) previously issued by the AICPA contained guidance on certain types of consulting services provided by members. This Statement on Standards for Consulting Services (SSCS) supersedes the SSMASs and provides standards of practice for a broader range of professional services, as described in paragraph .05.

**.04** This SSCS and any subsequent SSCSs apply to any AICPA member holding out as a CPA while providing Consulting Services as defined herein.

## **Definitions**

**.05** Terms established for the purpose of SSCSs are as follows:

***Consulting Services Practitioner.*** Any AICPA member holding out as a CPA while engaged in the performance of a Consulting Service for a client, or any other individual who is carrying out a Consulting Service for a client on behalf of any Institute member or member's firm holding out as a CPA.

***Consulting Process.*** The analytical approach and process applied in a Consulting Service. It typically involves some combination of activities relating to determination of client objective, fact-finding, definition of the problems or opportunities, evaluation of alternatives, formulation of proposed action, communication of results, implementation, and follow-up.

**Consulting Services.** Professional services that employ the practitioner's technical skills, education, observations, experiences, and knowledge of the consulting process.<sup>1</sup> Consulting Services may include one or more of the following:

- a. *Consultations*, in which the practitioner's function is to provide counsel in a short time frame, based mostly, if not entirely, on existing personal knowledge about the client, the circumstances, the technical matters involved, client representations, and the mutual intent of the parties. Examples of consultations are reviewing and commenting on a client-prepared business plan and suggesting computer software for further client investigation.
- b. *Advisory services*, in which the practitioner's function is to develop findings, conclusions, and recommendations for client consideration and decision making. Examples of advisory services are an operational review and improvement study, analysis of an accounting system, assistance with strategic planning, and definition of requirements for an information system.
- c. *Implementation services*, in which the practitioner's function is to put an action plan into effect. Client personnel and resources may be pooled with the practitioner's to accomplish the implementation objectives. The practitioner is responsible to the client for the conduct and management of engagement activities. Examples of implementation services are providing computer system installation and support, executing steps to improve productivity, and assisting with the merger of organizations.
- d. *Transaction services*, in which the practitioner's function is to provide services related to a specific client transaction, generally with a third party. Examples of transaction services are insolvency services, valuation services, preparation of information for obtaining financing, analysis of a potential merger or acquisition, and litigation services.
- e. *Staff and other support services*, in which the practitioner's function is to provide appropriate staff and possibly other support to perform tasks specified by the client. The staff provided will be directed by the client as circumstances require. Examples of staff and other support services are data processing facilities management, computer programming, bankruptcy trusteeship, and controllership activities.
- f. *Product services*, in which the practitioner's function is to provide the client with a product and associated professional services in support of the installation, use, or maintenance of the product. Examples of

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<sup>1</sup> The definition of Consulting Services excludes the following:

- a. Services subject to other AICPA Technical Standards such as Statements on Auditing Standards (SASs), Statements on Standards for Attestation Engagements (SSAEs), or Statements on Standards for Accounting and Review Services (SSARSs). (These excluded services may be performed in conjunction with Consulting Services, but only the Consulting Services are subject to the SSCS.)
- b. Engagements specifically to perform tax return preparation, tax planning/advice, tax representation, personal financial planning or bookkeeping services; or situations involving the preparation of written reports or the provision of oral advice on the application of accounting principles to specified transactions or events, either completed or proposed, and the reporting thereof.
- c. Recommendations and comments prepared during the same engagement as a direct result of observations made while performing the excluded services.

product services are the sale and delivery of packaged training programs, the sale and implementation of computer software, and the sale and installation of systems development methodologies.

## Standards for Consulting Services

.06 The general standards of the profession are contained in Rule 201 of the AICPA Code of Professional Conduct [ET section 201.01] and apply to all services performed by members. They are as follows:

*Professional competence.* Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.

*Due professional care.* Exercise due professional care in the performance of professional services.

*Planning and supervision.* Adequately plan and supervise the performance of professional services.

*Sufficient relevant data.* Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

.07 The following additional general standards for all Consulting Services are promulgated to address the distinctive nature of Consulting Services in which the understanding with the client may establish valid limitations on the practitioner's performance of services. These Standards are established under Rule 202 of the AICPA Code of Professional Conduct [ET section 202.01].

*Client interest.* Serve the client interest by seeking to accomplish the objectives established by the understanding with the client while maintaining integrity and objectivity.<sup>2</sup>

*Understanding with client.* Establish with the client a written or oral understanding about the responsibilities of the parties and the nature, scope, and limitations of services to be performed, and modify the understanding if circumstances require a significant change during the engagement.

*Communication with client.* Inform the client of (a) conflicts of interest that may occur pursuant to interpretations of Rule 102 of the Code of Professional Conduct [ET section 102.03],<sup>3</sup> (b) significant reservations concerning the scope or benefits of the engagement, and (c) significant engagement findings or events.

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<sup>2</sup> Article III of the Code of Professional Conduct [ET section 54.02] describes *integrity* as follows: "Integrity requires a member to be, among other things, honest and candid within the constraints of client confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. Integrity can accommodate the inadvertent error and the honest difference of opinion; it cannot accommodate deceit or subordination of principle."

Article IV of the Code of Professional Conduct [ET section 55.01] differentiates between *objectivity* and *independence* as follows:

"Objectivity is a state of mind, a quality that lends value to a member's services. It is a distinguishing feature of the profession. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest. Independence precludes relationships that may appear to impair a member's objectivity in rendering attestation services."

<sup>3</sup> Interpretation 102-02 [ET section 102.03] on Conflict of Interest states, in part, the following: "A conflict of interest may occur if a member performs a professional service for a client or employer and the member or his or her firm has a significant relationship with another person, entity, product, or service that could be viewed as impairing the member's objectivity. If this significant relationship is disclosed to and consent is obtained from such client, employer, or other appropriate parties, the rule shall not operate to prohibit the performance of the professional service...."

**.08** Professional judgment must be used in applying Statements on Standards for Consulting Services in a specific instance since the oral or written understanding with the client may establish constraints within which services are to be provided. For example, the understanding with the client may limit the practitioner's effort with regard to gathering relevant data. The practitioner is not required to decline or withdraw from a consulting engagement when the agreed-upon scope of services includes such limitations.

## Consulting Services for Attest Clients

**.09** The performance of Consulting Services for an attest client does not, in and of itself, impair independence.<sup>4</sup> However, members and their firms performing attest services for a client should comply with applicable independence standards, rules and regulations issued by AICPA, the state boards of accountancy, state CPA societies, and other regulatory agencies.

## Effective Date

**.10** This section is effective for engagements accepted on or after January 1, 1992. Early application of the provisions of this section is permissible.

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<sup>4</sup> AICPA independence standards relate only to the performance of attestation services; objectivity standards apply to all services. See footnote 2.

# CS TOPICAL INDEX

References are to CS section and paragraph numbers.

## A

### ATTEST SERVICES

- Consulting Services for Attest Clients ..... 100.09
- Versus Consulting Service ..... 100.02

## C

### CERTIFIED PUBLIC ACCOUNTANTS

- Consulting Services ..... 100.01-10

### CLIENTS

- Communications to Client ..... 100.07
- Consulting Services for Attest Clients ..... 100.09

### COMMUNICATION

- Consulting Services ..... 100.07

### CONDUCT, CODE OF PROFESSIONAL

- Applicability to Consulting Services ..... 100.06-07

### CONSULTING SERVICES

- Attest Clients ..... 100.09
- Background ..... 100.01-04
- Performance Standards ..... 100.06-08
- Relationship With Clients ..... 100.07
- Scope ..... 100.01-02;  
..... 100.05
- Scope Limitations ..... 100.08
- Terminology ..... 100.05
- Versus Attest Services ..... 100.02

## D

### DEFINITIONS—See Terminology

### DUE PROFESSIONAL CARE

- General Standards ..... 100.06

## J

### JUDGMENT

- Consulting Services ..... 100.08

## P

### PLANNING AND SUPERVISION

- General Standards ..... 100.06

## S

### SCOPE LIMITATIONS

- Consulting Services ..... 100.08

### STATEMENTS ON STANDARDS FOR CONSULTING SERVICES

- No. 1 ..... 100.01-10

### SUFFICIENT RELEVANT DATA

- General Standard ..... 100.06

## T

### TERMINOLOGY

- Consulting Process ..... 100.05
- Consulting Services ..... 100.05
- Consulting Services Practitioner ..... 100.05





**QC Section****QUALITY CONTROL****STATEMENTS ON  
QUALITY CONTROL STANDARDS**

## TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
10	A Firm's System of Quality Control	.01-.128
	Introduction .....	.01-02
	System of Quality Control .....	.03-04
	Definitions .....	.05-11
	Professional Requirements .....	.06-08
	Explanatory Material .....	.09-11
	Documentation and Communication of Quality Control	
	Policies and Procedures .....	.12-.13
	Elements of a System of Quality Control .....	.14-124
	Leadership Responsibilities for Quality Within the Firm (the "Tone at the Top") .....	.15-18
	Relevant Ethical Requirements .....	.19-26
	Acceptance and Continuance of Client Relationships and Specific Engagements .....	.27-36
	Human Resources .....	.37-41
	Competencies of Engagement Partner .....	.42-56
	Engagement Performance .....	.57-84
	Nature, Timing, and Extent of the Engagement Quality Control Review .....	.85-91
	Criteria for the Eligibility of Engagement Quality Control Review .....	.92-98
	Documentation of the Engagement Quality Control Review .....	.99
	Monitoring .....	.100-124
	Documentation of Operation of Quality Control Policies and Procedures .....	.125-127
	Effective Date .....	.128



## QC Section 10

# *A Firm's System of Quality Control*

Supersedes SQCSs Nos. 2–6. SQCS No. 1 was previously superseded by SQCS No. 2.

Source: SQCS No. 7.

Effective date: Applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2009.

Statements on Quality Control Standards (SQCS) are issued by the Auditing Standards Board. Firms that are enrolled in an Institute-approved practice-monitoring program are obligated to adhere to quality control standards established by the Institute.

On July 30, 2002, President Bush signed the Sarbanes-Oxley Act of 2002 (Act) which created a five-member Public Company Accounting Oversight Board (PCAOB) and charged it with overseeing audits of issuers, as defined by the Act, or other entities subject to SEC regulation (issuers). Under the Act, the PCAOB's duties include, among other things, establishing auditing, quality control, ethics, independence, and other Standards relating to audits of issuers.

The AICPA's Quality Control Standards do not address the quality-control ramifications of the Act nor do they address the quality control ramifications of PCAOB Standards that must be followed by auditors of issuers. The AICPA's Quality Control Standards do not purport to include any modifications that may be necessary for a firm's system of quality control to conform to PCAOB Standards. Additional information about the PCAOB and the Act can be obtained at the PCAOB web site, [www.pcaobus.org](http://www.pcaobus.org), and the AICPA web site, <http://thecaq.aicpa.org/Resources/Sarbanes+Oxley/>.

## Introduction

**.01** The purpose of this section is to establish standards and provide guidance for a CPA firm's responsibilities for its system of quality control for its accounting and auditing practice. This section describes elements of quality control and other matters essential to the effective design, implementation, and maintenance of the system. This section is to be read in conjunction with the AICPA Code of Professional Conduct.

**.02** This section also sets forth the meaning of certain terms used in SQCSs issued by the Auditing Standards Board in describing the professional requirements imposed on firms and engagement partners.

## System of Quality Control

**.03** The firm must establish a system of quality control designed to provide the firm with reasonable assurance that the firm and its personnel comply with

professional standards and applicable regulatory and legal requirements, and that the firm or engagement partners issue reports that are appropriate in the circumstances. A system of quality control consists of policies designed to achieve these objectives and the procedures necessary to implement and monitor compliance with those policies.

.04 The nature of the policies and procedures developed by individual firms to comply with this section will depend on various factors such as the size and operating characteristics of the firm. The system of quality control should be designed to provide the firm with reasonable assurance that the segments of the firm's engagements performed by its foreign member firms or offices or by its domestic or foreign affiliates, if any, are performed in accordance with professional standards in the United States when such standards are applicable.

## Definitions

.05 In this section, the following terms have the meanings given:

- a. *Accounting and auditing practice.* A practice that performs engagements covered by this section, which are audit, attestation, compilation, review and any other services for which standards have been established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under Rules 201 or 202 of the AICPA Code of Professional Conduct (ET sections 201–202). Although standards for other engagements may be established by other AICPA technical committees, engagements performed in accordance with those standards are not encompassed in the definition of an accounting and auditing practice.
- b. *Engagement documentation.* The record of work performed, results obtained, and conclusions the practitioner reached, also known as *working papers* or *workpapers*.
- c. *Engagement partner.* An individual responsible for supervising engagements covered by this section and signing or authorizing an individual to sign the report on such engagements, and who, where required, has the appropriate authority from a professional, legal or regulatory body. Firms may use different titles to refer to individuals with this authority.
- d. *Engagement quality control review.* A process designed to provide an objective evaluation, by an individual or individuals who are not members of the engagement team, of the significant judgments the engagement team made and the conclusions they reached in formulating the report.
- e. *Engagement quality control reviewer.* A partner, other person in the firm, qualified external person, or a team made up of such individuals, none of whom is part of the engagement team, with sufficient and appropriate experience and authority to perform the engagement quality control review.
- f. *Engagement team.* All personnel performing the engagement, excluding those who perform the engagement quality control review. The engagement team (i) includes all employees and contractors retained by the firm who perform engagement procedures, irrespective of their functional classification (for example, audit, tax, or management consulting services) and (ii) excludes specialists as discussed in AU section

- 336, *Using the Work of a Specialist*, and individuals who perform only routine clerical functions, such as word processing and photocopying.
- g. Firm.* A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the American Institute of Certified Public Accountants that is engaged in the practice of public accounting.
  - h. Inspection.* A retrospective evaluation of the adequacy of the firm's quality control policies and procedures, its personnel's understanding of those policies and procedures and the extent of the firm's compliance with them. Inspection is an element of monitoring.
  - i. Monitoring.* A process comprising an ongoing consideration and evaluation of the firm's system of quality control, the objective of which is to enable the firm to obtain reasonable assurance that its system of quality control is designed appropriately and operating effectively.
  - j. Partner.* An individual with authority to bind the firm with respect to the performance of a professional services engagement. For purposes of this definition, partner may include an employee with this authority who has not assumed the risks and benefits of ownership. Firms may use different titles to refer to individuals with this authority.
  - k. Personnel.* All individuals who perform professional services for which the firm is responsible, whether or not they are CPAs.
  - l. Professional standards.* Standards established by the AICPA Auditing Standards Board or the AICPA Accounting and Review Services Committee under Rules 201 or 202 of the AICPA Code of Professional Conduct or other standard setting bodies that set auditing and attest standards applicable to the engagement being performed.
  - m. Qualified external person.* An individual outside the firm with the capabilities and competence to act as an engagement partner.
  - n. Reasonable assurance.* In the context of this standard, a high, but not absolute, level of assurance.
  - o. Relevant ethical requirements.* Ethical requirements to which the firm and its personnel are subject, which consist of the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies, which may be more restrictive.
  - p. Staff.* Personnel, other than partners and engagement partners, including any specialists who are employees of the firm.

## Professional Requirements

**.06** SQCSs contain professional requirements together with related guidance in the form of explanatory material. Firms have a responsibility to consider the entire text of an SQCS with regard to their system of quality control and in understanding and applying the professional requirements of the relevant SQCSs.

**.07** Not every paragraph of an SQCS carries a professional requirement that the firm is expected to fulfill. Rather, the professional requirements are communicated by the language and the meaning of the words used in the SQCSs.

**.08** SQCSs use two categories of professional requirements, identified by specific terms, to describe the degree of responsibility they impose on firms, as follows:

- *Unconditional requirements.* The firm is required to comply with an unconditional requirement in all cases in which the circumstances exist to which the unconditional requirement applies. SQCSs use the words *must* or *is required* to indicate an unconditional requirement.
- *Presumptively mandatory requirements.* The firm is also required to comply with a presumptively mandatory requirement in all cases in which the circumstances exist to which the presumptively mandatory requirement applies; however, in rare circumstances, the firm may depart from a presumptively mandatory requirement provided the practitioner documents his or her justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement. SQCSs use the word *should* to indicate a presumptively mandatory requirement.

If an SQCS provides that a procedure or action is one that the firm "should consider," the consideration of the procedure or action is presumptively required, whereas carrying out the procedure or action is not. The professional requirements of an SQCS are to be understood and applied in the context of the explanatory material that provides guidance for their application.

## Explanatory Material

**.09** Explanatory material is defined as the text within an SQCS (excluding any related interpretations<sup>1</sup>) that may:

- Provide further explanation and guidance on the professional requirements; or
- Identify and describe other procedures or actions relating to the activities of the firm.

**.10** Explanatory material that provides further explanation and guidance on the professional requirements is intended to be descriptive rather than imperative. That is, it explains the objective of the professional requirements (where not otherwise self-evident); it explains why the firm might consider or employ particular procedures, depending on the circumstances; and it provides additional information for the firm to consider in exercising professional judgment with regard to its system of quality control.

**.11** Explanatory material that identifies and describes other procedures or actions relating to the activities of the firm is not intended to impose a professional requirement for the firm to perform the suggested procedures or actions. Rather, these procedures or actions require the firm's attention and understanding; how and whether the firm carries out such procedures or actions with regard to its system of quality control depends on the exercise of professional judgment in the circumstances consistent with the objective of the standard. The words *may*, *might*, and *could* are used to describe these actions and procedures.

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<sup>1</sup> Interpretive publications differ from explanatory material. Interpretive publications, for example, interpretations of the SQCSs, reside outside of the standards section of an SQCS and are recommendations on the application of the SQCS in specific circumstances. In contrast, explanatory material is always contained within the standards sections of the SQCS and is meant to be more descriptive in nature.

## Documentation and Communication of Quality Control Policies and Procedures

**.12** The firm should document its quality control policies and procedures. The size, structure, and nature of the practice of the firm are important considerations in determining the extent of the documentation of established quality control policies and procedures. For example, documentation of established quality control policies and procedures would generally be expected to be more extensive in a large firm than in a small firm and in a multioffice firm than in a single-office firm.

**.13** The firm should communicate its quality control policies and procedures to its personnel. Although communication is enhanced if it is in writing, the communication of quality control policies and procedures is not required to be in writing. Effective communication of the firm's quality control policies and procedures:

- Describes the quality control policies and procedures and the objectives they are designed to achieve;
- Includes the message that each individual has a personal responsibility for quality and is expected to be familiar with and to comply with these policies and procedures; and
- Stresses the importance of obtaining feedback on its system of quality control from its personnel and encourages its personnel to communicate their views or concerns on quality control matters.

## Elements of a System of Quality Control

**.14** The firm's system of quality control should include policies and procedures addressing each of the following elements:

- a. Leadership responsibilities for quality within the firm (the "tone at the top")
- b. Relevant ethical requirements
- c. Acceptance and continuance of client relationships and specific engagements
- d. Human resources
- e. Engagement performance
- f. Monitoring

## Leadership Responsibilities for Quality Within the Firm (the "Tone at the Top")

**.15** The firm should promote an internal culture based on the recognition that quality is essential in performing engagements and should establish policies and procedures to support that culture. Such policies and procedures should require the firm's leadership (managing partner or board of managing partners, chief executive officer, or equivalent) to assume ultimate responsibility for the firm's system of quality control.

**.16** The firm's leadership and the examples it sets significantly influence the internal culture of the firm. The promotion of a quality-oriented internal culture depends on clear, consistent, and frequent actions and messages from all levels of the firm's management that emphasize the firm's quality control policies and procedures, and the requirement to:



- a. Perform work that complies with professional standards and regulatory and legal requirements.
- b. Issue reports that are appropriate in the circumstances.

Such actions and messages encourage a culture that recognizes and rewards quality work. These actions and messages may be communicated by training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They may be incorporated in the firm's internal documentation and training materials, and in partner and staff appraisal procedures such that they will support and reinforce the firm's view on the importance of quality and how, practically, it is to be achieved.

.17 Of particular importance in promoting an internal culture based on quality is the need for the firm's leadership to recognize that the firm's business strategy is subject to the overarching requirement for the firm to achieve the objectives of the system of quality control in all the engagements that the firm performs. Accordingly, the firm should establish policies to:

- a. Assign management responsibilities so that commercial considerations do not override the quality of work performed;
- b. Address performance evaluation, compensation, and advancement (including incentive systems) with regard to its personnel, to demonstrate the firm's overarching commitment to the objectives of the system of quality control; and
- c. Devote sufficient and appropriate resources for the development, communication, and support of its quality control policies and procedures.

.18 Any person or persons assigned operational responsibility for the firm's quality control system by the firm's leadership should have sufficient and appropriate experience and ability to identify and understand quality control issues and to develop appropriate policies and procedures, as well as the necessary authority to implement those policies and procedures.

## Relevant Ethical Requirements

.19 The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel comply with relevant ethical requirements.

.20 The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include:

- Responsibilities
- The public interest
- Integrity
- Objectivity and independence
- Due care
- Scope and nature of services

.21 The firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel, and, where applicable, others subject to independence requirements, maintain independence where required. Independence requirements are set forth in Rule 101 (ET section 101) and its related interpretations and rulings of the AICPA Code of Professional Conduct and the rules of state boards of accountancy and applicable regulatory agencies. Guidance on threats to independence, including the familiarity threat that may be created by using the same senior personnel on an audit

or attest engagement over a long period of time, and safeguards to mitigate such threats involving matters that are not explicitly addressed in the Code of Professional Conduct, are set forth in the AICPA's Conceptual Framework for AICPA Independence Standards. Such policies and procedures should enable the firm to:

- a. Communicate its independence requirements to its personnel and, where applicable, others subject to them.
- b. Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if effective safeguards cannot be applied, withdrawing from the engagement.<sup>2</sup>

**.22** Such policies and procedures should require:

- a. The engagement partner to consider relevant information about client engagements, including the scope of services, to enable him or her to evaluate the overall effect, if any, on independence requirements.
- b. Personnel to promptly notify the engagement partner and the firm of circumstances and relationships that create a threat to independence so that appropriate action can be taken.
- c. The accumulation and communication of relevant information to appropriate personnel so that:
  - (i) The firm, the engagement partner, and other firm personnel can readily determine whether they satisfy independence requirements;
  - (ii) The firm can maintain and update information relating to independence; and
  - (iii) The firm and the engagement partner can take appropriate action regarding identified threats to independence.

**.23** The firm should establish policies and procedures designed to provide it with reasonable assurance that it is notified of breaches of independence requirements, and to enable it to take appropriate actions to resolve such situations. The policies and procedures should include requirements for:

- a. Personnel to promptly notify the firm of independence breaches of which they become aware.
- b. The firm to promptly communicate identified breaches of these policies and procedures and the required corrective actions to:
  - (i) The engagement partner who, with the firm, has the responsibility to address the breach; and
  - (ii) Other relevant personnel in the firm and those subject to the independence requirements who need to take appropriate action.
- c. Confirmation to the firm by the engagement partner and the other individuals referred to in subparagraph b.(ii) that the required corrective actions have been taken.

**.24** At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent by the requirements set forth in Rule 101 and its related interpretations and rulings of the AICPA Code of Professional Conduct

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<sup>2</sup> An accountant is not precluded from issuing a report with respect to a compilation of financial statements for an entity with respect to which the accountant is not independent. If the accountant is not independent, disclosure of the accountant's lack of independence is the appropriate response.

and the rules of state boards of accountancy and applicable regulatory agencies. Written confirmation may be in paper or electronic form.

**.25** The purpose of obtaining confirmation and taking appropriate action on information indicating noncompliance is to demonstrate the importance that the firm attaches to independence and keep the issue current for and visible to its personnel.

**.26** For all audit or attestation engagements where regulatory or other authorities require the rotation of personnel after a specified period, the firm's policies and procedures should address these requirements.

## Acceptance and Continuance of Client Relationships and Specific Engagements

**.27** The firm should establish policies and procedures for the acceptance and continuance of client relationships and specific engagements, designed to provide the firm with reasonable assurance that it will undertake or continue relationships and engagements only where the firm:

- a. Has considered the integrity of the client, including the identity and business reputation of the client's principal owners, key management, related parties, and those charged with its governance, and the risks associated with providing professional services in the particular circumstances;
- b. Is competent to perform the engagement and has the capabilities and resources to do so; and
- c. Can comply with legal and ethical requirements.

The firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client.

**.28** To minimize the risk of misunderstandings regarding the nature, scope, and limitations of the services to be performed, policies and procedures should provide for obtaining an understanding with the client regarding those services. Professional standards may provide guidance in deciding whether the understanding should be oral or written.

**.29** When issues have been identified, and the firm has decided to accept or continue the client relationship or a specific engagement, the firm should document how the issues were resolved.

**.30** Factors to consider regarding the integrity of a client include:

- The nature of the client's operations, including its business practices.
- Information concerning the attitude of the client's principal owners, key management, and those charged with its governance toward such matters as aggressive interpretation of accounting standards and internal control over financial reporting.

The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

**.31** Matters to consider in accepting or continuing the client engagement include whether:

- Firm personnel have knowledge of relevant industries or subject matters or the ability to effectively gain the necessary knowledge;

- Firm personnel have experience with relevant regulatory or reporting requirements, or the ability to effectively gain the necessary competencies;
- The firm has sufficient personnel with the necessary capabilities and competence;
- Specialists are available, if needed;
- Individuals meeting the criteria and eligibility requirements to perform an engagement quality control review are available, where applicable; and
- The firm is able to complete the engagement within the reporting deadline.

**.32** If a potential conflict of interest is identified in accepting an engagement from a new or an existing client, the firm should determine whether it is appropriate to accept the engagement. Where the engagement is accepted, the firm should consider any ethical requirements that exist under AICPA Interpretation No. 102-2, "Conflicts of Interest," under Rule 102, *Integrity and Objectivity* (ET section 102), such as disclosure of the relationship to the client and other appropriate parties.

**.33** Deciding whether to continue a client relationship includes consideration of significant issues that have arisen during the current or previous engagements, and their implications for continuing the relationship.

**.34** If the firm obtains information that would have caused it to decline an engagement if that information had been available earlier, policies and procedures on the continuance of the engagement and the client relationship should include consideration of the professional and legal responsibilities that apply to the circumstances, and the possibility of withdrawing from the engagement or from both the engagement and the client relationship.

**.35** Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship should include documenting significant issues, consultations, conclusions, and the basis for the conclusions. Policies and procedures may include:

- Discussing with the appropriate level of the client's management and those charged with its governance the appropriate action that the firm might take based on the relevant facts and circumstances.
- Considering whether there is a professional, regulatory, or legal requirement for the firm to remain in place, or for the firm to report the withdrawal from the engagement or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.
- If the firm determines that it is appropriate to withdraw, discussing with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship.

**.36** In certain situations, the auditor may be appointed by statutory procedure or required by law or regulation to perform the engagement. Accordingly, certain of the considerations regarding the acceptance and continuance of client relationships and specific engagements, as set out in paragraphs .27–.35, may not be relevant. Nonetheless, establishing policies and procedures as described may provide valuable information to public sector auditors in performing risk assessments and in carrying out reporting responsibilities.

## Human Resources

.37 The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to:

- a. Perform its engagements in accordance with professional standards and regulatory and legal requirements, and
- b. Enable the firm to issue reports that are appropriate in the circumstances.

.38 Such policies and procedures should address the following:

- Recruitment and hiring, if applicable;
- Determining capabilities and competencies;
- Assigning personnel to engagements, if applicable;
- Professional development; and
- Performance evaluation, compensation, and advancement.

### *Recruitment and Hiring*

.39 Effective recruitment processes and procedures help the firm select individuals of integrity, who have the capacity to develop the capabilities and competence necessary to perform the firm's work, and possess the appropriate characteristics to enable them to perform competently. Examples of such characteristics may include meeting minimum academic requirements established by the firm, maturity, integrity, and leadership traits.

### *Determining Capabilities and Competencies*

.40 Capabilities and competencies are the knowledge, skills, and abilities that qualify personnel to perform an engagement covered by this section. Capabilities and competencies are not measured by periods of time because such a quantitative measurement may not accurately reflect the kinds of experiences gained by personnel in any given time period. Accordingly, for purposes of this section, a measure of overall competency is qualitative rather than quantitative.

.41 Capabilities and competence are developed through a variety of methods; for example:

- Professional education
- Continuing professional development, including training
- Work experience
- Mentoring by more experienced staff; for example, other members of the engagement team

### *Competencies of Engagement Partner*

.42 A firm's quality control policies and procedures should provide reasonable assurance that an engagement partner possesses the competencies necessary to fulfill his or her engagement responsibilities.

.43 In most cases, an engagement partner will have gained the necessary competencies through relevant and appropriate experience in engagements covered by this section. In some cases, however, an engagement partner may have

obtained the necessary competencies through disciplines other than the practice of public accounting, such as in relevant industry, governmental, and academic positions. When necessary, the experience of the engagement partner may be supplemented by continuing professional education (CPE) and consultation. The following are examples.

- An engagement partner whose recent experience has consisted primarily in providing tax services may acquire the competencies necessary in the circumstances to perform a compilation or review engagement by obtaining relevant CPE.
- An engagement partner whose experience consists of performing review and compilation engagements may be able to obtain the necessary competencies to perform an audit by becoming familiar with the industry in which the client operates, obtaining CPE relating to auditing, using consulting sources during the course of performing the audit engagement, or any combination of these.
- A person in academia might obtain the necessary competencies to perform engagements covered by this section by (a) obtaining specialized knowledge through teaching or authorship of research projects or similar papers and (b) performing a rigorous self-study program, or by engaging a consultant to assist on such engagements.

.44 The characteristics of a particular client, industry, and the kind of service being provided determine the nature and extent of competencies established by a firm that are expected of the engagement partner for an engagement. For example:

- The competencies expected of an engagement partner for an engagement to compile financial statements would be different than those expected of a practitioner engaged to review or audit financial statements.
- Supervising engagements and signing or authorizing others to sign reports for clients in certain industries or engagements, such as financial services, governmental, or employee benefit plan engagements, would require different competencies than those expected in performing attest services for clients in other industries.
- The engagement partner for an attestation engagement to examine management's assertion about the effectiveness of an entity's internal control over financial reporting would be expected to have technical proficiency in understanding and evaluating the effectiveness of controls, while an engagement partner for an attestation engagement to examine investment performance statistics would be expected to have different competencies, including an understanding of the subject matter of the underlying assertion.

.45 In practice, the competency requirements necessary for the engagement partner are broad and varied in both their nature and number. Required competencies include the following, as well as other competencies as necessary in the circumstances.

- *Understanding of the role of a system of quality control and the Code of Professional Conduct.* An understanding of the role of a firm's system of quality control and the AICPA's Code of Professional Conduct, both of which play critical roles in assuring the integrity of the various kinds of reports.

- *Understanding of the service to be performed.* An understanding of the performance, supervision, and reporting aspects of the engagement. This understanding is usually gained through actual participation under appropriate supervision in that type of engagement.
- *Technical proficiency.* An understanding of the applicable professional standards including those standards directly related to the industry in which a client operates and the kinds of transactions in which a client engages.
- *Familiarity with the industry.* An understanding of the industry in which a client operates, to the extent required by professional standards applicable to the kind of service being performed. In performing an audit or review of financial statements, this understanding would include an industry's organization and operating characteristics sufficient to identify areas of high or unusual risk associated with an engagement and to evaluate the reasonableness of industry-specific estimates.
- *Professional judgment.* Skills that indicate sound professional judgment. In performing engagements covered by this section, such skills would typically include the ability to exercise professional skepticism and identify areas requiring special consideration including, for example, the evaluation of the reasonableness of estimates and representations made by management and the determination of the kind of report appropriate in the circumstances.
- *Understanding the organization's information technology systems.* A sufficient understanding of how the organization is dependent on or enabled by information technologies and the manner in which the information systems are used to record and maintain financial information, to determine when involvement of an IT professional is necessary for an audit engagement.

### ***Interrelationship of Competencies and Other Elements of a Firm's System of Quality Control***

.46 The competencies listed above are interrelated and gaining one particular competency may be related to achieving another. For example, familiarity with the client's industry interrelates with a practitioner's ability to make professional judgments relating to the client.

.47 In establishing policies and procedures related to the nature of competencies needed by the engagement partner for an engagement, a firm may consider the requirements of policies and procedures established for other elements of quality control. For example, a firm might consider its requirements related to engagement performance in determining the nature of competency requirements that describe the degree of technical proficiency necessary in a given set of circumstances.

### ***The Relationship of the Competency Requirement of the Uniform Accountancy Act to the Human Resource Element of Quality Control***

.48 CPAs are required to follow the accountancy laws of the individual licensing jurisdictions in the United States that govern the practice of public accounting. These jurisdictions may have adopted, in whole or in part, the Uniform Accountancy Act (UAA), which is a model legislative statute and related administrative rules designed by the AICPA and the National Association of State Boards of Accountancy (NASBA) to provide a uniform approach to the

regulation of the accounting profession. The UAA provides that "any individual licensee who is responsible for supervising attest or compilation services and signs or authorizes someone to sign the accountant's report on the financial statements on behalf of the firm shall meet the competency requirements set out in the professional standards for such services." A firm's compliance with this section is intended to enable a practitioner who performs the services described in the preceding sentence on the firm's behalf to meet the competency requirement referred to in the UAA.

### ***Assignment of Engagement Teams***

**.49** The firm should assign responsibility for each engagement to an engagement partner and should establish policies and procedures requiring that:

- a. The identity and role of the engagement partner are communicated to management and those charged with governance;
- b. The engagement partner has the appropriate capabilities, competence, authority, and time to perform the role; and
- c. The responsibilities of the engagement partner are clearly defined and communicated to that individual.

**.50** Policies and procedures may include systems to monitor the workload and availability of engagement partners so as to enable these individuals to have sufficient time to adequately discharge their responsibilities.

**.51** The firm should establish policies and procedures to assign appropriate staff with the necessary capabilities, competence, and time to:

- a. Perform engagements in accordance with professional standards and regulatory and legal requirements; and
- b. Enable the firm or engagement partners to issue reports that are appropriate in the circumstances.

**.52** When assigning engagement teams, and in determining the level of supervision required, the firm might consider factors such as the engagement team's:

- Understanding of, and practical experience with, engagements of a similar nature and complexity through appropriate training and participation.
- Understanding of professional standards and regulatory and legal requirements.
- Technical knowledge and expertise, including knowledge of relevant information technology.
- Knowledge of relevant industries in which the client operates.
- Ability to apply professional judgment.
- Understanding of the firm's quality control policies and procedures.

Generally, as the ability and experience levels of assigned staff increase, the need for direct supervision decreases.

**.53** Appropriate teamwork and training assist less experienced members of the engagement team to clearly understand the objectives of the assigned work.

### ***Professional Development***

**.54** The continuing competence of the firm's personnel depends to a significant extent on an appropriate level of continuing professional development so that personnel maintain their knowledge and capabilities. Effective policies



and procedures emphasize the need for all levels of firm personnel to participate in general and industry-specific continuing professional education and other professional development activities that enable them to fulfill responsibilities assigned, and to satisfy applicable continuing professional education requirements of the AICPA and regulatory agencies. Effective policies and procedures also place importance on passing the Uniform CPA Examination. The firm may provide the necessary training resources and assistance to enable personnel to develop and maintain the required capabilities and competence. The firm may use an external source that is qualified for that purpose if internal technical and training resources are unavailable, or for any other reason.

### ***Performance Evaluation, Compensation, and Advancement***

**.55** The firm's policies and procedures should provide that personnel selected for advancement have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.

**.56** Effective performance evaluation, compensation, and advancement procedures give due recognition and reward to the development and maintenance of competence and commitment to ethical principles. Steps a firm may take in developing and maintaining competence and commitment to ethical principles include:

- Making personnel aware of the firm's expectations regarding performance and ethical principles;
- Providing personnel with evaluation of, and counseling on, performance, progress, and career development; and
- Helping personnel understand that their compensation and advancement to positions of greater responsibility depend upon, among other things, performance quality and adherence to ethical principles, and that failure to comply with the firm's policies and procedures may result in disciplinary action.

The size and circumstances of the firm are important considerations in determining the structure of the firm's performance evaluation process. Smaller firms, in particular, may employ less formal methods of evaluating the performance of their personnel.

### **Engagement Performance**

**.57** The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are consistently performed in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issues reports that are appropriate in the circumstances. Required policies and procedures should address:

- a. Engagement performance,
- b. Supervision responsibilities, and
- c. Review responsibilities.

**.58** Effective policies and procedures facilitate consistency in the quality of engagement performance. This may be accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry- or subject-matter-specific guidance materials. The firm might address, for example:

- How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work,

- Processes for complying with applicable engagement standards,
- Processes of engagement supervision, staff training, and mentoring,
- Methods of reviewing the work performed, the significant judgments made, and the type of report being issued,
- Appropriate documentation of the work performed and of the timing and extent of the review,
- Appropriate communication of the results of each engagement, and
- Processes to keep all policies and procedures current.

**.59** Policies and procedures for engagement supervision might include:

- Tracking the progress of the engagement;
- Considering the capabilities and competence of individual members of the engagement team, whether they have sufficient time to carry out their work, whether they understand their instructions, and whether the work is being carried out in accordance with the planned approach to the engagement;
- Addressing significant issues arising during the engagement, considering their significance, and appropriately modifying the planned approach; and
- Identifying matters for consultation or consideration by more-experienced engagement team members during the engagement.

**.60** Review responsibility policies and procedures should be determined on the basis that qualified engagement team members, which may include the engagement partner, review work performed by other team members on a timely basis.

**.61** A review may include consideration of whether, for example:

- The work has been performed in accordance with professional standards and regulatory and legal requirements;
- Significant findings and issues have been raised for further consideration;
- Appropriate consultations have taken place and the resulting conclusions have been documented and implemented;
- The nature, timing, and extent of work performed is appropriate and without need for revision;
- The work performed supports the conclusions reached and is appropriately documented;
- The evidence obtained is sufficient and appropriate to support the report; and
- The objectives of the engagement procedures have been achieved.

**.62** The firm should establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis, as appropriate for the nature of the engagement, after the engagement reports have been released. Professional standards, laws, or regulations may prescribe the time limits by which the assembly of final engagement files for specific types of engagements is to be completed.

***Confidentiality, Safe Custody, Integrity, Accessibility, and Retrievability of Engagement Documentation***

**.63** The firm should establish policies and procedures designed to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation.

**.64** Relevant ethical requirements establish an obligation for the firm's personnel to observe at all times the confidentiality of information contained in engagement documentation, unless specific client authority has been given to disclose information or there is a legal or professional duty to do so. Specific laws or regulations may impose additional obligations on the firm's personnel to maintain client confidentiality, particularly where data of a personal nature are concerned.

**.65** Whether engagement documentation is in paper, electronic, or other media, the integrity, accessibility, and retrievability of the underlying data may be compromised if the documentation could be altered, added to, or deleted without the firm's knowledge, or could be permanently lost or damaged. Appropriate and reasonable controls for engagement documentation may include those that:

- Clearly determine when and by whom engagement documentation was prepared or reviewed;
- Protect the integrity of the information at all stages of the engagement, especially when the information is shared within the engagement team or transmitted to other parties via electronic means;
- Prevent unauthorized changes to the engagement documentation; and
- Allow access to the engagement documentation by the engagement team and other authorized parties as necessary to properly discharge their responsibilities.

**.66** Controls that the firm may design and implement to maintain the confidentiality, safe custody, integrity, accessibility, and retrievability of engagement documentation may include, for example:

- The use of a password by engagement team members and data encryption to restrict access to electronic engagement documentation to authorized users;
- Appropriate back-up routines for electronic engagement documentation at appropriate stages during the engagement;
- Procedures for properly distributing engagement documentation to the team members at the start of the engagement, processing it during the engagement, and collating it at the end of the engagement; and
- Procedures for restricting access to and enabling proper distribution and confidential storage of hardcopy engagement documentation.

**.67** For practical reasons, original paper documentation may be electronically scanned or otherwise copied to another media for inclusion in engagement files. In that case, the firm should establish procedures designed to maintain the integrity, accessibility, and retrievability of the documentation.

**.68** These procedures may include, for example:

- Generating scanned copies that reflect the entire content of the original paper documentation, including manual signatures, cross-references and annotations;

- Integrating the scanned copies into the engagement files, including indexing and signing off on the copies as necessary; and
- Enabling the scanned copies to be retrieved and printed as necessary.

There may be legal, regulatory, or other reasons to retain original paper documentation.

### ***Retention of Engagement Documentation***

**.69** The firm should establish policies and procedures for the retention of engagement documentation for a period sufficient to meet the needs of the firm, professional standards, laws, and regulations.

**.70** In determining the needs of the firm for retention of engagement documentation and the period of such retention, the firm may consider the nature of the engagement and the firm's circumstances; for example, whether the engagement documentation is needed to provide a record of matters of continuing significance to future engagements. The retention period may also depend on other factors, such as whether professional standards, laws, or regulations prescribe specific retention periods for certain types of engagements, or whether there are generally accepted retention periods in the absence of specific legal or regulatory requirements.

**.71** Procedures that the firm may adopt for retention of engagement documentation include those that:

- Enable the retrieval of and access to the engagement documentation during the retention period, particularly in the case of electronic documentation, as the underlying technology may be upgraded or changed over time.
- Provide, where necessary, a record of changes made to engagement documentation after the assembly of engagement files has been completed.
- Enable authorized external parties to access and review specific engagement documentation for quality control or other purposes.

### ***Consultation***

**.72** The firm should establish policies and procedures designed to provide it with reasonable assurance that:

- a. Consultation takes place when appropriate (for example, when dealing with complex, unusual, unfamiliar, difficult, or contentious issues);
- b. Sufficient and appropriate resources are available to enable appropriate consultation to take place;
- c. All the relevant facts known to the engagement team are provided to those consulted;
- d. The nature and scope of such consultations are documented, and are understood by both the individual seeking consultation and the individual consulted; and
- e. The conclusions resulting from such consultations are documented and implemented.

**.73** Consultation includes discussion, at the appropriate professional level, with individuals within or outside the firm who have relevant specialized expertise.

**.74** Consultation uses appropriate research resources as well as the collective experience and technical expertise of the firm. Consultation helps to promote quality and improves the application of professional judgment. Appropriate recognition of consultation in the firm's policies and procedures helps to promote a culture in which consultation is recognized as a strength and encourages personnel to consult on complex, unusual, unfamiliar, difficult, or contentious issues.

**.75** The firm's consultation procedures should provide for consultation with those having appropriate knowledge, seniority, and experience within the firm (or, where applicable, outside the firm) on significant technical, ethical, and other matters, and for appropriate documentation and implementation of conclusions resulting from consultations.

**.76** A firm needing to consult externally may take advantage of advisory services provided by other firms, professional and regulatory bodies, or commercial organizations that provide relevant quality control services. Before using such services, the firm should evaluate whether the external provider is qualified for that purpose.

**.77** Documentation of consultations with other professionals that involve complex, unusual, unfamiliar, difficult, or contentious matters that is sufficiently complete and detailed contributes to an understanding of:

- The issue on which consultation was sought; and
- The results of the consultation, including any decisions made, the basis for those decisions, and how they were implemented.

### ***Differences of Opinion***

**.78** The firm should establish policies and procedures for dealing with and resolving differences of opinion within the engagement team, with those consulted, and, where applicable, between the engagement partner and the engagement quality control reviewer (including a qualified external person). Such policies and procedures should require that:

- a. Conclusions reached be documented and implemented; and
- b. The report not be released until the matter is resolved.

**.79** Effective procedures encourage identification of differences of opinion at an early stage, provide clear guidelines about the successive steps to be taken thereafter, and require documentation regarding the resolution of the differences and the implementation of the conclusions reached. Procedures to resolve such differences may include consulting with another practitioner or firm, or a professional or regulatory body.

### ***Engagement Quality Control Review***

**.80** The firm should establish criteria against which all engagements covered by this section are to be evaluated to determine whether an engagement quality control review should be performed.

**.81** The firm's policies and procedures should require that if an engagement meets the criteria established, an engagement quality control review be performed for that engagement, and that the review be completed before the report is released.

**.82** The firm's policies and procedures should require the engagement partner to remain responsible for the engagement and its performance, notwithstanding involvement of the engagement quality control reviewer.

**.83** The structure and nature of the firm's practice are important considerations in establishing criteria to consider when determining which engagements are to be subject to an engagement quality control review. Such criteria may include:

- The nature of the engagement, including the extent to which it involves a matter of public interest;
- The identification of unusual circumstances or risks in an engagement or class of engagements; and
- Whether laws or regulations require an engagement quality control review.

**.84** If the firm has no engagements that meet the criteria, paragraphs .85–.99 do not apply.

### **Nature, Timing, and Extent of the Engagement Quality Control Review**

**.85** The engagement quality control review procedures should include an objective evaluation of the significant judgments made by the engagement team and the conclusions reached in formulating the report.

**.86** The engagement quality control review should include reading the financial statements or other subject matter information and the report and considering whether the report is appropriate.

**.87** An engagement quality control review also should include a review of selected engagement documentation relating to the significant judgments the engagement team made and the conclusions they reached, and should include a discussion with the engagement partner regarding significant findings and issues. The extent of the engagement quality control review may depend upon, among other things, the complexity of the engagement and the risk that the report might not be appropriate in the circumstances.

**.88** An engagement quality control review may include consideration of the following:

- The engagement team's evaluation of the firm's independence in relation to the specific engagement;
- Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters and the conclusions arising from those consultations; and
- Whether working papers selected for review reflect the work performed in relation to the significant judgments and support the conclusions reached.

**.89** Significant judgments made by the engagement team may include, for example:

- Significant risks identified during the engagement and the responses to those risks.
- Judgments made, particularly with respect to materiality and significant risks.
- The significance and disposition of corrected and uncorrected misstatements identified during the engagement.

- The matters to be communicated to management and those charged with governance and, where applicable, other parties such as regulatory bodies.

**.90** The firm's policies and procedures should require the engagement quality control reviewer to conduct the review in a timely manner so that significant issues may be promptly resolved to the reviewer's satisfaction before the report is released. The review may be conducted at appropriate stages during the engagement.

**.91** When the engagement quality control reviewer makes recommendations that the engagement partner does not accept and the matter is not resolved to the reviewer's satisfaction, the firm's procedures for dealing with differences of opinion apply (see paragraphs .78–.79).

### Criteria for the Eligibility of Engagement Quality Control Reviewers

**.92** The firm should establish policies and procedures addressing

- a. The appointment of engagement quality control reviewers; and
- b. The technical qualifications required to perform the role, including the necessary experience and authority.

**.93** The firm's policies and procedures on the technical qualifications of engagement quality control reviewers may address the technical expertise, experience, and authority necessary to fulfill the role. What constitutes sufficient and appropriate technical expertise, experience, and authority depends on the circumstances of the engagement.

**.94** The firm should establish policies and procedures designed to maintain the objectivity of the engagement quality control reviewer. Such policies and procedures should provide that while the engagement quality control reviewer is not a member of the engagement team, the engagement quality control reviewer should satisfy the independence requirements relating to the engagements reviewed.

**.95** Policies and procedures designed to maintain the objectivity of the engagement quality control reviewer may include a requirement, where practicable, that the engagement quality control reviewer is not selected by the engagement partner, and requirements that the engagement quality control reviewer not:

- a. Participate in the performance of the engagement except as discussed in paragraph .96 or
- b. Make decisions for the engagement team.

It may not be practicable, in the case of firms with few partners, for the engagement partner not to be involved in selecting the engagement quality control reviewer.

**.96** The engagement partner may consult the engagement quality control reviewer at any stage during the engagement, for example, to establish that a judgment made by the engagement partner will be acceptable to the engagement quality control reviewer. Such consultation need not impair the engagement quality control reviewer's eligibility to perform the role. However, when the nature and extent of the consultations become significant, the reviewer's objectivity may be impaired unless both the engagement team and the reviewer are careful to maintain the reviewer's objectivity.

**.97** The firm's policies and procedures should provide for the replacement of the engagement quality control reviewer when the reviewer's ability to perform an objective review has been impaired.

**.98** Qualified external persons may be contracted when sole practitioners or small firms identify engagements requiring engagement quality control reviews. Alternatively, some sole practitioners or small firms may wish to use other firms to facilitate engagement quality control reviews. When the firm contracts qualified external persons or other firms, the requirements and guidance in paragraphs .85–.97 apply.

## Documentation of the Engagement Quality Control Review

**.99** The firm should establish policies and procedures that provide for appropriate documentation of the engagement quality control review, including documentation that:

- a. The procedures required by the firm's policies on engagement quality control review have been performed;
- b. The engagement quality control review has been completed before the report is released; and
- c. The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

## Monitoring

**.100** The firm should establish policies and procedures designed to provide the firm and its engagement partners with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively, and complied with in practice. Such policies and procedures should:

- a. Include an ongoing consideration and evaluation of the firm's system of quality control to determine
  - (i) The appropriateness of the design and
  - (ii) The effectiveness of the operation of the system of quality control.
- b. Assign responsibility for the monitoring process to a partner or partners or other persons with sufficient and appropriate experience and authority in the firm to assume that responsibility.
- c. Assign performance of monitoring of the firm's system of quality control to qualified individuals.

**.101** The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:

- Adherence to professional standards and regulatory and legal requirements;
- Whether the quality control system has been appropriately designed and effectively implemented; and
- Whether the firm's quality control policies and procedures have been operating effectively, so that reports that are issued by the firm are appropriate in the circumstances.



The evaluation may identify circumstances that necessitate changes to, or the need to improve compliance with, the firm's policies and procedures to provide the firm with reasonable assurance that its system of quality control is effective.

**.102** The firm's policies should require the performance of monitoring procedures that are sufficiently comprehensive to enable the firm to assess compliance with all applicable professional standards and regulatory requirements, and the firm's quality control policies and procedures. Monitoring procedures include:

- Review of selected administrative and personnel records pertaining to the quality control elements.
- Review of engagement working papers, reports, and clients' financial statements.
- Discussions with the firm's personnel.
- Summarization of the findings from the monitoring procedures, at least annually, and consideration of the systemic causes of findings that indicate improvements are needed.
- Determination of any corrective actions to be taken or improvements to be made with respect to the specific engagements reviewed or the firm's quality control policies and procedures.
- Communication of the identified findings to appropriate firm management personnel.
- Consideration of findings by appropriate firm management personnel who should also determine that any actions necessary, including necessary modifications to the quality control system, are taken on a timely basis.

**.103** Monitoring procedures also include an assessment of:

- The appropriateness of the firm's guidance materials and any practice aids;
- New developments in professional standards and regulatory and legal requirements, and how they are reflected in the firm's policies and procedures where appropriate;
- Compliance with policies and procedures on independence;
- The effectiveness of continuing professional development, including training;
- Decisions related to acceptance and continuance of client relationships and specific engagements; and
- Firm personnel's understanding of the firm's quality control policies and procedures, and implementation thereof.

**.104** Some of the monitoring procedures discussed above may be accomplished through the performance of:

- Engagement quality control review.
- Postissuance review of engagement working papers, reports, and clients' financial statements for selected engagements.
- Inspection procedures.

**.105** The need for and extent of inspection procedures depends in part on the existence and effectiveness of the other monitoring procedures. The nature of inspection procedures varies based on the firm's quality control policies and procedures and the effectiveness and results of other monitoring procedures.

**.106** The inspection of a selection of completed engagements may be performed on a cyclical basis. For example, engagements selected for inspection may include at least one engagement for each engagement partner over an inspection cycle that spans three years. The manner in which the inspection cycle is organized, including the timing of selection of individual engagements, depends on many factors, including the following:

- The size of the firm.
- The number and geographical location of offices.
- The results of previous monitoring procedures.
- The degree of authority both personnel and offices have (for example, whether individual offices are authorized to conduct their own inspections or whether only the head office may conduct them).
- The nature and complexity of the firm's practice and organization.
- The risks associated with the firm's clients and specific engagements.

**.107** The inspection process involves the selection of individual engagements, some of which may be selected without prior notification to the engagement team. In determining the scope of the inspections, the firm may take into account the scope or conclusions of a peer review or regulatory inspections. (See paragraph .119.)

**.108** Inspection procedures with respect to the engagement performance element of a quality control system are particularly appropriate in a firm with more than a limited number of management-level individuals responsible for the conduct of its accounting and auditing practice.

**.109** In small firms with a limited number of persons with sufficient and appropriate experience and authority in the firm, monitoring procedures may need to be performed by some of the same individuals who are responsible for compliance with the firm's quality control policies and procedures. This includes postissuance review of engagement working papers, reports, and clients' financial statements by the person with final responsibility for the engagement. To effectively monitor one's own compliance with the firm's policies and procedures, it is necessary that an individual be able to critically review his or her own performance, assess his or her own strengths and weaknesses, and maintain an attitude of continual improvement. Changes in conditions and in the environment within the firm (such as obtaining clients in an industry not previously serviced or significantly changing the size of the firm) may indicate the need to have quality control policies and procedures monitored by another qualified individual.

**.110** Having an individual inspect his or her own compliance with a quality control system may be less effective than having such compliance inspected by another qualified individual. When one individual inspects his or her own compliance, the firm has a higher risk that noncompliance with policies and procedures will not be detected. Accordingly, a firm with a limited number of persons with sufficient and appropriate experience and authority in the firm may find it beneficial to engage a qualified individual from outside the firm to perform inspection procedures.

**.111** Any system of quality control has inherent limitations that can reduce its effectiveness. Deficiencies in individual engagements covered by this section do not, in and of themselves, indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that its personnel comply with applicable professional standards. The firm should evaluate the effect of

deficiencies noted as a result of the monitoring process and determine whether they require prompt corrective action.

**.112** Deficiencies identified during the monitoring process may be

- a. Instances that do not necessarily indicate that the firm's system of quality control is insufficient to provide it with reasonable assurance that it complies with professional standards and regulatory and legal requirements, and that the reports issued by the firm or engagement partners are appropriate in the circumstances; or
- b. Systemic, repetitive or other significant deficiencies that require prompt corrective action.

**.113** The firm should communicate to relevant engagement partners and other appropriate personnel deficiencies noted as a result of the monitoring process and recommendations for appropriate remedial action.

**.114** The firm's evaluation of each type of deficiency should result in recommendations for one or more of the following:

- a. Taking appropriate remedial action in relation to an individual engagement or member of personnel.
- b. The communication of the findings to those responsible for training and professional development.
- c. Changes to the quality control policies and procedures.
- d. Disciplinary action against those who fail to comply with the policies and procedures of the firm, especially those who do so repeatedly.

**.115** When the results of the monitoring procedures indicate that a report may be inappropriate or that procedures were omitted during the performance of the engagement, the firm should determine what further action is appropriate to comply with relevant professional standards and regulatory and legal requirements. The firm may also consider obtaining legal advice.

**.116** At least annually, the firm should communicate the results of the monitoring of its quality control system process to relevant engagement partners and other appropriate individuals within the firm, including the firm's leadership. Such communication should enable the firm and these individuals to take prompt and appropriate action where necessary in accordance with their defined roles and responsibilities and provide a basis for them to rely on the firm's system of quality control. Information communicated should include the following:

- a. A description of the monitoring procedures performed.
- b. The conclusions drawn from the monitoring procedures.
- c. Where relevant, a description of systemic, repetitive, or other significant deficiencies and of the actions taken to resolve or amend those deficiencies.

**.117** The reporting of identified deficiencies to individuals other than the relevant engagement partner need not include an identification of the specific engagements concerned, unless such identification is necessary for the proper discharge of the responsibilities of the individuals other than the engagement partner.

**.118** The firm should establish policies and procedures requiring appropriate documentation of monitoring (see paragraph .125). Appropriate documentation relating to monitoring includes:

- a. Monitoring procedures, including the procedure for selecting completed engagements to be inspected;
- b. A record of the evaluation of:
  - (i) Adherence to professional standards and regulatory and legal requirements;
  - (ii) Whether the quality control system has been appropriately designed and effectively implemented; and
  - (iii) Whether the firm's quality control policies and procedures have been operating effectively, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances; and
- c. Identification of the deficiencies noted, an evaluation of their effect, and the basis for determining whether and what further action is necessary.

### ***The Relationship of Peer Review to Monitoring***

**.119** A peer review does not substitute for all monitoring procedures. However, since the objective of a peer review is similar to that of inspection procedures, a firm's quality control policies and procedures may provide that a peer review conducted under standards established by the AICPA may substitute for the inspection of engagement working papers, reports, and clients' financial statements for some or all engagements for the period covered by the peer review.

### ***Complaints and Allegations***

**.120** The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:

- a. Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and
- b. Allegations of noncompliance with the firm's system of quality control; and
- c. Deficiencies in the design or operation of the firm's quality control policies and procedures, or noncompliance with the firm's system of quality control by an individual or individuals, as identified during the investigations into complaints and allegations.

**.121** As part of this process, the firm should establish clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals.

**.122** Complaints and allegations of noncompliance with the firm's system of quality control (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients, state boards of accountancy, other regulators, or other third parties. They may be received by engagement team members or other firm personnel.

**.123** The firm should require that investigations of such complaints and allegations in accordance with established policies and procedures be supervised by a person with sufficient and appropriate experience and authority who is not otherwise involved in the engagement. The firm's policies and procedures may require involving legal counsel in the investigation. Small firms and sole practitioners may use the services of a qualified external person or another firm to carry out the investigation.

.124 The firm should establish policies and procedures requiring documentation of complaints and allegations, and the responses to them.

## Documentation of Operation of Quality Control Policies and Procedures

.125 The firm should establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element of its system of quality control.

.126 The form and content of documentation evidencing the operation of each of the elements of the system of quality control is a matter of judgment and depends on a number of factors, including, for example:

- The size of the firm and the number of offices.
- The nature and complexity of the firm's practice and organization.

For example, large firms may use electronic databases to document matters such as independence confirmations, performance evaluations and the results of monitoring inspections. Smaller firms may use more informal methods such as manual notes, checklists, and forms.

.127 The firm should establish policies and procedures that require retention of documentation for a period of time sufficient to permit those performing monitoring procedures and peer review to evaluate the firm's compliance with its system of quality control, or for a longer period if required by law or regulation.

## Effective Date

.128 The provisions of this section are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2009.

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## PR Section

# STANDARDS FOR PERFORMING AND REPORTING ON PEER REVIEWS

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### TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
100	Standards for Performing and Reporting on Peer Reviews	.01-.199
	Overview .....	.01-.10
	Summary of the Nature, Objectives, Scope, Limitations of, and Procedures Performed in System and Engagement Reviews (as Referred to in a Peer Review Report) .....	.01-.04
	Introduction and Scope .....	.05-.10
	General Considerations .....	.11-.25
	Administrative Requirements .....	.11-.12
	Timing of Peer Reviews .....	.13-.19
	Confidentiality .....	.20
	Independence, Integrity, and Objectivity .....	.21-.22
	Due Professional Care .....	.23
	Peer Review Documentation and Retention Policy .....	.24-.25
	Organizing the System or Engagement Review Team .....	.26-.30
	Qualifying for Service as a Peer Reviewer .....	.31-.35
	System and Engagement Reviewers .....	.31
	Team Captain or Review Captain .....	.32-.33
	Other Peer Reviewer or Reviewing Firm Qualification Considerations .....	.34-.35
	Performing System Reviews .....	.36-.93
	Objectives .....	.36-.37
	Basic Requirements .....	.38
	Planning Considerations .....	.39-.40
	Understanding the Firm's Accounting and Auditing Practice and System of Quality Control .....	.41-.45
	Understanding and Assessing Peer Review Risk Factors .....	.46-.52
	Planning and Performing Compliance Tests .....	.53-.68
	Identifying Matters, Findings, Deficiencies, and Significant Deficiencies .....	.69-.74
	Aggregating and Systemically Evaluating Matters .....	.75-.86
	Forming Conclusions on the Type of Report to Issue in a System Review .....	.87-.90
	Communicating Conclusions at the Exit Conference .....	.91-.92

<i>Section</i>	<i>Paragraph</i>
100	Standards for Performing and Reporting on Peer Reviews—continued
	Addressing Disagreements Between the Reviewer and the Reviewed Firm ..... 93
	Reporting on System Reviews ..... 94-101
	General ..... 94
	Preparing the Report in a System Review ..... 95-96
	Firm Responses in a System Review ..... 97-101
	Performing Engagement Reviews ..... 102-116
	Objectives ..... 102-103
	Basic Requirements ..... 104-109
	Identifying Matters, Findings, Deficiencies, and Significant Deficiencies ..... 110-115
	Addressing Disagreements Between the Reviewer and the Reviewed Firm ..... 116
	Reporting on Engagement Reviews ..... 117-127
	Forming Conclusions on the Type of Report to Issue in an Engagement Review ..... 117-119
	General ..... 120-122
	Firm Responses in an Engagement Review ..... 123-127
	Administering Peer Reviews ..... 128-131
	Fulfilling Peer Review Committee and Report Acceptance Body Responsibilities ..... 132-135
	Accepting System and Engagement Reviews ..... 136-140
	Cooperating in a Peer Review ..... 141-145
	Publicizing Peer Review Information ..... 146
	Peer Reviewers' Performance and Cooperation ..... 147-153
	Performing and Reporting on Peer Reviews of Quality Control Materials (QCM) and Continuing Professional Education (CPE) Programs ..... 154-178
	Introduction ..... 154-157
	Objectives of a Peer Review of QCM or CPE Programs ..... 158
	Applicability ..... 159-163
	Qualifications for Serving as QCM or CPE Reviewers ... 164-165
	Procedures for Performing QCM or CPE Reviews ..... 166-169
	Reporting on QCM or CPE Reviews ..... 170-174
	Provider Responses on QCM and CPE Program Reviews ..... 175-178
	Effective Date ..... 179
	Appendixes
	A. Summary of the Nature, Objectives, Scope, Limitations of, and Procedures Performed in System and Engagement Reviews and Quality Control Materials and Continuing Professional Education Program Reviews (as Referred to in a Peer Review Report) ..... 180
	B. Considerations and Illustrations of Firm Representations ..... 181

Section	Paragraph
100	Standards for Performing and Reporting on Peer Reviews—continued
	C. Illustration of a Report With a Peer Review Rating of <i>Pass</i> in a System Review ..... .182
	D. Illustration of a Report With a Peer Review Rating of <i>Pass (With a Scope Limitation)</i> in a System Review ..... .183
	E. Illustration of a Report With a Peer Review Rating of <i>Pass With Deficiencies</i> in a System Review ..... .184
	F. Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of <i>Pass With Deficiencies</i> in a System Review ..... .185
	G. Illustration of a Report With a Peer Review Rating of <i>Pass With Deficiencies (With a Scope Limitation)</i> in a System Review ..... .186
	H. Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of <i>Pass With Deficiencies (With a Scope Limitation)</i> in a System Review ..... .187
	I. Illustration of a Report With a Peer Review Rating of <i>Fail</i> in a System Review ..... .188
	J. Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of <i>Fail</i> in a System Review ..... .189
	K. Illustration of a Report With a Peer Review Rating of <i>Fail (With a Scope Limitation)</i> in a System Review ..... .190
	L. Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of <i>Fail (With a Scope Limitation)</i> in a System Review ..... .191
	M. Illustration of a Report With a Peer Review Rating of <i>Pass</i> in an Engagement Review ..... .192
	N. Illustration of a Report With a Peer Review Rating of <i>Pass With Deficiencies</i> in an Engagement Review ..... .193
	O. Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of <i>Pass With Deficiencies</i> in an Engagement Review ..... .194
	P. Illustration of a Report With a Peer Review Rating of <i>Fail</i> in an Engagement Review ..... .195
	Q. Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of <i>Fail</i> in an Engagement Review ..... .196
	R. Illustration of a Report With a Peer Review Rating of <i>Pass</i> in a Peer Review of Quality Control Materials or Continuing Professional Education Programs ..... .197
	S. Illustration of a Report With a Peer Review Rating of <i>Pass With Deficiencies</i> in a Peer Review of Quality Control Materials or Continuing Professional Education Programs ..... .198



<i>Section</i>	<i>Paragraph</i>
100	Standards for Performing and Reporting on Peer Reviews—continued
	T. Illustration of a Report With a Peer Review Rating of <i>Fail</i> in a Peer Review of Quality Control Materials or Continuing Professional Education Programs . . . . .
	.199
9100	Standards for Performing and Reporting on Peer Reviews: Interpretations of Section 100
	1. Use of the Standards
	2. Individual Enrollment in the Program
	3. Acquisitions and Divestitures and Their Effect on Peer Review Scope
	4. Resignations From and Reenrollment in the Program
	5. Cooperating in a Peer Review
	6. Compilations Performed Under the Statement on Standards for Accounting and Review Services No. 1, Amended by Statement on Standards for Accounting and Review Services No. 8, Where No Compilation Report Is Issued
	7. Performing System Reviews at a Location Other Than the Reviewed Firm's Office
	8. Peer Reviews to Be Administered by the National Peer Review Committee
	9. Timing of Peer Reviews
	10. Independence, Integrity, and Objectivity
	11. Illegal Acts
	12. Peer Review Documentation and Retention Policy
	13. Associations of CPA Firms and Association Formed Review Teams
	14. Organizing the System or Engagement Review Team
	15. Qualifying for Service as a Peer Reviewer
	16. Other Planning Considerations and Reporting of PCAOB Inspection Results
	17. Understanding the Firm's System of Quality Control
	18. Considering the Firm's Monitoring Procedures
	19. Understanding, Assessing, and Documenting Peer Review Risk Factors and Risk Assessment
	20. Planning and Performing Compliance Tests of Requirements of Voluntary Membership Organizations
	21. Inclusion of Engagements and Aspects of Functional Areas in the Scope of the Peer Review
	22. Office and Engagement Selection in System Reviews
	23. Concluding on the Review of an Engagement
	24. Determining the Cause for a Finding in a System Review
	25. Isolated Matters in a System Review
	26. Communicating Conclusions at the Exit Conference
	27. Notification and Submission of Peer Review Documentation to the Administering Entities by the Team Captain or Review Captain

Section	Paragraph
9100	Standards for Performing and Reporting on Peer Reviews: Interpretations of Section 100—continued
	28. Reporting on System and Engagement Reviews When a Report With a Peer Review Rating of <i>Pass With Deficiency</i> or <i>Fail</i> is Issued
	29. Firm Responses in a System or Engagement Review
	30. Submission of FFC Forms to the Administering Entities by the Team Captain or Review Captain
	31. Election to Have a System Review
	32. Impact of SQCS No. 7 on Engagement Reviews
	33. Qualifying for Service as a Peer Review Committee Member, Report Acceptance Body Member, or Technical Reviewer
	34. Accepting Engagement Reviews by the Technical Reviewer
	35. Cooperating in a Peer Review—Implementation Plans and Correction Action Plans
	36. Publicizing Peer Review Information
	37. Firm Representations
	38. Firm and Individual Licenses
	39. Communications Received by the Reviewed Firm Relating to Allegations or Investigations in the Conduct of Accounting, Auditing, or Attestation Engagements From Regulatory, Monitoring, or Enforcement Bodies

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## PR Section 100

# ***Standards for Performing and Reporting on Peer Reviews***

[Originally issued March 2008; revised December 2008.]

### **NOTICE TO READERS**

In order to be admitted to or retain their membership in the AICPA, members of the AICPA who are engaged in the practice of public accounting in the United States or its territories are required to be practicing as partners or employees of firms enrolled in an approved practice-monitoring program or, if practicing in firms not eligible to enroll, are themselves enrolled in such a program if the services performed by such a firm or individual are within the scope of the AICPA's practice-monitoring standards and the firm or individual issues reports purporting to be in accordance with AICPA professional standards.

Firms have peer reviews because of the public interest in the quality of the accounting, auditing, and attestation services provided by public accounting firms. In addition, firms indicate that peer review contributes to the quality and effectiveness of their practices. Furthermore, most state boards of accountancy require its licensees to undergo peer review, which they may also call compliance assurance, to practice in their state. Other regulators require peer review in order to perform engagements and to issue reports under their standards.

A firm (or individual) enrolled in the AICPA Peer Review Program is deemed to be enrolled in an approved practice-monitoring program. See BL sections 230, *2.3 Requirements for Retention of Membership*, 220, *2.2 Requirements for Admission to Membership*, and 760, *7.6 Publication of Disciplinary Action*; AICPA Code of Professional Conduct Rule 505, *Form of Organization and Name* (ET sec. 505); and the implementing council resolutions under those sections.

These standards are applicable to firms (and individuals) enrolled in the program and to individuals and firms who perform and report on such peer reviews, to entities approved to administer the peer reviews, and to associations of CPA firms authorized by the AICPA Peer Review Board to assist its members in forming review teams. These standards are not intended for peer reviews of organizations that are not public accounting firms.

Users of these standards should be knowledgeable about the standards and their interpretations and effective dates, as well as guidance issued by the board that might affect the application of these standards. Those subject to the standards should be prepared to justify departures from these standards, and it is expected that departures will be rare.

These standards are effective for peer reviews commencing on or after January 1, 2009. Early implementation of these standards is not permitted.

**Effective for Peer Reviews commencing on or after January 1, 2009.**

**See section 9100 for interpretations of this section.**

## Overview

### Summary of the Nature, Objectives, Scope, Limitations of, and Procedures Performed in System and Engagement Reviews (as Referred to in a Peer Review Report)

**.01** The purpose of this document is to provide standards for administering, planning, performing, reporting on and the acceptance of peer reviews of CPA firms (and individuals) enrolled in the AICPA Peer Review Program (see interpretations). Those processes collectively are also called practice monitoring because it is the monitoring of a CPA firm's accounting and auditing practice.

**.02** The goal of practice monitoring, and the program itself, is to promote quality in the accounting and auditing services provided by the CPA firms (and individuals) subject to these standards. This goal serves the public interest and enhances the significance of AICPA membership.

**.03** Firms (and individuals) (see interpretations) enrolled in the program are required to have a peer review, once every three years, of their accounting and auditing practice related to non-Securities and Exchange Commission (SEC) issuers covering a one-year period. The peer review is conducted by an independent evaluator known as a peer reviewer. The AICPA oversees the program, and the review is administered by an entity approved by the AICPA to perform that role.

**.04** There are two types of peer reviews: System Reviews and Engagement Reviews. System Reviews focus on a firm's system of quality control, and Engagement Reviews focus on work performed on selected engagements. A further description of these peer reviews as well as a summary of the nature, objectives, scope, limitations of, and procedures performed in them is included in appendix A.

## Introduction and Scope

**.05** Firms (and individuals) (see interpretations) enrolled in the program have the responsibility to:

- a. Design and comply with a system of quality control for its accounting and auditing practice that provides the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Statement on Quality Control Standards (SQCS) No. 7, *A Firm's System of Quality Control* (QC sec. 10), requires every CPA firm, regardless of its size, to have a system of quality control for its accounting and auditing practice.
- b. Perform accounting and auditing engagements in accordance with applicable professional standards using competent personnel.<sup>1</sup>
- c. Have independent peer reviews of their accounting and auditing practices (see interpretations). All firms that an AICPA member is

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<sup>1</sup> *Personnel* are defined per Statements on Quality Control Standards as all individuals who perform professional services for which the firm is responsible, whether or not they are CPAs.

associated with should undergo a peer review if the services performed and reports issued by the firm require a peer review.

- d. Engage a peer reviewer to perform the peer review in accordance with these standards, in a timely manner.
- e. Take such measures, if any, as may be necessary to satisfy its obligations concerning client confidentiality any time state statutes or ethics rules promulgated by state boards of accountancy do not clearly provide an exemption from confidentiality requirements when peer reviews are undertaken.
- f. Provide written representations to describe matters significant to the peer review (see appendix B "Considerations and Illustrations of Firm Representations").
- g. Understand the AICPA Peer Review Board's guidance on resignations from the program (see interpretations).
- h. Cooperate with the peer reviewer, administering entity, and the board in all matters related to the peer review including arranging, scheduling, and completing the review and taking remedial, corrective actions and implementing other plans as needed (see interpretations).

**.06** An *accounting and auditing practice* for the purposes of these standards is defined as all engagements covered by Statements on Auditing Standards (SASs); Statements on Standards for Accounting and Review Services (SSARS)<sup>2</sup> (see interpretations); Statements on Standards for Attestation Engagements (SSAEs); *Government Auditing Standards* (the Yellow Book) issued by the U.S. Government Accountability Office; and audits of non-SEC issuers performed pursuant to the standards of the Public Company Accounting Oversight Board (PCAOB).

**.07** The objectives of the program are achieved through the performance of peer reviews involving procedures tailored to the size of the firm and the nature of its practice. Firms that perform engagements under the SASs or *Government Auditing Standards*, examinations of prospective financial statements under the SSAEs, or audits of non-SEC issuers performed pursuant to the standards of the PCAOB have peer reviews called *System Reviews*. A System Review includes determining whether the firm's system of quality control for its accounting and auditing practice is designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards, including SQCS No. 7 (QC sec. 10), in all material respects. Firms that only perform services under SSARS or services under the SSAEs not included in System Reviews have peer reviews called *Engagement Reviews*.<sup>3</sup> Firms that perform audits or play a substantial role in the audit of one or more SEC issuers, as defined by the PCAOB, are required to be registered with and have their accounting and auditing practice applicable to SEC issuers inspected by the PCAOB. Therefore, these standards are not intended for and exclude the review of the firm's accounting and auditing practice applicable to SEC issuers. Firms that do not provide any of the services listed in paragraph .06 are not peer reviewed.

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<sup>2</sup> Statements on Standards for Accounting and Review Services that provide an exemption from those standards in certain situations are likewise excluded from this definition of an accounting and auditing practice for peer review purposes (see interpretations).

<sup>3</sup> Although standards no longer permit the performance of Report Reviews as of January 1, 2009, a firm's last peer review could have been a Report Review.

**.08** The majority of the procedures in a System Review should be performed at the reviewed firm's office (see interpretations). Engagement Reviews are normally performed at a location other than the reviewed firm's office.

**.09** The program is based on the principle that a systematic monitoring and educational process is the most effective way to attain high quality performance throughout the profession. Thus, it depends on mutual trust and cooperation. On System Reviews, the reviewed firm is expected to take appropriate actions in response to findings, deficiencies, and significant deficiencies identified with their system of quality control or their compliance with the system, or both. On Engagement Reviews, the reviewed firm is expected to take appropriate actions in response to findings, deficiencies, and significant deficiencies identified in engagements. These actions will be positive and remedial. Disciplinary actions (including those that can result in the termination of a firm's enrollment in the program and the subsequent loss of membership in the AICPA and some state CPA societies by its partners<sup>4</sup> and employees) will be taken only for a failure to cooperate, failure to correct inadequacies, or when a firm is found to be so seriously deficient in its performance that education and remedial, corrective actions are not adequate.

**.10** Compliance with the positive enforcement program of a state board of accountancy does not constitute compliance with the AICPA's peer review requirements.

## General Considerations

### Administrative Requirements

**.11** All peer reviews intended to meet the requirements of the program should be carried out in conformity with these standards under the supervision of a state CPA society, group of state CPA societies, the AICPA Peer Review Board's National Peer Review Committee (National PRC) (see interpretations), or other entity (hereinafter, administering entity) approved by the board to administer peer reviews.

**.12** Peer reviews, including the reviewed firm and peer reviewers, are subject to oversight by the administering entity. In addition, peer reviews and administering entities are subject to oversight by the board and other bodies agreed upon by the board and/or the administering entity. The objectives of oversight are to ensure compliance with the standards and consistency in implementation. Reviewed firms, peer reviewers, and administering entities are expected to cooperate during the oversight process.

### Timing of Peer Reviews

**.13** A firm's due date for its initial peer review is 18 months from the date it enrolled in the program or should have enrolled, whichever date is earlier (see interpretations).

**.14** A firm does not undergo a peer review if it does not perform engagements requiring it to undergo a peer review (see paragraph .07). However, when a firm performs its first engagement requiring a peer review or its first engagement requiring it to have a System Review, the firm's next due date will be

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<sup>4</sup> A *partner* is a proprietor, shareholder, equity or nonequity partner, 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. Depending on how a CPA firm is legally organized, its partner(s) could have other names, such as *shareholder*, *member*, or *proprietor*.

18 months from the year-end of that engagement (18 months from the report date if it is an attestation engagement, including financial forecasts and projections) (see interpretations).

**.15** A firm's subsequent peer review ordinarily has a due date of three years and six months from the year-end of the previous peer review.

**.16** The due date for a peer review is the date by which the peer review report, and if applicable, letter of response and the peer reviewer's materials are to be submitted to the administering entity.

**.17** Peer reviews must cover a current period of one year to be mutually agreed upon by the reviewed firm and the reviewing firm. Ordinarily, the peer review should be conducted within three to five months following the end of the year to be reviewed.

**.18** A firm is expected to maintain the same year-end on subsequent peer reviews (which is three years from the previous year-end) and the same review due date (which is three years from the previous review due date) (see interpretations).

**.19** If a firm resigns from the program and subsequently reenrolls in the program, the firm's due date is the later of the due date originally assigned or 90 days after reenrolling.

## Confidentiality

**.20** A peer review should be conducted in compliance with the confidentiality requirements set forth in the section of the AICPA Code of Professional Conduct Rule 301, *Confidential Client Information* (ET sec. 301). Except as discussed in paragraph .146, information concerning the reviewed firm or any of its clients or personnel that is obtained as a consequence of the review is confidential. Such information should not be disclosed, except as required by law, by review team members or by administering entities to anyone not involved in performing the review, or administering or carrying out the program, or used in any way not related to meeting the objectives of the program.

## Independence, Integrity, and Objectivity

**.21** Independence in fact and in appearance should be maintained with respect to the reviewed firm by a reviewing firm, by review team members, and by any other individuals who participate in or are associated with the review (see interpretations). In addition, the review team should perform all peer review responsibilities with integrity and maintain objectivity in discharging those responsibilities.

**.22** *Independence* encompasses an impartiality that recognizes an obligation for fairness not only to the reviewed firm but also to those who may use the peer review report. The reviewing firm, the review team, and any other individuals who participate on the peer review should be free from any obligation to, or interest in, the reviewed firm or its personnel. The concepts in the AICPA Code of Professional Conduct's *Article III—Integrity* and *Article IV—Objectivity and Independence* (ET sec. 54 and 55), should be considered in making independence judgments. *Integrity* requires the review team to be honest and candid within the constraints of the reviewed firm's confidentiality. Service and the public trust should not be subordinated to personal gain and advantage. *Objectivity* is a state of mind and a quality that lends value to a review team's services. The principle of objectivity imposes the obligation to be impartial, intellectually honest, and free of conflicts of interest.



## Due Professional Care

**.23** Due professional care, as addressed by the AICPA Code of Professional Conduct's *Article V—Due Care* (ET sec. 56), should be exercised in performing and reporting on the review. This imposes an obligation on all those involved in carrying out the review to fulfill assigned responsibilities in a professional manner.

## Peer Review Documentation and Retention Policy

**.24** Peer review documentation should be prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached. The documentation provides evidence of the work performed and is the basis for the review of the quality of the work. It should demonstrate that the peer reviewer complied with these standards and should support the basis for the peer reviewer's conclusions. Also, the documentation should be appropriately organized to provide a clear link from the working papers to the peer review report (see interpretations).

**.25** Peer review documentation should not be retained for an extended period of time after the peer review's completion, with the exception of certain documents that are maintained until the subsequent peer review's acceptance and completion (see interpretations).

## Organizing the System or Engagement Review Team

**.26** A System Review team comprises one or more individuals, depending upon the size and nature of the reviewed firm's practice and other factors. An Engagement Review team ordinarily comprises one individual. A review team may be formed by a firm engaged by the firm under review (a firm-on-firm review) or an association of CPA firms authorized by the board to assist its members in forming review teams (an association formed review team) (see interpretations). For Engagement Reviews, review teams may also be formed by the administering entity if it chooses to appoint such teams (hereinafter, a committee-appointed review team, also known as a CART review).

**.27** A reviewing firm (including for these purposes the team captain, for an association formed review team) must determine its capability to perform a peer review. This determination includes assigning peer reviewers with appropriate levels of expertise and experience to perform the review. Before accepting a peer review engagement, the reviewing firm should obtain and consider information about the firm to be reviewed, including certain operating statistics concerning size, nature of practice, industry specializations, and levels of service.

**.28** In determining its capability to perform the review, the reviewing firm should consider the size of the firm to be reviewed in relation to its own size. A reviewing firm must recognize that the performance of a peer review may demand substantial commitments of time, especially from its supervisory accounting and auditing personnel. Therefore, a reviewing firm should consider carefully the number and availability of its supervisory personnel in determining whether it can perform a peer review of another firm.

**.29** One member of the System Review team is designated the team captain. The individual performing an Engagement Review is designated the review captain. The team captain or review captain is responsible for supervising and conducting the review, communicating the review team's findings to the reviewed firm and to the administering entity, preparing the report on the review, and ensuring that peer review documentation is complete and submitted to the administering entity on a timely basis. If applicable, the team captain, or review captain in unusual circumstances, should supervise and review the

work performed by other reviewers on the review team to the extent deemed necessary under the circumstances.

.30 A System Review team, a review captain on an Engagement Review and, in unusual circumstances any additional reviewers on an Engagement Review, ordinarily should be approved by the administering entity prior to the planning and commencement of the peer review (see interpretations).

## Qualifying for Service as a Peer Reviewer

### System and Engagement Reviewers

.31 Performing and reporting on a peer review requires the exercise of professional judgment by peers (see paragraphs .147–.153 for a discussion of a reviewer's responsibilities when performing a peer review). Accordingly, an individual serving as a reviewer on a System or Engagement Review should at a minimum:

- a. Be a member of the AICPA in good standing (that is, AICPA membership in active, nonsuspended status) licensed to practice as a CPA.
- b. Be currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in the program (see interpretations), as a partner of the firm, or as a manager or person with equivalent supervisory responsibilities.<sup>5,6</sup> To be considered currently active in the accounting or auditing function, a reviewer should be presently involved in the accounting or auditing practice of a firm supervising one or more of the firm's accounting or auditing engagements or carrying out a quality control function on the firm's accounting or auditing engagements.
- c. Be associated with a firm (or all firms if associated with more than one firm) that has received a report with a peer review rating of *pass*<sup>7</sup> for its most recent System or Engagement Review that was accepted timely, ordinarily within the last three years and six months (see interpretations).<sup>8</sup>
- d. Possess current knowledge of professional standards applicable to the kind of practice to be reviewed, including quality control and peer review standards. This includes recent experience in and knowledge about current rules and regulations appropriate to the level of service

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<sup>5</sup> The board recognizes that practitioners often perform a number of functions, including tax and consulting work, and cannot restrict themselves to accounting and auditing work. These standards are not intended to require that reviewers be individuals who spend all their time on accounting and auditing engagements. However, CPAs who wish to serve as reviewers should carefully consider whether their day-to-day involvement in accounting and auditing work is sufficiently comprehensive to enable them to perform a peer review with professional expertise. For instance, in a System Review, a reviewer of auditing engagements should be currently reviewing or performing auditing engagements. In an Engagement Review, a reviewer of engagements performed under the Statements on Standards for Attestation Engagements should also be currently reviewing or performing the same type of engagements.

<sup>6</sup> A manager or person with equivalent supervisory responsibilities is a professional employee of the firm who has either a continuing responsibility for the overall planning and supervision of engagements for specified clients or authority to determine that an engagement is complete subject to final partner approval if required.

<sup>7</sup> A peer review report with a rating of *pass* was previously referred to as an unmodified report (with or without a letter of comments). If a firm's most recent peer review rating was a *pass with deficiencies* or *fail*, the firm's members are not eligible to perform peer reviews.

<sup>8</sup> If a firm's most recent review was a report review, then the firm's members are not eligible to perform peer reviews.

applicable to the industries of the engagements that the individual will be reviewing (see interpretations).

- e. Have at least five years of recent experience in the practice of public accounting in the accounting or auditing function.<sup>9</sup>
- f. Have provided the administering entity with information that accurately reflects the qualifications of the reviewer including recent industry experience, which is updated on a timely basis (see interpretations).

## Team Captain or Review Captain

**.32** In addition to adhering to the general requirements in paragraph .31 to be a peer reviewer, a System Review team captain must be a partner.<sup>10</sup> For an Engagement Review, the review captain is not required to be a partner. The team captain, or the review captain in limited circumstances, is required to ensure that all team members possess the necessary capabilities and competencies to perform assigned responsibilities and that team members are adequately supervised. The team captain or review captain has the ultimate responsibility for the review, including the work performed by team members (see interpretations).

**.33** Also, team captains and review captains should have completed peer review training that meets the requirements established by the board (see interpretations). For additional team captain qualification requirements, see the interpretations.

## Other Peer Reviewer or Reviewing Firm Qualification Considerations

**.34** Communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of a peer reviewer or reviewing firm's accounting and auditing practice, and notifications of limitations or restrictions on a peer reviewer or reviewing firm to practice, may impact the peer reviewer or reviewing firm's ability to perform the peer review. The peer reviewer or reviewing firm has a responsibility to inform the administering entity of such communications or notifications (see interpretations).

**.35** If required by the nature of the reviewed firm's practice, individuals with expertise in specialized areas may assist the review team in a consulting capacity. For example, computer specialists, statistical sampling specialists, actuaries, or experts in continuing professional education (CPE) may participate in certain segments of the review.

## Performing System Reviews

### Objectives

**.36** A System Review is intended to provide the reviewer with a reasonable basis for expressing an opinion on whether, during the year under review:

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<sup>9</sup> For this purpose, *recent* means having experience within the last five years in the industries and related levels of service for which engagements are reviewed. However, a reviewer should be cautious of those high-risk engagements or industries in which new standards have been issued. For example, in those cases in which new industry standards or practices have occurred in the most recent year, it may be necessary to have *current* practice experience in that industry in order to have *recent* experience.

<sup>10</sup> If the peer reviewer's firm's (see paragraph .31c) most recent peer review was an Engagement or Report Review, then the peer reviewer is not eligible to be a System Review team captain.

- a. The reviewed firm's system of quality control for its accounting and auditing practice has been designed in accordance with quality control standards established by the AICPA (see SQCS No. 7 [QC sec. 10]).
- b. The reviewed firm's quality control policies and procedures were being complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

**.37** A System Review is designed to test a reasonable cross section of the firm's engagements with a focus on high-risk engagements, in addition to significant risk areas where the possibility exists of engagements not being performed and/or reported on in conformity with applicable professional standards in all material respects. A System Review is not designed to test every engagement or compliance with every professional standard and every detailed component of the firm's system of quality control.

## Basic Requirements

**.38** A System Review should include, but not be limited to, the following procedures:

- a. Planning the review, as follows:
  1. Obtain the results of the prior peer review (see paragraph .39).
  2. Inquire of the firm about the areas to be addressed in the written representations (see paragraph .40).
  3. Obtain a sufficient understanding of the nature and extent of the firm's accounting and auditing practice to plan the review (see paragraphs .41–.45).
  4. Obtain a sufficient understanding of the design of the firm's system of quality control, including an understanding of the monitoring procedures performed since the prior review, to plan the review (see paragraphs .41–.45).
  5. Assess peer review risk (see paragraphs .46–.52).
  6. Use the knowledge obtained from the foregoing to select the offices and the engagements to be reviewed and to determine the nature and extent of the tests to be applied in the functional areas (see paragraphs .53–.63).
- b. Performing the review, as follows:
  1. Review the firm's design and compliance with its system of quality control. The review should cover all organizational or functional levels within the firm (see paragraphs .53–.54).
  2. Review significant risk areas on selected engagements, including the relevant accounting, audit, and attestation documentation and reporting (see paragraphs .64–.65).
  3. Conclude on the review of engagements (see paragraphs .66–.67).
  4. Reassess the adequacy of the scope of the review based on the results obtained to determine whether additional procedures are necessary (see paragraph .68).
  5. Determine the relative importance of matters (see paragraphs .69–.72).
  6. Prepare the Matter for Further Consideration (MFC) forms, Disposition of MFC (DMFC) forms, and any related Finding for Further Consideration (FFC) forms (see paragraphs .73–.74).

7. Aggregate and systemically evaluate the matters (see paragraphs .75–.86).
8. Form conclusions on the type of report to issue (see paragraphs .87–.90).
9. Obtain the written representations from the reviewed firm (see paragraph .05(f) and appendix B).
10. Conduct an exit conference with senior members of the reviewed firm to discuss the review team's comments; matters, findings, deficiencies, and significant deficiencies identified; recommendations; MFCs and related FFCs; and the type of report to be issued and the deficiencies or significant deficiencies to be included in such report and to resolve any disagreements (see paragraphs .91–.92).
11. Prepare a written report on the results of the review (see paragraphs .94–.96).
12. Review and provide comments to the reviewed firm on its response to the report, if applicable (see paragraphs .97–.101).

## Planning Considerations

**.39** To assist the review team in the planning of the review, the team captain should obtain the prior peer review report,<sup>11</sup> the letter of response, if applicable, and the letter of acceptance, all from the reviewed firm. The team captain should also obtain the prior FFC forms, if applicable (from the administering entity if the team captain's firm did not perform the prior peer review). The team captain should consider whether the issues discussed in those documents require additional emphasis in the current review and, in the course of the review, should evaluate the actions of the firm in response to the prior report.

**.40** The reviewer should inquire of the firm regarding the areas to be addressed in the written representation (see paragraph .05(f) and appendix B) and consider whether the areas discussed require additional emphasis in the course of the review (see interpretations).

## Understanding the Firm's Accounting and Auditing Practice and System of Quality Control

**.41** The review team should obtain a sufficient understanding of the nature and extent of the reviewed firm's accounting and auditing practice to plan the review. This understanding should include knowledge about the reviewed firm's organization and philosophy, as well as the composition of its accounting and auditing practice.

**.42** The review team should also obtain a sufficient understanding of the reviewed firm's system of quality control with respect to each of the quality control elements in SQCS No. 7 (QC sec. 10) to plan the review (see interpretations). SQCS No. 7 (QC sec. 10) requires every CPA firm, regardless of its size, to have a system of quality control for its accounting and auditing practice. It states that the quality control policies and procedures applicable to a professional service provided by the firm should encompass the following elements: leadership responsibilities for quality within the firm (the "tone at the top"); relevant ethical requirements (such as independence, integrity, and objectivity; acceptance and continuance of client relationships and specific engagements; human

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<sup>11</sup> And the letter of comments, if applicable, for reviews commenced prior to January 1, 2009.

resources; engagement performance; and monitoring. It also states that the nature, extent, and formality of a firm's quality control policies and procedures should be appropriately comprehensive and suitably designed in relation to the firm's size, the number of its offices, the degree of operating autonomy allowed its personnel and its offices, the knowledge and experience of its personnel, the nature and complexity of the firm's practice, and appropriate cost-benefit considerations.

**.43** The understanding obtained by the review team should include knowledge about the design of the reviewed firm's quality control policies and procedures in accordance with quality control standards established by the AICPA and how the policies and procedures identify and mitigate risk of material non-compliance with applicable professional standards.

**.44** The understanding of the firm's accounting and auditing practice and system of quality control is ordinarily obtained through such procedures as inquiries of appropriate management and other personnel, reviewing the firm's internal policies and procedures, and reviewing the firm's responses to questionnaires developed by the board.

**.45** The review team should obtain a sufficient understanding of the reviewed firm's monitoring policies and procedures since its last peer review and their potential effectiveness. In doing so, the review team may determine that the firm's current year's internal monitoring procedures could enable the review team to reduce, in a cost-beneficial manner, the number of offices and engagements selected for review or the extent of the other testing (see interpretations).

## Understanding and Assessing Peer Review Risk Factors

**.46** Just as the performance of an audit involves audit risk, the performance of a System Review involves peer review risk. Peer review risk is the risk that the review team:

- a. Fails to identify significant weaknesses in the reviewed firm's system of quality control for its accounting and auditing practice, its lack of compliance with that system, or a combination thereof.
- b. Issues an inappropriate opinion on the reviewed firm's system of quality control for its accounting and auditing practice, its compliance with that system, or a combination thereof.
- c. Reaches an inappropriate decision about the matters to be included in, or excluded from, the report.

**.47** Peer review risk consists of the following two parts:

- a. The risk (consisting of *inherent risk* and *control risk*) that an engagement will not be performed and/or reported on in conformity with applicable professional standards in all materials respects, that the reviewed firm's system of quality control will not prevent such failure, or both.<sup>12,13</sup>

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<sup>12</sup> *Inherent risk* is the likelihood that an accounting or auditing engagement will fail to conform to professional standards, assuming the firm does not have a system of quality control.

<sup>13</sup> *Control risk* is the risk that a firm's system of quality control will not prevent the performance of an engagement that does not conform to professional standards. It consists of two parts: the firm's control environment and its quality control policies and procedures. The control environment represents the collective effort of various factors on establishing, enhancing, or mitigating the effectiveness of specific quality control policies and procedures. The control environment reflects the overall attitude, awareness, and actions of firm management concerning the importance of quality work and its emphasis in the firm.

- b. The risk (detection risk) that the review team will fail to detect and report on the design and/or compliance deficiencies or significant deficiencies in the reviewed firm's system of quality control.

.48 Inherent risk and control risk relate to the reviewed firm's accounting and auditing practice and its system of quality control. These risks may be affected by circumstances arising within the firm (for example, individual partners have engagements in numerous specialized industries or the firm has a few engagements constituting a significant portion of the firm's accounting and auditing practice) or outside the firm (for example, new professional standards being applied for the first time or adverse economic developments in an industry).

### ***Assessing Peer Review Risk***

.49 In planning the review, the review team should use the understanding it has obtained of the reviewed firm's accounting and auditing practice and its system of quality control to assess the inherent and control risks. The assessment of risks is qualitative and not quantitative. The lower the inherent and control risk, the higher the detection risk that can be tolerated and vice versa. Based on its assessment of inherent and control risk, the review team determines the acceptable level of detection risk.

.50 When assessing risk, the review team should evaluate the reviewed firm's quality control policies and procedures over its accounting and auditing practice in relation to the requirements contained in SQCS No. 7 (QC sec. 10). This evaluation provides a basis for the review team to determine whether the reviewed firm has adopted appropriately comprehensive and suitably designed policies and procedures that are relevant to the size and nature of its practice.

### ***Relationship of Risk to Scope***

.51 The review team should consider the combined assessed levels of inherent and control risk when selecting offices and engagements to be reviewed. The higher the combined assessed levels of inherent and control risk, the higher the peer review risk. To reduce the peer review risk to an acceptable low level, the detection risk needs to be low, and thus the greater the scope (that is, the greater the number of offices that should be visited or the greater the number of engagements that should be reviewed, or both). Conversely, the lower the combined assessed levels of inherent and control risk, the smaller the scope that needs to be considered for review. The combined assessed levels of inherent and control risk may vary among offices and engagements so that the scope may be greater for some types of offices and engagements than for others.

.52 However, even when the combined assessed levels are low, the peer review team must review some engagements to obtain reasonable assurance that the reviewed firm is complying with its quality control policies and procedures and applicable professional standards. For the review team to obtain such assurance, a reasonable cross section of the reviewed firm's accounting and auditing engagements must be reviewed or inspected, with greater emphasis on those portions of the practice with higher combined assessed levels of inherent and control risk (see interpretations).

## **Planning and Performing Compliance Tests**

.53 After performing the aforementioned planning procedures, the team captain should then develop a general plan for the nature and extent of conducting compliance tests of engagements (to directly test the "engagement performance" element in SQCS No. 7 [QC sec. 10]) and the other elements described in

SQCS No. 7 (QC sec. 10) (collectively referred to as the *functional areas*). The compliance tests should be tailored to the practice of the reviewed firm and, taken as a whole, should be sufficiently comprehensive to provide a reasonable basis for concluding whether the reviewed firm's system of quality control was complied with to provide the firm with reasonable (not absolute) assurance of performing and reporting in conformity with applicable professional standards in the conduct of its accounting and auditing practice in all material respects.

**.54** Such tests should be performed at the practice office(s) visited and should relate to individual engagements and the functional areas. The tests should include the following:

- a. Review significant risk areas (see paragraph .65) on selected engagements, including accounting and auditing documentation, and reports, to evaluate whether the engagements were performed and reported on in conformity with applicable professional standards and in compliance with relevant firm quality control policies and procedures.
- b. Interview firm personnel at various levels and, if applicable, other persons responsible for a function or activity to assess their understanding of, and compliance with, the firm's quality control policies and procedures.
- c. Review evidential material to determine whether the firm has complied with its policies and procedures for monitoring its system of quality control.
- d. Review other evidential material as appropriate. Examples include selected administrative or personnel files, correspondence files documenting consultations on technical or ethical questions, files evidencing compliance with human resource requirements, and the firm's technical reference sources (see interpretations).

### **Scope Limitations**

**.55** There is a presumption that all engagements and all aspects of functional areas otherwise subject to the peer review will be included in the scope of the review. However, in the rare situations when exclusions or other limitations on the scope of the review are being contemplated, a reviewer should carefully consider the implications of such exclusion. This includes communicating to the firm and the administering entity the effect on the review and on the ability of the reviewer to issue a peer review report (see interpretations).

### **Selection of Offices**

**.56** Visits to practice offices should be sufficient to provide the review team with a reasonable basis for its conclusions regarding whether the reviewed firm's quality control policies and procedures are adequately communicated throughout the firm and whether its system of quality control was complied with during the year under review based on a reasonable cross section of the reviewed firm's accounting and auditing practice, with greater emphasis on those offices with higher assessed levels of peer review risk. Examples of the factors to consider when assessing peer review risk at the office level include the following (see interpretations):

- a. The number, size, and geographic distribution of offices
- b. The degree of centralization of accounting and auditing practice control and supervision
- c. The review team's evaluation, if applicable, of the firm's monitoring procedures



- d. Recently merged or recently opened offices
- e. The significance of industry concentrations and of specialty practice areas, such as governmental compliance audits or regulated industries, to the firm and to individual offices
- f. Extent of nonaudit services to audit clients
- g. Significant clients' fees to practice office(s) and partner(s)

.57 For a multioffice firm, the review should include, in addition to any offices selected using the risk-based criteria, a visit to the firm's executive office if one is designated as such.

### **Selection of Engagements**

.58 Engagements subject to selection for review ordinarily should be those with periods ending during the year under review (see interpretations). For attestation engagements, including financial forecasts or projections, the selection for review ordinarily should be those with report dates during the year under review. If the current year's engagement has not been completed and issued, and if a comparable engagement within the peer review year is not available, the prior year's engagement may be reviewed. If the subsequent year's engagement has been completed and issued, the review team should consider, based on its assessment of peer review risk, whether the more recently completed and issued engagement should be reviewed instead (see interpretations). Review team members should not have contact with or access to any client of the reviewed firm in connection with the peer review.

.59 Engagements selected for review should provide a reasonable cross section of the reviewed firm's accounting and auditing practice, with greater emphasis on those engagements in the practice with higher assessed levels of peer review risk. Examples of the factors to consider when assessing peer review risk at the engagement level include size; industry area; level of service; personnel (including turnover, use of merged-in personnel, or personnel not routinely assigned to accounting and auditing engagements); communications from regulatory, monitoring, or enforcement bodies; extent of nonaudit services to audit clients; significant clients' fees to practice office(s) and partner(s); and initial engagements (see interpretations).

.60 The review of engagements should usually be directed toward the accounting and auditing work performed by the practice office visited, including the work performed on those engagements by other practice offices of the reviewed firm or other public accounting firms. For those situations in which the practice office being visited performed accounting and auditing work for another practice office, the review team may limit its review to portions of the engagements performed by the practice office being visited but should evaluate the appropriateness of the instructions issued by the other practice office and the adequacy of the procedures followed in performing and reporting in conformity with applicable professional standards. When combined with other procedures performed, the number and type of accounting and auditing engagements selected by the review team for review should be sufficient to provide the review team with a reasonable basis for its conclusions regarding the reviewed firm's system of quality control.

.61 The initial selection of engagements to be reviewed should ordinarily be provided to the reviewed firm no earlier than three weeks prior to the commencement of the peer review procedures at the related practice office or location. This should provide ample time to enable the firm (or office) to assemble the required client information and engagement documentation before the review team commences the review. However, at least one engagement from the

initial selection to be reviewed should be provided to the firm once the review commences and not provided to the firm in advance. Ordinarily, based on the nature of the firm's practice and assuming that the engagement would not be automatically anticipated for selection by the reviewed firm, the engagement should be an audit. Otherwise, the engagement should be the firm's next highest level of service where the same criteria can be met. This should not increase the scope of the review (see interpretations).

**.62** The process of engagement selection, except as noted in paragraph .63, like office selection, is not subject to definitive criteria. Nevertheless, if the team captain finds that meeting all of the preceding criteria results in the selection of an inappropriate scope of the firm's accounting and auditing practice, the team captain should consult with the administering entity about the selection of engagements for review (see interpretations).

**.63** Specific types and/or number of engagements must be selected in a System Review (see interpretations).

### ***Extent of the Review of Engagements***

**.64** The review of engagements should include the review of financial statements, accountants' reports, accounting and audit documentation, and correspondence, as well as discussions with professional personnel of the reviewed firm.

**.65** Audit engagements have areas in which risk may be inherently significant, such as, but not limited to, fraud considerations, use of estimates, emerging issues, and assertions that are difficult to audit. The review team's procedures should include determining whether the reviewed firm has appropriately:

- a. Identified the significant risk areas on each audit engagement selected for the peer review,
- b. Performed the necessary audit procedures related to the identified significant risk areas, and
- c. Documented the auditing procedures performed in these significant risk areas.

### ***Concluding on the Review of an Engagement***

**.66** For each engagement reviewed, the review team should conclude on its review by documenting whether anything came to its attention that caused it to believe that the engagement was not performed and/or reported on in conformity with applicable professional standards in all material respects (see interpretations).

**.67** The team captain should promptly inform the firm when an engagement is not performed and/or reported on in conformity with applicable professional standards and remind the firm of its obligation under professional standards to take appropriate actions (see interpretations).

### ***Expansion of Scope***

**.68** If, during the peer review, the review team concludes that there was a failure to reach an appropriate conclusion on the application of professional standards in all material respects on one or more of the reviewed engagements, the review team should consider whether the application of additional peer review procedures is necessary. This consideration should be documented in the peer review working papers. The objective of the application of additional procedures would be to determine whether the failure is indicative of a pattern of

such failures, whether it is a significant deficiency in the design of the reviewed firm's system of quality control or in its compliance with the system, or whether it is both. In some circumstances, the reviewer may conclude that, because of compensating controls or for other reasons, further procedures are unnecessary. If, however, additional procedures are deemed necessary, they may include an expansion of scope to review all or relevant portions of one or more additional engagements or aspects of functional areas. Additional engagements may be in the same industry, supervised by the same individual in the reviewed firm, or otherwise have characteristics associated with the failure to perform and/or report in conformity with professional standards.

## Identifying Matters, Findings, Deficiencies, and Significant Deficiencies

.69 In understanding the firm's system of quality control, the team captain may note that the system is not designed appropriately. Similarly, the performance of compliance tests may uncover that the system is not being complied with appropriately or may identify a design weakness that was not identified during the planning of the peer review. With any of these items, the team captain has available a set of definitions to assist in classifying the condition noted.

.70 Determining the relative importance of matters noted during the peer review, individually or combined with others, requires professional judgment. Careful consideration is required in forming conclusions. The descriptions that follow, used in conjunction with practice aids (MFC, DMFC, and FFC forms) to document these items when applicable, are intended to assist in aggregating and evaluating the peer review results, concluding on them, and determining the nature of the peer review report to issue:

- a. A peer reviewer notes a *matter* as a result of his or her evaluation of the design of the reviewed firm's system of quality control and/or tests of compliance with it. Tests of compliance include inspection, inquiry, and observation performed by reviewing engagements and testing other aspects of the reviewed firm's system of quality control. Matters are typically one or more "No" answers to questions in peer review questionnaire(s) that a reviewer concludes warrants further consideration in the evaluation of a firm's system of quality control. A matter is documented on a Matter for Further Consideration (MFC) form.
- b. A *finding* is one or more related matters that result from a condition in the reviewed firm's system of quality control or compliance with it such that there is more than a remote possibility that the reviewed firm would not perform and/or report in conformity with applicable professional standards. A peer reviewer will conclude whether one or more findings are a deficiency or significant deficiency. If the peer reviewer concludes that no finding, individually or combined with others, rises to the level of deficiency or significant deficiency, a report rating of *pass* is appropriate. A finding not rising to the level of a deficiency or significant deficiency is documented on a Finding for Further Consideration (FFC) form.
- c. A *deficiency* is one or more findings that the peer reviewer has concluded, due to the nature, causes, pattern, or pervasiveness, including the relative importance of the finding to the reviewed firm's system of quality control taken as a whole, could create a situation in which the firm would not have reasonable assurance of performing and/or reporting in conformity with applicable professional standards in one or

more important respects. It is not a significant deficiency if the peer reviewer has concluded that except for the deficiency or deficiencies, the reviewed firm has reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Such deficiencies are communicated in a report with a peer review rating of *pass with deficiencies*.

- d. A *significant deficiency* is one or more deficiencies that the peer reviewer has concluded results from a condition in the reviewed firm's system of quality control or compliance with it such that the reviewed firm's system of quality control taken as a whole does not provide the reviewed firm with reasonable assurance of performing and/or reporting in conformity with applicable professional standards in all material respects. Such deficiencies are communicated in a report with a peer rating of *fail*.

**.71** A broad understanding of the peer review process, from the preliminary evaluation of the design of the system of quality control, to the tests of compliance, to the decision making process of determining whether an item noted during a System Review is a matter, finding, deficiency, or significant deficiency, is shown in exhibit A. The exhibit also illustrates the aggregation of these items, where those items are documented in the practice aids and how they might affect the type of report issued.

**.72** As described by exhibit A in paragraph .71, depending on the resolution of a matter and the process of aggregating and evaluating peer review results, a matter may develop into a finding. Findings will also be evaluated and, after considering the nature, causes, pattern, pervasiveness, and relative importance to the system of quality control as a whole, may not get elevated to a deficiency. A matter may develop into a finding and get elevated to a deficiency. That deficiency may or may not be further elevated to a significant deficiency.

**.73** A matter is documented on an MFC form. If the matter, after further evaluation, gets elevated to a finding but not a deficiency or significant deficiency, it is documented on an FFC form. The FFC form is a standalone document that includes the reviewer's recommendation and the reviewed firm's response regarding actions planned or taken and the timing of those actions by the firm. MFC and FFC forms are subject to review and oversight by the administering entity, who will evaluate the reviewed firm's FFC form responses for appropriateness and responsiveness (see paragraphs .141–.145 and determine whether any further action is necessary. If the matter documented on the MFC form is instead elevated to a deficiency or significant deficiency, then it is communicated in the report itself, along with the reviewer's recommendation. The firm submits a letter of response regarding actions planned or taken and the timing of those actions by the firm, which is also evaluated for appropriateness and responsiveness (see paragraphs .139–.140).

**.74** In order to document the disposition of all the MFCs, the team captain completes a DMFC form. The DMFC form is included in the Summary Review Memorandum as part of the working papers and provides a trail of the disposition of the MFCs for the peer reviewer, administering entity, and individuals conducting technical reviews or oversight. All of the MFCs are identified on the DMFC form with an indication after each as to whether it was cleared, discussed with the firm during the exit conference, included on a specific FFC form (individually or combined with other MFCs), or included as a deficiency in a report with a peer review rating of *pass with deficiencies* or as a significant deficiency in a report with a peer review rating of *fail*.

## Aggregating and Systemically Evaluating Matters

.75 To conclude on the results of a peer review, the review team must aggregate the matters noted during the peer review and determine whether the matters were the result of the design of the reviewed firm's system of quality control or the failure of its personnel to comply with the firm's quality control policies and procedures. The review team should consider their relative importance to the firm's system of quality control as a whole and their nature, causes, pattern, and pervasiveness.

.76 Use of professional judgment is essential in determining whether the aggregation of the matters noted during the review are findings and whether one or more findings is a deficiency or significant deficiency for purposes of reporting on the results of the peer review.

### **Design Matters**

.77 A design matter exists when the reviewed firm's system of quality control is missing a quality control policy or procedure or the reviewed firm's existing quality control policies and procedures, even if fully complied with, would not result in engagements performed and/or reported on in accordance with professional standards in some respect. To be effective, a system of quality control must be designed properly, and all of the quality control policies and procedures necessary to provide the reviewed firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects should be in place. Therefore, the review team will need to determine whether the quality control policies and procedures would be effective if they were complied with. To make this determination, the review team should consider the implications of the evidence obtained during its evaluation of the system of quality control and its tests of compliance, including its reviews of engagements. For example, a pattern of engagement failures to perform and/or report in conformity with applicable professional standards in all material respects (that is, failures requiring the application of AU section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*, or AU section 390, *Consideration of Omitted Procedures After the Report Date*) likely is indicative of a finding pertaining to the design of the reviewed firm's quality control policies and procedures.

.78 As noted in SQCS No. 7 (QC sec. 10), "The nature of the policies and procedures developed by individual firms to comply with this Statement will depend on various factors such as the size and operating characteristics of the firm." Likewise, the relative importance of design matters noted in the reviewed firm's quality control policies and procedures, individually and in the aggregate, need to be evaluated in the context of the firm's size, organizational structure, and the nature of its practice. For example, a matter noted during the review of a quality control policy or procedures may be particularly or wholly offset by another policy or procedure. In this circumstance, the review team should consider the interrelationships among the elements of quality and weigh the matters noted against compensating policies and procedures to determine whether a finding exists and its relative importance.

.79 There may be circumstances in which the reviewer finds few findings in the work performed by the firm and yet may conclude that the design of the firm's system of quality control needs to be improved. For example, a firm that is growing rapidly and adding personnel and clients may not be giving appropriate attention to the policies and procedures necessary in areas such as human resources (hiring, assigning personnel to engagements, and advancement) and acceptance and continuance of clients and engagements. A reviewer

might conclude that these conditions could create a situation in which the firm would not have reasonable assurance of performing and/or reporting in conformity with applicable professional standards in one or more important respects. However, in the absence of findings in the engagements reviewed, the reviewer would ordinarily conclude that the matter should be addressed in an FFC as a finding rather than result in a report with a peer review rating of *pass with deficiencies* or *fail*.

### **Compliance Matters**

.80 A compliance matter exists when a properly designed quality control policy or procedure does not operate as designed because of the failure of the personnel of the reviewed firm to comply with it. Since a variance in individual performance and professional interpretation will affect the degree of compliance, adherence to all policies and procedures in every case generally is not possible. However, the degree of compliance by the personnel of the reviewed firm with its prescribed quality control policies and procedures should be adequate to provide the reviewed firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.

.81 In assessing whether the degree of compliance was adequate to provide the required assurance, the review team should consider the nature, causes, pattern, and pervasiveness of the instances of noncompliance noted and their relative importance to the firm's system of quality control as a whole, not merely their importance in the specific circumstances in which they were observed. As with the evaluation of design matters, compliance matters also need to be evaluated in the context of the firm's size, organizational structure, and the nature of its practice.

.82 To determine the degree of noncompliance, the review team should evaluate the matters of noncompliance, both individually and in the aggregate, recognizing that adherence to certain policies and procedures of the reviewed firm is more critical to the firm obtaining reasonable assurance of performing and reporting in conformity with applicable professional standards than adherence to others. In this context, the review team should consider the likelihood that noncompliance with a given quality control policy or procedure could have resulted in engagements not being performed and/or reported on in conformity with applicable professional standards in all material respects. The more direct the relationship between a specific quality control policy or procedure and the application of professional standards, the lower the degree of noncompliance necessary to determine whether a matter (or matters) is a finding and whether a finding is a deficiency or significant deficiency.

### **Determining the Cause for a Finding**

.83 When the review team is faced with an indication that the firm failed to perform and/or report in conformity with applicable professional standards in all material respects, the review team's first task in such circumstances is to determine the cause of the failure (see interpretations). Causes that might be systemic and might affect the type of peer review report issued include, but are not limited to, the following:

- a. The failure related to a specialized industry practice, and the firm had no experience in that industry and made no attempt to acquire training in the industry or to obtain appropriate consultation and assistance.
- b. The failure related to an issue covered by a recent professional pronouncement, and the firm had failed to identify, through professional

development programs or appropriate supervision, the relevance of that pronouncement to its practice.

- c. The failure should have been detected if the firm's quality control policies and procedures had been followed.
- d. The failure should have been detected by the application of quality control policies and procedures commonly found in firms similar in size or nature of practice. That judgment can often be made by the reviewer based on personal experience or knowledge; in some cases, the reviewer will wish to consult with the administering entity before reaching such a conclusion.

.84 The failure to perform and/or report in conformity with applicable professional standards in all material respects may be the result of an isolated human error and, therefore, would not necessarily mean that a peer review report with a peer review rating of *pass with deficiencies* or *fail* should be issued (see interpretations). However, if the reviewer believes that the probable cause (for example, a failure to provide or follow appropriate policies for supervision of the work of assistants) of a failure to perform and/or report in conformity with applicable professional standards in all material respects on an engagement or a finding within a functional area also exists in other engagements or in other functional areas, the reviewer needs to consider carefully the need to issue a peer review report with a peer review rating of *pass with deficiencies* or *fail*.

.85 Although an isolated matter or an instance of noncompliance with the firm's quality control policies and procedures ordinarily would not be included in the report, its nature, cause (if determinable), and relative importance for the firm's system of quality control as a whole should be evaluated in conjunction with the review team's other findings before making a final determination (see interpretations).

### ***The Pattern and Pervasiveness of Matters***

.86 The review team must consider the pattern and pervasiveness of matters and their implications for compliance with the firm's system of quality control as a whole, in addition to their nature, causes, and relative importance in the specific circumstances in which they were observed. As noted in the preceding paragraphs, the review team's first task is to try to determine why the matters occurred. In some cases, the design of the firm's system of quality control may be deficient (for example, when it does not provide for timely involvement in the planning process by a partner of the firm or there is inadequate supervision of engagement planning). In other cases, there may be a pattern of noncompliance with a quality control policy or procedure such as when firm policy requires the completion of a financial statement disclosure checklist but such checklists often were not used or relevant questions or points were incorrectly considered. That increases the possibility that the firm might not perform and/or report in conformity with applicable professional standards in all material respects, which also means that the reviewer must consider carefully whether the matter(s) individually or in the aggregate is (are) a deficiency or a significant deficiency and whether there is the need to issue a peer review report with a peer review rating of *pass with deficiencies* or *fail*. On the other hand, the types of matters noted may be individually different, not individually significant, and not directly traceable to the design of or compliance with a particular quality control policy or procedure. This may lead the reviewer to the conclusion that the matters were isolated cases of human error that should not result in a peer review report with a peer review rating of *pass with deficiencies* or *fail*.

## Forming Conclusions on the Type of Report to Issue in a System Review

.87 The team captain must use professional judgment in determining the type of peer review report to issue. This judgment requires the consideration of several factors, including an understanding of the firm's system of quality control and the nature, causes, pattern, and pervasiveness of matters and their relative importance to the firm's system of quality control taken as a whole, including limitations on the scope of the review.

### **System Review Report With a Peer Review Rating of Pass**

.88 A report with a peer review rating of *pass* should be issued when the team captain concludes that the firm's system of quality control for the accounting and auditing practice has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. There are no deficiencies or significant deficiencies that affect the nature of the report and, therefore, the report does not contain any deficiencies, significant deficiencies, or recommendations. In the event of a scope limitation, a report with a peer review rating of *pass (with a scope limitation)* is issued.

### **System Review Report With a Peer Review Rating of Pass With Deficiencies**

.89 A report with a peer review rating of *pass with deficiencies* should be issued when the team captain concludes that the firm's system of quality control for the accounting and auditing practice has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects with the exception of a certain deficiency or deficiencies that are described in the report. These deficiencies are conditions related to the firm's design of and compliance with its system of quality control that could create a situation in which the firm would have less than reasonable assurance of performing and/or reporting in conformity with applicable professional standards in one or more important respects due to the nature, causes, pattern, or pervasiveness, including the relative importance of the deficiencies to the quality control system taken as a whole. In the event of a scope limitation, a report with a peer review rating of *pass with deficiencies (with a scope limitation)* is issued.

### **System Review Report With a Peer Review Rating of Fail**

.90 A report with a peer review rating of *fail* should be issued when the team captain has identified significant deficiencies and concludes that the firm's system of quality control is not suitably designed to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects or the firm has not complied with its system of quality control to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. In the event of a scope limitation, a report with a peer review rating of *fail (with a scope limitation)* is issued.

## Communicating Conclusions at the Exit Conference

.91 A firm that has a System Review should respond promptly to questions raised in the review in order to assist the review team in reaching its



conclusions. Prior to issuing its report or finalizing FFC form(s), if applicable, the review team should communicate its conclusions to senior members of the reviewed firm at an exit conference (see interpretations). Ordinarily, the team captain should be physically present at the exit conference, unless the System Review is performed at a location other than the reviewed firm's office. The exit conference may also be attended by representatives of the administering entity, the board, AICPA staff, or other board authorized organizations with oversight responsibilities.

**.92** The reviewed firm is entitled to be informed at the exit conference about any matters documented on the MFC form(s), findings documented on the FFC form(s), deficiencies or significant deficiencies to be included in the peer review report, and the type of report to be issued. Accordingly, except in rare circumstances that should be explained to the reviewed firm, the exit conference should be postponed if there is any uncertainty about the report to be issued or the deficiencies or significant deficiencies to be included in the report. The review team should also communicate, if applicable, that the firm will be required to respond to the findings documented on the FFC form(s), and/or the deficiency(ies) or significant deficiencies included in the peer review report. The review team should also communicate that the firm may be required, if applicable, to (1) take certain actions to correct the deficiencies or significant deficiencies noted in the report and/or (2) complete an implementation plan to address the findings noted in the FFC form(s). The review team should also discuss with the reviewed firm the implications of these steps on the acceptance and completion of the peer review and the reviewed firm's enrollment in the program. The exit conference is also the appropriate vehicle for providing suggestions to the firm that are not included in the report, FFC form(s), or MFC form(s).

## Addressing Disagreements Between the Reviewer and the Reviewed Firm

**.93** Disagreements may arise on the resolution of various issues, for instance, related to the review of particular engagements, the systemic cause for a deficiency, or issues related to a design deficiency. In addition, there could be a disagreement on the appropriate approach to be taken in performing and/or reporting in conformity with applicable professional standards, or the review team might not believe that the actions planned or taken by the firm, if any, are appropriate (for example, if the reviewed firm believes that it can continue to support a previously issued report and the review team continues to believe that there may be a failure to reach appropriate conclusions in the application of professional standards). Reviewers and reviewed firms should understand that professional judgment often becomes a part of the process and that each party has the right to challenge each other on an issue. Nevertheless, a disagreement on the resolution of an issue may persist in some circumstances. The reviewed firm or reviewer should be aware that they may consult with their administering entity and, if necessary, request that the administering entity's peer review committee resolve the disagreement. If the administering entity's full peer review committee is unable to resolve the disagreement, the administering entity may refer unresolved issues to the board for a final determination. Only the administering entity's peer review committee will be responsible for determining whether a disagreement still exists, or whether the reviewed firm or review team is not cooperating, in order for the administering entity to refer the issue to the board.

## Reporting on System Reviews

### General

.94 The team captain should furnish the reviewed firm with a written report within 30 days of the exit conference date or by the firm's peer review due date, whichever is earlier. A report on a review performed by a firm is to be issued on the letterhead of the firm performing the review. A report by a review team formed by an association of CPA firms is to be issued on the letterhead of the firm of the team captain performing the review. The report in a System Review ordinarily should be dated as of the date of the exit conference. See interpretations for guidance on notification requirements and submission of peer review documentation to the administering entity.

### Preparing the Report in a System Review

.95 The standard form for a report with a peer review rating of *pass* is illustrated in appendix C, "Illustration of a Report With a Peer Review Rating of *Pass* in a System Review." Illustrations of reports with a peer review rating of *pass with deficiencies* and *fail* are presented in appendixes E, "Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies* in a System Review" and I, "Illustration of a Report With a Peer Review Rating of *Fail* in a System Review," respectively. Illustrations of reports with a peer review rating of *pass (with a scope limitation)*, *pass with deficiencies (with a scope limitation)*, and *fail (with a scope limitation)* are presented in appendixes D, "Illustration of a Report With a Peer Review Rating of *Pass (With a Scope Limitation)* in a System Review;" G, "Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies (With a Scope Limitation)* in a System Review;" and K, "Illustration of a Report With a Peer Review Rating of *Fail (With a Scope Limitation)* in a System Review," respectively.

.96 The written report in a System Review should:

- a. State at the top of the report the title "System Review Report."
- b. State that the system of quality control for the accounting and auditing practice of the firm was reviewed and include the year-end covered by the peer review.
- c. State that the peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants.
- d. State that the firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.
- e. State that the reviewer's responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on the review.
- f. State that the nature, objectives, scope, limitations of, and procedures performed in a System Review are described in the standards.
- g. Include a URL reference to the AICPA Web site where the standards are located.
- h. Identify engagement types required to be selected by the board in the interpretations, when applicable.
- i. Identify the different peer review ratings that the firm could receive.

- j.* In a report with a peer review rating of *pass*:
- Express an opinion that the system of quality control for the accounting and auditing practice of the reviewed firm in effect for the year-ended has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.
  - State at the end of the opinion paragraph that therefore the firm has received a peer review rating of *pass*.
  - In the event of a scope limitation, include an additional paragraph before the opinion paragraph that describes the relationship of the excluded engagement(s) or functional area(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from potential selection, and the affect of the exclusion on the scope and results of the peer review.
  - Reports with a peer review rating of *pass* do not contain any findings, deficiencies, significant deficiencies, or recommendations.
- k.* In a report with a peer review rating of *pass with deficiencies*:<sup>14</sup>
- Express an opinion that, except for the deficiencies described above, the system of quality control for the accounting and auditing practice of the reviewed firm in effect for the year-ended has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.
  - State at the end of the opinion paragraph that therefore the firm has received a peer review rating of *pass with deficiencies*.
  - In the event of a scope limitation, include an additional paragraph before the deficiencies that describes the relationship of the excluded engagement(s) or functional area(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from potential selection, and the affect of the exclusion on the scope and results of the peer review.
- l.* In a report with a peer review rating of *fail*:
- Express an opinion that as a result of the significant deficiencies described above, the system of quality control for the accounting and auditing practice of the reviewed firm in effect for the year-ended was not suitably designed or complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects.
  - State at the end of the opinion paragraph that therefore the firm has received a peer review rating of *fail*.
  - In the event of a scope limitation, include an additional paragraph before the significant deficiencies that describes the relationship of

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<sup>14</sup> Reference to plural could also apply to a singular item within the standards. For instance, there could be deficiencies or a deficiency. The wording in the peer review report should be tailored as necessary.

the excluded engagement(s) or functional area(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from potential selection, and the affect of the exclusion on the scope and results of the peer review.

- m. Include, for reports with a peer review rating of *pass with deficiencies* or *fail*, systemically written descriptions of the deficiencies or significant deficiencies and the reviewing firm's recommendations (each of these should be numbered) (see interpretations).
- n. Identify, for any deficiencies or significant deficiencies included in the report with a peer review rating of *pass with deficiencies* or *fail*, any that were also made in the report<sup>15</sup> issued on the firm's previous peer review (see interpretations). This should be determined based on the underlying systemic cause of the deficiencies or significant deficiencies.
- o. Identify the industry and level of service for any deficiencies or significant deficiencies that are determined to be industry specific included in the report with a peer review rating of *pass with deficiencies* or *fail*.

### Firm Responses in a System Review

**.97** If the reviewed firm receives a report with a peer review rating of *pass with deficiencies* or *fail*, the reviewed firm should respond in writing to the deficiencies or significant deficiencies and related recommendations identified in the report. The letter of response should be addressed to the administering entity's peer review committee and should describe the actions planned (including timing) or taken by the reviewed firm with respect to each deficiency in the report. The reviewed firm should submit a copy of the report, and its letter of response, to the administering entity within 30 days of the date it received the report from the team captain or by the firm's peer review due date, whichever date is earlier. Prior to submitting the response to the administering entity, the reviewed firm should submit the response to the team captain for review, evaluation, and comment (see interpretations).

**.98** If the reviewed firm receives a report with a peer review rating of *pass* or *pass (with a scope limitation)*, a letter of response is not applicable, and the reviewed firm does not submit a copy of the report to the administering entity.

**.99** The reviewed firm should respond to all findings and related recommendations not rising to the level of a deficiency or significant deficiency on the related FFC forms. These responses should describe the plan the reviewed firm has implemented or will implement (including timing) with respect to each finding. The team captain should review and evaluate the responses on the FFC forms before they are submitted to the administering entity (see interpretations).

**.100** If, after a discussion with the team captain, the reviewed firm disagrees with one or more of the findings, deficiencies, or significant deficiencies, the reviewed firm should contact the administering entity for assistance in the matter (see paragraph .93). If the reviewed firm still disagrees with one or more of the findings, deficiencies, or significant deficiencies, its response on either the FFC form or in the letter of response, as applicable, should describe the reasons for the disagreement.

**.101** Illustrations of letters of response by a reviewed firm to reports in a System Review with a peer review rating of *pass with deficiencies* and *fail*

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<sup>15</sup> And/or the letter of comments, if applicable, for reviews commenced prior to January 1, 2009.

are included in appendixes F, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies* in a System Review;" H, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies (With a Scope Limitation)* in a System Review;" J, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail* in a System Review;" and L, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail (With a Scope Limitation)* in a System Review."

## Performing Engagement Reviews

### Objectives

.102 The objective of an Engagement Review is to evaluate whether engagements submitted for review are performed and reported on in conformity with applicable professional standards in all material respects. An Engagement Review consists of reading the financial statements or information submitted by the reviewed firm and the accountant's report thereon, together with certain background information and representations and, except for compilation engagements performed under SSARS, the applicable documentation required by professional standards.

.103 Engagement Reviews are available only to firms that do not perform engagements under the SASs, *Government Auditing Standards*, examinations of prospective financial statements under the SSAEs, or audits of non-SEC issuers performed pursuant to the standards of the PCAOB. However, firms eligible to have an Engagement Review may elect to have a System Review (see interpretations).

### Basic Requirements

.104 The criteria for selecting the peer review year-end and the period to be covered by an Engagement Review are the same as those for a System Review (see paragraphs .13–.19). Engagements subject to review ordinarily should be those with periods ending during the year under review. For attestation engagements, including financial forecasts or projections, the selection for review ordinarily should be those engagements with report dates during the year under review. The reviewed firm should provide summarized information showing the number of its compilation and review engagements performed under SSARS and engagements performed under the SSAEs, classified into industry categories. That information should be provided for each partner, or individual if not a partner, of the firm who is responsible for the issuance of reports on such engagements. On the basis of that information, the review captain or the administering entity ordinarily should select the types of engagements to be submitted for review, in accordance with the following guidelines:

- a. One engagement should be selected from each of the following areas of service performed by the firm:
  1. Review of historical financial statements (performed under SSARS)
  2. Compilation of historical financial statements, with disclosures (performed under SSARS)
  3. Compilation of historical financial statements that omits substantially all disclosures (performed under SSARS)
  4. Engagements performed under the SSAEs other than examinations of prospective financial statements.

- b. One engagement should be selected from each partner, or individual of the firm if not a partner, responsible for the issuance of reports listed in item (a).
- c. Ordinarily, at least two engagements should be selected for review.

**.105** The preceding criteria are not mutually exclusive. The objective is to ensure that one engagement is selected for each partner and one engagement is selected from each of the areas of service performed by the firm listed in item (a) in the previous list. Therefore, one of every type of engagement that a partner, or individual if not a partner, responsible for the issuance of the reports listed in item (a) in the previous list performs does not have to be reviewed as long as, for the firm taken as a whole, all types of engagements noted in item (a) in the previous list performed by the firm are covered.

**.106** The review captain should obtain the required representations submitted by the firm (see paragraph .05(f)) and should obtain the firm's prior peer review report,<sup>16</sup> the letter response, if applicable, and the letter accepting those documents, all from the reviewed firm. The review captain should also obtain the prior FFC forms (from the administering entity if the review captain's firm did not perform the prior review).

**.107** For each engagement selected for review, the reviewed firm should submit the appropriate financial statements or information and the accountant's report, masking client identity if it desires, along with specified background information, representations about each engagement and, except for compilation engagements performed under SSARS, the firm's documentation required by applicable professional standards for each of these engagements. There is a presumption that all engagements otherwise subject to the peer review will be included in the scope of the review. However, in the rare situations when exclusions or other limitations on the scope of the review are being contemplated, a reviewer should carefully consider the implications of such exclusion. This includes communicating with the firm and the administering entity the effect on the review and on the ability of the reviewer to issue a peer review report.

**.108** The evaluation of each engagement submitted for review includes:

- a. Consideration of the financial statements or information and the related accountant's report on the compilation and review engagements performed under SSARS and engagements performed under SSAEs.
- b. Consideration of the documentation on the engagements performed via reviewing background and engagement profile information, representations made by the firm, and inquiries.
- c. For engagements other than compilation engagements performed under SSARS, review of all other documentation required by applicable professional standards on the engagements.
- d. The review captain may request to review all other documentation on compilation engagements performed under SSARS if the firm has represented that the documentation is appropriate but the review captain has cause to believe that the documentation may not have been prepared in accordance with applicable professional standards, or to support presentation or measurement issues relating to the financial statements or information, if necessary.

**.109** An Engagement Review does not include a review of other documentation prepared on the engagements submitted for review (other than the

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<sup>16</sup> And the letter of comments, if applicable, for reviews commenced prior to January 1, 2009.

documentation referred to in paragraphs .107–.108), tests of the firm's administrative or personnel files, interviews of selected firm personnel, or other procedures performed in a System Review (see interpretations). Accordingly, an Engagement Review does not provide the review captain with a basis for expressing any form of assurance on the firm's system of quality control for its accounting practice. The review captain's report does indicate, however, whether anything came to the review captain's attention that caused him or her to believe that the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects (see interpretations). The review captain should promptly inform the firm when an engagement is not performed and/or reported on in conformity with applicable professional standards and remind the firm of its obligation under professional standards to take appropriate actions (see interpretations).

### Identifying Matters, Findings, Deficiencies, and Significant Deficiencies

.110 Determining the relative importance of matters noted during the peer review, individually or combined with others, is a matter of professional judgment. Careful consideration is required in forming conclusions. The descriptions that follow, used in conjunction with practice aids (MFC, DMFC, and FFC forms) described below to document these items, are intended to assist in determining the nature of the peer review report to issue:

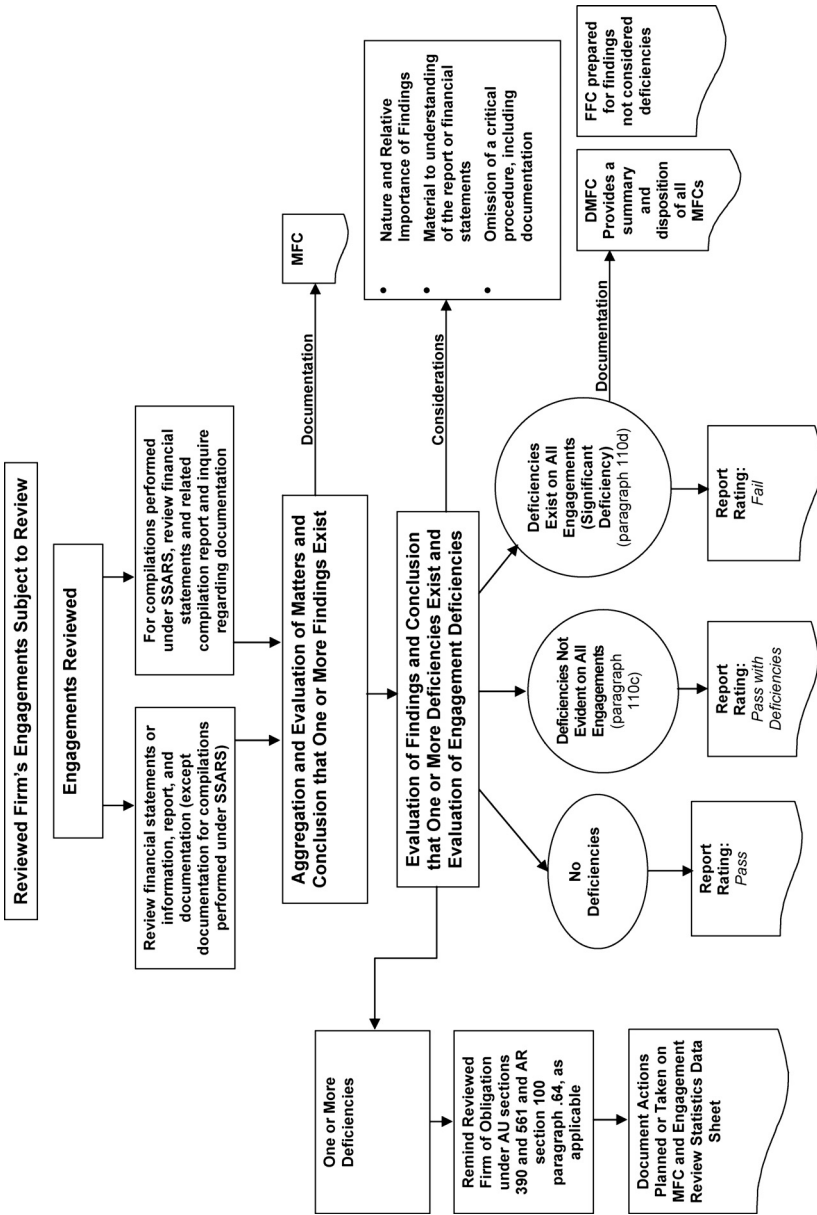
- a. A *matter* is noted as a result of evaluating whether an engagement submitted for review was performed and/or reported on in conformity with applicable professional standards. The evaluation includes reviewing the financial statements or information, the related accountant's reports, and the adequacy of procedures performed, including related documentation. Matters are typically one or more "No" answers to questions in peer review questionnaire(s). A matter is documented on a Matter for Further Consideration (MFC) form.
- b. A *finding* is one or more matters that the review captain has concluded result in financial statements or information, the related accountant's reports submitted for review, or the procedures performed, including related documentation, not being performed and/or reported on in conformity with the requirements of applicable professional standards. A review captain will conclude whether one or more findings are a deficiency or significant deficiency. If the review captain concludes that no finding, individually or combined with others, rises to the level of deficiency or significant deficiency, a report rating of *pass* is appropriate. A finding not rising to the level of a deficiency or significant deficiency is documented on an Finding for Further Consideration (FFC) form.
- c. A *deficiency* is one or more findings that the review captain concludes are material to the understanding of the financial statements or information and/or related accountant's reports or that represent omission of a critical procedure, including documentation, required by applicable professional standards. When the review captain concludes that deficiencies are not evident on all of the engagements submitted for review, or when the exact same deficiency occurs on each of the engagements submitted for review and there are no other deficiencies, such deficiencies are communicated in a report with a peer review rating of *pass with deficiencies*.
- d. A *significant deficiency* exists when the review captain concludes that deficiencies are evident on all of the engagements submitted for review

(with the exception of when more than one engagement has been submitted for review, the exact same deficiency occurs on each of those engagements, and there are no other deficiencies, which ordinarily would result in a report with a peer review rating of *pass with deficiencies*). When a significant deficiency is noted, the review captain concludes that all engagements submitted for review were not performed and/or reported on in conformity with applicable professional standards in all material respects. Such significant deficiencies are communicated in a report with a peer review rating of *fail*.

**.111** A broad understanding of the peer review process, from the review of submitted engagements to the decision making process of determining whether an item noted during an Engagement Review is a matter, finding, deficiency, or significant deficiency, is shown in exhibit A. The exhibit also illustrates the aggregation of these items, where those items are documented in the practice aids, and how they might affect the type of report issued.



Exhibit A



**.112** As described by exhibit A in paragraph .111, depending on the resolution of a matter and the process of aggregating and evaluating peer review results, a matter may develop into a finding. Findings will also be evaluated, and after considering their nature and relative importance, including whether they are material to the understanding of the report or financial statements and/or represent the omission of a critical procedure including documentation, may not get elevated to a deficiency. Alternatively, a matter may develop into a finding and get elevated to a deficiency. That deficiency may or may not be further elevated to a significant deficiency.

**.113** A matter is documented on an MFC form. If the matter, after further evaluation, gets elevated to a finding, but not a deficiency or significant deficiency, it is documented on an FFC form. The FFC form is a standalone document that includes the reviewer's recommendation and the reviewed firm's response regarding actions planned or taken and the timing of those actions by the firm. MFC and FFC forms are subject to review and oversight by the administering entity, who will evaluate the reviewed firm's FFC form responses for appropriateness and responsiveness (see paragraphs .141–.145). If the matter documented on the MFC form is instead elevated to a deficiency or significant deficiency, then it is communicated in the report itself, along with the reviewer's recommendation. The firm submits a letter of response regarding actions planned or taken and the timing of those actions by the firm, which is also evaluated for appropriateness and responsiveness (see paragraphs .139–.140).

**.114** In order to document the disposition of all the MFCs, the review captain completes a DMFC form. The DMFC form is included in the review captain's checklist as part of the working papers and provides a trail of the disposition of the MFCs for the peer reviewer, administering entity, and individuals conducting technical reviews or oversight. All of the MFCs are identified on the DMFC form with an indication after each as to whether it was cleared, discussed with the firm, included on a specific FFC form (individually or combined with other MFCs), or included as a deficiency in a report with a peer review rating of *pass with deficiencies* or as a significant deficiency in a report with a peer review rating of *fail*.

**.115** A firm that has an Engagement Review should respond promptly to questions raised in the review, whether those questions are raised orally or in writing. The review captain will contact the firm, before issuing the final peer review report, to resolve questions raised during the peer review and to complete the MFC, DMFC, and FFC forms as applicable. In addition to discussing deficiencies or significant deficiencies and recommendations to be included in a report with a peer review rating of *pass with deficiencies* or *fail*, ordinarily, these should be discussed, along with the content of the letter of response, and agreed upon with the firm prior to the issuance of the final written report. The review captain should also communicate, if applicable, that the firm may be required to (1) take certain actions to correct the deficiencies or significant deficiencies noted in the report and/or (2) complete an implementation plan to address the findings noted on the FFC form(s). The review team should also discuss with the reviewed firm the implications of these steps on the acceptance and completion of the peer review and the reviewed firm's enrollment in the program. This is also the appropriate opportunity for providing suggestions to the firm that are not included in the report, FFC form(s), or MFC form(s).

## Addressing Disagreements Between the Reviewer and the Reviewed Firm

.116 Disagreements may arise on the resolution of various issues. For instance, there could be a disagreement on the appropriate approach to performing and/or reporting in conformity with applicable professional standards, or the review team might not believe that the actions planned or taken by the firm, if any, are appropriate (for example, if the reviewed firm believes that it can continue to support a previously issued report and the review team continues to believe that there may be a failure to reach appropriate conclusions in the application of professional standards). Reviewers and reviewed firms should understand that professional judgment often becomes a part of the process and that each party has the right to challenge each other on an issue. Nevertheless, a disagreement on the resolution of an issue may persist in some circumstances. The reviewed firm and reviewer should be aware that they may consult with their administering entity and, if necessary, request that the administering entity's peer review committee resolve the disagreement. If the administering entity's full peer review committee is unable to resolve the disagreement, the administering entity may refer unresolved issues to the board for a final determination. Only the administering entity's peer review committee will be responsible for determining whether a disagreement still exists or whether the reviewed firm or review team is not cooperating in order to refer the issue to the board.

## Reporting on Engagement Reviews

### Forming Conclusions on the Type of Report to Issue in an Engagement Review

#### ***Engagement Review Report With a Peer Review Rating of Pass***

.117 A report with a peer review rating of *pass* is issued when the reviewer concludes that nothing came to his or her attention that caused him or her to believe that the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects. There are no deficiencies or significant deficiencies that affect the nature of the report and, therefore, the report does not contain any deficiencies, significant deficiencies, or recommendations. In the event of a scope limitation, a report with a peer review rating of *pass (with a scope limitation)* is issued.

#### ***Engagement Review Report With a Peer Review Rating of Pass With Deficiencies***

.118 A report with a peer review rating of *pass with deficiencies* is issued when the review captain concludes that nothing came to his or her attention that caused him or her to believe that the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects except for the deficiencies that are described in the report. The deficiencies are one or more findings that the peer reviewer concludes are material to the understanding of the report or financial statements or represents omission of a critical procedure, including documentation, required by applicable professional standards. A report with a peer review rating of *pass with deficiencies* is issued when at least one but not all of the engagements submitted for review contain a deficiency. However, when more than one engagement has been submitted for review, and the exact same deficiency

occurs on each of the engagements, and there are no other deficiencies, a report with a peer review rating of *pass with deficiency* should be issued rather than with a peer review rating of *fail*. In the event of a scope limitation, a report with a peer review rating of *pass with deficiencies (with a scope limitation)* is issued.

### **Engagement Review Report With a Peer Review Rating of Fail**

.119 A report with a peer review rating of *fail* is issued when the review captain concludes that, as a result of the deficiencies described in the report, the engagements submitted for review were not performed and/or reported on in conformity with applicable professional standards in all material respects. A report with a peer review rating of *fail* is issued when deficiencies are evident on all of the engagements submitted for review. However, a report with a peer review rating of *pass with deficiency* should be issued when more than one engagement has been submitted for review, and the exact same deficiency occurs on each of the engagements, and there are no other deficiencies. The review captain should not expand scope beyond the original selection of engagements in an effort to change the conclusion from a peer review rating of *fail* in these circumstances. In the event of a scope limitation, a report with a peer review rating of *fail (with a scope limitation)* is issued.

### **General**

.120 In an Engagement Review, the review captain should furnish the reviewed firm with a written report within 30 days of the review of engagements or by the firm's peer review due date, whichever is earlier. A report on a review performed by a firm is to be issued on the letterhead of the firm performing the review. A report by a review team formed by an association of CPA firms is to be issued on the letterhead of the firm of the review captain performing the review. Other reports are issued on the letterhead of the administering entity. The report in an Engagement Review ordinarily should be dated as of the date of the completion of the peer review procedures. See interpretations for guidance on notification requirements and submission of peer review documentation to the administering entity.

### **Illustrations of Reports in an Engagement Review**

.121 The standard form for a report with a peer review rating of *pass* is illustrated in appendix M, "Illustration of a Report with a Peer Review Rating of *Pass* in an Engagement Review." Illustrations of reports with a peer review rating of *pass with deficiencies* and *fail* are presented in appendixes N, "Illustration of a Report with a Peer Review Rating of *Pass with Deficiencies* in an Engagement Review," and P, "Illustration of a Report with a Peer Review Rating of *Fail* in an Engagement Review," respectively. Additional paragraphs included for scope limitations follow the illustrations for System Reviews with scope limitations (see appendixes D, G, and K).

.122 The written report in an Engagement Review should:

- a. State at the top of the report the title "Engagement Review Report."
- b. State that the review captain reviewed selected accounting engagements of the firm and include the year-end covered by the peer review.
- c. State that the peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants.

- d. State that the firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects (even though this is an Engagement Review, the statement reflects the responsibility of the firm).
- e. State that the reviewer's responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects.
- f. State that an Engagement Review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, the reviewers express no opinion or any form of assurance on that system.
- g. State that the nature, objectives, scope, limitations of, and procedures performed in an Engagement Review are described in the standards.
- h. Include a URL to the AICPA Web site where the standards are located.
- i. Identify the different peer review ratings that the firm could receive.
- j. In a report with a peer review rating of *pass*, state:
  - That nothing came to the review captain's attention that caused the review captain to believe that the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects.
  - At the end of the second paragraph, that therefore the firm has received a peer review rating of *pass*.
  - In the event of a scope limitation, include an additional paragraph before the last paragraph that describes the relationship of the excluded engagement(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from the potential selection, and the affect of the exclusion on the scope and results of the peer review.
  - Reports with a peer review rating of *pass* do not contain any findings, deficiencies, significant deficiencies, or recommendations.
- k. In a report with a peer review rating of *pass with deficiencies*,<sup>17</sup> state:
  - That except for the deficiencies described above, nothing came to the review captain's attention that caused the review captain to believe that the engagements submitted for review were not performed and reported on in conformity with applicable professional standards in all material respects.
  - At the end of the last paragraph, that therefore the firm has received a peer review rating of *pass with deficiencies*.
  - In the event of a scope limitation, include an additional paragraph before the deficiencies that describes the relationship of the excluded engagement(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from the potential selection, and the affect of the exclusion on the scope and results of the peer review.

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<sup>17</sup> Reference to plural could also apply to a singular item within the standards. For instance, there could be deficiencies or a deficiency. The wording in the peer review report should be tailored as necessary.

- l. In a report with a peer review rating of *fail*, state:
- That as a result of the deficiencies described above, the review captain believes that the engagements submitted for review were not performed and/or reported on in conformity with applicable professional standards in all material respects.
  - At the end of the last paragraph, that therefore the firm has received a peer review rating of *fail*.
  - In the event of a scope limitation, include an additional paragraph before the significant deficiencies that describes the relationship of the excluded engagement(s) to the reviewed firm's practice as a whole, the highest level of service and industry concentration, if any, of the engagement(s) excluded from the potential selection, and the affect of the exclusion on the scope and results of the peer review.
- m. Include, for reports with a peer review rating of *pass with deficiencies* or *fail*, descriptions of the deficiencies or significant deficiencies and the reviewing firm's recommendations (each of these should be numbered) (see interpretations).
- n. Identify, for any deficiencies or significant deficiencies included in the report with a peer review rating of *pass with deficiencies* or *fail*, any that were also made in the report<sup>18</sup> in the firm's previous peer review. However, if the specific types of reporting, presentation, disclosure, or documentation deficiencies or significant deficiencies are not substantially the same on the current review as on the prior review, the deficiencies or significant deficiencies would not be considered a repeat (see interpretations).
- o. Identify the industry and level of service for any deficiencies or significant deficiencies that are determined to be industry specific included in the report with a peer review rating of *pass with deficiencies* or *fail*.

## Firm Responses in an Engagement Review

**.123** In an Engagement Review, if the firm receives a report with a peer review rating of *pass with deficiencies* or *fail*, the reviewed firm should respond in writing to the deficiencies or significant deficiencies and related recommendations identified in the report. The letter of response should be addressed to the administering entity's peer review committee and should describe the actions planned (including timing) or taken by the reviewed firm with respect to each deficiency in the report. The reviewed firm should submit a copy of the report, and its letter of response, to the administering entity within 30 days of the date it received the report from the review captain or by the firm's peer review due date, whichever date is earlier. Prior to submitting the letter of response to the administering entity, the reviewed firm should submit the response to the review captain for review, evaluation, and comment (see interpretations).

**.124** If the firm receives a report with a peer review rating of *pass* or *pass (with a scope limitation)*, a letter of response is not applicable, and the reviewed firm does not submit a copy of the report to the administering entity.

**.125** The reviewed firm should respond to all findings and related recommendations not rising to the level of a deficiency or significant deficiency on the related FFC forms. These responses should describe the plan the reviewed firm has implemented or will implement (including timing) with respect to each finding. The review captain should review and evaluate the responses on the

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<sup>18</sup> And/or the letter of comments, if applicable, for reviews commenced prior to January 1, 2009.

FFC forms before they are submitted to the administering entity (see interpretations).

**.126** If, after a discussion with the review captain, the reviewed firm disagrees with one or more of the findings, deficiencies, or significant deficiencies, the reviewed firm should contact the administering entity for assistance in the matter (see paragraph .116). If the reviewed firm still disagrees with one or more of the findings, deficiencies, or significant deficiencies, its response on either the FFC form or in the letter of response, as applicable, should describe the reasons for such disagreement.

**.127** Illustrations of letters of responses by a reviewed firm to reports with a peer review rating of *pass with deficiencies* and *fail* are included in appendixes O, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies* in an Engagement Review" and Q, "Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail* in an Engagement Review."

## Administering Peer Reviews

**.128** All peer reviews intended to meet the requirements of the program should be carried out in conformity with these standards under the supervision of a state CPA society, group of state CPA societies, the AICPA Peer Review Board's National PRC (see interpretations), or other entity (hereinafter, administering entity) approved by the board to administer peer reviews. This imposes an obligation on reviewed firms to facilitate completion of their peer reviews in compliance with the procedures established by the board, and to cooperate with the peer reviewer, administering entity, and the board in all matters related to the review.

**.129** Entities requesting to administer the program are required to complete and sign a Plan of Administration annually whereby the entity agrees to administer the program in compliance with these standards, interpretations, and other guidance established by the board. Upon receipt of the plans by the AICPA, including jurisdictions not requesting to administer the program for their state, the board annually approves the administering entities for all of the jurisdictions covered by the program.

**.130** This imposes an obligation on the administering entities to ensure that their staff, technical reviewers, committee members, and all others involved in the administration of the program and performance of peer reviews comply with these standards, interpretations, and other guidance established by the board. Administering entities shall also cooperate with the board in all matters related to the administration of the program. Failure to comply with these standards, interpretations, and other guidance may result in the revocation of the administering entity's plan by the board. If an administering entity refuses to cooperate or is found to be deficient in administering the program in compliance with these standards or with other guidance, the board may decide pursuant to fair procedures whether the administering entity's plan should be revoked or whether some other action should be taken.

**.131** Due to the volume of peer reviews, firms, reviewers, and other contributing factors, the board recognizes that administering entities, and in some situations firms and peer reviewers, may need the flexibility, in specific circumstances, to implement alternate methods of complying with the standards, interpretations, or guidance issued by the board. The board and/or its staff will consider reasonable requests from administering entities' peer review committees on such matters. The comprehensiveness of the administering entity's

oversight policies and procedures will be considered as well as such factors as whether the objectives of the standards, interpretations, or guidance would still be met. Administering entities must submit a request in writing to the board for approval prior to implementing alternative methods of complying with the standards, interpretations, or other guidance. This request should ordinarily be submitted in conjunction with the submission of its plan.

## Fulfilling Peer Review Committee and Report Acceptance Body Responsibilities

**.132** An administering entity appoints a peer review committee to oversee the administration, acceptance, and completion of peer reviews. The committee may decide to delegate a portion of the report acceptance function to report acceptance bodies (RABs), whose members may be, but are not required to be, members of the committee as well. Members of a committee or a RAB must meet minimum qualification requirements (see interpretations). It is ultimately the committee's responsibility to ensure that it (or a RAB on its behalf) considers the results of peer reviews it administers that are undertaken to meet the requirements of the program. The activities of the committee should be carried out in accordance with administrative procedures and guidance issued by the board. Committee members may not participate in any discussion or have any vote with respect to a reviewed firm if the member lacks independence or has a conflict of interest with the reviewing firm, the reviewer, or the reviewed firm.

**.133** The committee's report acceptance responsibilities include, but are not limited to:

- a. Ensuring that peer reviews are presented to an RAB in a timely manner, ordinarily within 120 days of the later of receipt of the working papers and peer review report from the team captain or review captain or, if applicable, the report with a peer review rating of *pass with deficiencies* or *fail* and the related letter of response from the reviewed firm, or within 60 days for Engagement Reviews meeting certain criteria (see paragraphs .137–.138).
- b. Considering whether the review has been performed in accordance with these standards, interpretations, and related guidance materials.
- c. Considering whether the report, and the response thereto, if applicable, are in accordance with these standards, interpretations, and related guidance materials, including an evaluation of the adequacy of the corrective actions the reviewed firm has represented that it has taken or will take in its letter of response.
- d. Determining whether it should require any remedial, corrective actions related to the deficiencies or significant deficiencies noted in the peer review report, in addition to those described by the reviewed firm in its letter of response. Examples of such corrective actions include, but are not limited to, requiring certain individuals to obtain specified kinds and specified amounts of CPE, requiring the firm to carry out more comprehensive monitoring procedures, or requiring it to engage another CPA to perform preissuance or postissuance reviews of financial statements, reports, and accounting and audit documentation to attempt to strengthen the performance of the firm's personnel.
- e. In relation to FFCs:
  1. Considering whether FFC (and associated MFC and DMFC) forms are prepared in accordance with these standards,



interpretations, and related guidance materials, including whether the findings addressed on the FFC forms should have been included in a report with a peer review rating of *pass with deficiencies* or *fail*.

2. Determining the adequacy of the plan the reviewed firm has represented that it has implemented or will implement in its response on the FFC form(s).
  3. Determining whether it should require an implementation plan in addition to or as an affirmation of the plan described by the reviewed firm in its response to the findings on the FFC form(s).
- f. Ensuring that all corrective actions related to deficiencies or significant deficiencies in the peer review report and all implementation plans related to findings on FFC forms have been completed to the satisfaction of the committee.
- g. Ensuring that all firms within its jurisdiction have timely peer reviews and keeping track of the timing of the completion of corrective actions and implementation plans by all firms that the committee has required, including those that are overdue.

**.134** In reaching its conclusions on the preceding items, the committee is authorized to make whatever inquiries or initiate whatever actions it considers necessary in the circumstances, including but not limited to requesting expansion of scope, revisions to the report, or the reviewed firm's response thereto. Such inquiries or actions by the committee should be made with the understanding that the program is intended to be positive and remedial in nature and is based on mutual trust and cooperation.

**.135** In the rare event of a disagreement between the administering entity and either the reviewer or the reviewed firm that cannot be resolved by ordinary good-faith efforts, the administering entity may request that the matter be referred to the board for final resolution. Only the approved administering entity's peer review committee will be responsible for determining whether a disagreement still exists in order to refer the matter to the board. In these circumstances, the board may consult with representatives of other AICPA committees or with appropriate AICPA staff.

## Accepting System and Engagement Reviews

**.136** Technical reviews are required to be performed by the administering entity on all peer reviews. Technical reviewers must meet minimum qualification requirements (see interpretations).

**.137** All System Reviews are required to be presented for committee consideration, but committee consideration is not always required in an Engagement Review. The technical reviewer<sup>19</sup> should be delegated the authority from the committee to accept Engagement Reviews in certain circumstances (see interpretations).

**.138** Engagement Reviews that do not require committee consideration are required to be accepted by the technical reviewer within 60 days of receipt of the working papers and report from the review captain. If the committee does not delegate the authority to the technical reviewer to accept Engagement Reviews under the specific criteria indicated previously, the review is required to be

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<sup>19</sup> The responsibilities and the role of technical reviewers are included in the AICPA Peer Review Program Report Acceptance Body Handbook, which is provided to all administering entities.

presented to the committee within 60 days of receipt of the working papers and report from the review captain.

**.139** In deciding on the need for and nature of any corrective actions, the committee should consider the nature and significance (and for System Reviews, the causes, pattern, pervasiveness, and relative importance to the system of quality control as a whole) of the deficiencies or significant deficiencies. It should evaluate whether the recommendations of the review team appear to address those deficiencies or significant deficiencies adequately and whether the reviewed firm's responses to those recommendations appear comprehensive, genuine, and feasible.

**.140** If the peer review committee determines that corrective actions related to the deficiencies or significant deficiencies noted in the peer review report, in addition or as an affirmation of those described by the firm in its letter of response, are appropriate, the firm will be required to evidence its agreement to perform these corrective action(s) in writing before the report is accepted and complete the action(s) as a condition of cooperation with the administering entity and the board.

## Cooperating in a Peer Review

**.141** Paragraph .05(h) of the standards noted that firms (and individuals) enrolled in the program have the responsibility to cooperate with the peer reviewer, administering entity, and the board in all matters related to the peer review, including taking remedial, corrective actions or implementing FFC plans as needed.

**.142** In deciding on the need for and nature of any implementation plan in addition to that described by the firm in its response on the FFC form, the committee should consider the nature and significance (and for System Reviews, the causes, pattern, pervasiveness, and relative importance to the system of quality control as a whole) of the findings. It should evaluate whether the recommendations of the review team appear to address those findings adequately and whether the reviewed firm's responses to those recommendations appear comprehensive, genuine, and feasible.

**.143** If the peer review committee determines, as part of its deliberations regarding the peer review, that an implementation plan in addition to or as an affirmation of those described by the firm in its responses on the FFC form are warranted, the firm will be required to evidence its agreement to perform this FFC implementation plan in writing and complete the plan as a condition of cooperation with the administering entity and the board (see interpretations). Although agreeing to and completing such a plan is not tied to the acceptance of the peer review, if a firm fails to cooperate, the firm would be subject to fair procedures that could result in the firm's enrollment in the program being terminated (see interpretations). The resulting MFC, DMFC, and FFC forms, as well as any correspondence relating to the implementation plan to be followed by the firm related to these documents, are outside of the reporting and acceptance process.

**.144** If a reviewed firm refuses to cooperate, fails to correct deficiencies or significant deficiencies, or is found to be so seriously deficient in its performance that education and remedial, corrective actions or implementation plans are not adequate, the board may decide, pursuant to fair procedures that it has established, to appoint a hearing panel to consider whether the firm's enrollment in the program should be terminated or whether some other action should be taken. A firm that receives peer reviews with recurring deficiencies or significant deficiencies that are not corrected may be deemed as a firm refusing

to cooperate. In addition, a firm that fails to correct deficiencies or significant deficiencies after consecutive corrective actions requested by the committee may also be deemed as a firm refusing to cooperate.

**.145** If a decision is made by the hearing panel to terminate a firm's enrollment in the program, the firm will have the right to appeal to the AICPA Joint Trial Board for a review of the hearing panel's findings. The fact that a firm's enrollment in the program has been terminated shall be published in such form and manner as the AICPA Council may prescribe.

## Publicizing Peer Review Information

**.146** The reviewed firm should not publicize the results of the review or distribute copies of the peer review report to its personnel, clients, or others until it has been advised that the report has been accepted (see interpretations) by the administering entity as meeting the requirements of the program. Neither the administering entity nor the AICPA shall make the results of the review available to the public, except as authorized or permitted by the firm under certain circumstances (see interpretations). The administering entity and the AICPA may disclose the following information:

- a. The firm's name and address
- b. The firm's enrollment in the program
- c. The date of acceptance and the period covered by the firm's most recently accepted peer review
- d. If applicable, whether the firm's enrollment in the program has been dropped or terminated

## Peer Reviewers' Performance and Cooperation

**.147** A team captain, review captain, or reviewer (hereinafter, reviewer) has a responsibility to perform a review in a timely, professional manner. This relates not only to the initial submission of the report and materials on the review, but also to the timely completion of any additional actions necessary to complete the review, such as completing omitted documentation of the work performed on the review or resolving questions raised by the committee or technical reviewer accepting the review as well as the board and AICPA staff.

**.148** In considering peer review documents for acceptance, the committee evaluates the reviewer's performance on the peer review. In addition to the committee's evaluation, the board and AICPA staff also evaluate and track reviewers' performance on peer reviews. If serious weaknesses in the reviewer's performance are noted on a particular review, or if a pattern of poor performance by a particular reviewer is noted, then the board or committee, depending on the particular circumstances, will consider the need to impose corrective actions on the service of the reviewer. The board or committee may require the reviewer to comply with certain actions in order for the reviewer to continue performing peer reviews, such as (but not limited to) the following:

- a. Submitting evidence of attendance at a future reviewer's training or accounting or auditing course(s)
- b. Having committee oversight on the next review(s) performed by the reviewer at the expense of the reviewer's firm (including out-of-pocket expenses, such as cost of travel)
- c. Submitting all reports and appropriate documentation on all outstanding peer reviews before scheduling or performing another review

- d.* Having preissuance review(s) of the report and peer review documentation on future peer reviews by an individual acceptable to the committee chair or designee who has experience in performing peer reviews

**.149** In situations in which one or more of such actions is imposed, the administering entity will inform the board and may request that the board ratify the action(s) to be recognized by other administering entities.

**.150** Any condition imposed on a reviewer will generally apply to the individual's service as a team captain, review captain, or a team member unless the condition is specific to the individual's service as only a team captain, review captain, or team member.

**.151** If a reviewer refuses to cooperate with the committee or board, fails to revise peer review documents as requested by the committee or board, fails to correct the poor performance, or is found to be deficient in his or her performance, and education or other corrective or monitoring actions are not considered adequate to correct the poor performance, the committee may recommend to the board that the reviewer be prohibited from performing peer reviews in the future. In such situations imposed by a committee, the board would consider ratifying the action(s) taken by the committee for the reviewer's name to be removed from the list of qualified reviewers. The board may decide, with or without committee recommendation pursuant to fair procedures that it has established, to consider whether the reviewer should be prohibited from performing peer reviews or whether some other action should be taken.

**.152** Corrective or other action(s) can only initially be appealed to the committee that imposed the action(s). For actions previously appealed to the committee or imposed or ratified by the board, if the reviewer disagrees with the corrective action(s), he or she may appeal the decision by writing the board and explaining why he or she believes that the action(s) are unwarranted. The board will review and consider the request upon its receipt.

**.153** If a reviewer has a corrective or other action(s) imposed on him or her by the committee or board, and the reviewer had previously been approved to perform a peer review that has either begun or has yet to begin, then the committee or board will need to consider whether the review should be performed by another reviewer, or if the review should be overseen by a member of the committee at the reviewer's expense, or other actions, if any (whether or not the reviewer has filed an appeal with the committee or board). If the reviewer has completed the fieldwork on one or more peer reviews prior to the imposition of the corrective action, then the committee or board will consider what action, if any, to take regarding those peer reviews based on the facts and circumstances.

## **Performing and Reporting on Peer Reviews of Quality Control Materials (QCM) and Continuing Professional Education (CPE) Programs**

### **Introduction**

**.154** Quality control materials (QCM) are materials that are suitable for adoption by a firm as an integral part of that firm's system of quality control. Such materials provide guidance to assist firms in performing and reporting in conformity with professional standards and may include, but are not limited to, such items as:

- a.* Engagement aids, including accounting and auditing manuals, checklists, questionnaires, work programs, computer-aided accounting and

auditing tools, and similar materials intended for use by accounting and auditing engagement teams

- b. Personnel manuals, inspection checklists, hiring forms, and client acceptance and continuance forms

**.155** Occasionally, organizations (hereinafter referred to as *providers*) may sell or otherwise distribute to CPA firms (hereinafter referred to as *user firms*) QCM that they have developed. They may also sell or distribute CPE programs that they have developed.

**.156** Providers may elect voluntarily or be required (see paragraph .159) to have an independent review of their system of quality control for the development and maintenance of the QCM or CPE programs they have developed and of the materials themselves. The reasons for having such a review are:

- a. To provide assurance to user firms that the QCM or CPE programs they have acquired are reliable aids to assist them in conforming to those professional standards the materials purport to encompass.
- b. To provide more cost-effective peer reviews for firms that have acquired or use such materials.
- c. To ensure that independence and objectivity on peer reviews of user firms is maintained when such peer reviews are performed by providers or other user firms in the same association of CPA firms.

**.157** A summary of the nature, objectives, scope, limitations of, and procedures performed on QCM or CPE programs is included in appendix A.

## Objectives of a Peer Review of QCM or CPE Programs

**.158** The objectives of a peer review of QCM or CPE programs developed by a provider are:

- a. To determine whether the provider's system for the development and maintenance of the QCM or the CPE programs was suitably designed and was being complied with during the period under review to provide user firms with reasonable assurance that the materials are reliable aids to assist them in conforming with those professional standards the materials purport to encompass.
- b. To determine whether the resultant materials are reliable aids.

## Applicability

**.159** An independent review of the system for the development and maintenance of QCM or CPE programs and the resultant materials (the *QCM review* or *CPE review*) is required for the following classes of providers:

- a. A firm providing QCM or CPE programs to another firm for which the provider firm will perform the peer review
- b. An association of CPA firms' provider when a user firm in the association will perform a peer review of another user firm in the association

**.160** A provider of QCM or CPE programs falling into either of these categories should have a QCM or CPE review once every three years and should arrange to have such a peer review administered by the National PRC performed in accordance with these standards. In the event of substantial change in the system for the development and maintenance of the materials or in the resultant materials, the provider should consult with the National PRC to determine whether an accelerated peer review is warranted.

**.161** Any other provider of QCM or CPE programs that voluntarily elects to have a QCM or CPE review performed in accordance with these standards

should also consult with the National PRC. A provider may have a review voluntarily so that peer reviewers of user firms can place reliance on the QCM or CPE review to reduce the scope of the review of the firm's QCM or CPE programs.

**.162** A QCM or CPE review under these standards may not include materials relating to audits of SEC issuers performed pursuant to the standards of the PCAOB.

**.163** All providers that plan to have a QCM or CPE review performed in accordance with these standards must notify the National PRC in advance of that review so it can be appropriately scheduled. If a QCM or CPE review has commenced, providers must also notify the National PRC before a review is terminated prior to completion.

### **Qualifications for Serving as QCM or CPE Reviewers**

**.164** A QCM or CPE review team may be formed by a firm engaged by the provider under review or an association of CPA firms authorized by the board to assist its members in forming review teams (an association formed review team). Peer reviews of association QCM or CPE programs may not be performed by a member of the association whose materials or programs are being reviewed. Furthermore, the National PRC will not appoint to the QCM or CPE review team a person with a firm that is a member of the association or a person or firm that may have a conflict of interest with respect to the QCM or CPE review, such as someone who assisted in the development or review of such materials or uses the materials as an integral part of the firm's system of quality control.

**.165** A QCM or CPE reviewer shall possess the qualifications set forth in the paragraphs under "Organizing the System or Engagement Review Team" and "Qualifying for Service as a Peer Reviewer" (see paragraphs .26–.35).

### **Procedures for Performing QCM or CPE Reviews**

**.166** The provider should identify the materials, whether QCM or CPE program materials, to be reviewed and on which an opinion is to be expressed. A QCM or CPE review should include a study and evaluation of the system for the development and maintenance of the QCM or CPE program that have been identified and a review of the materials themselves. Where not otherwise addressed in the following list, the peer reviewer should refer to the guidance for performing and reporting on System Reviews (see paragraphs .36–.101) and accepting System and Engagement Reviews (see paragraphs .132–.140) for additional guidance on performing, reporting on, and accepting QCM and CPE reviews.

**.167** A provider's system for the development and maintenance of the materials normally should include:

- a. A requirement that the materials be developed by individuals qualified in the subject matter.
- b. A requirement that the materials be reviewed for technical accuracy by a qualified person(s) other than the developer(s) to ensure that the materials are reliable aids to assist users in conforming to those professional standards the materials purport to encompass.
- c. Procedures to ensure the currency and relevancy of the materials.
- d. Procedures for soliciting and evaluating feedback from users of the materials.

- e. Procedures for communicating the period and, where appropriate, the professional standards encompassed by the materials, and the provider's policy, if any, regarding the issuance of updates to the materials and, if a policy exists, the method of updating.
- f. Procedures for ensuring that the materials are updated in accordance with the provider's policy when it has undertaken to update them.

**.168** A study and evaluation of the system for the development and maintenance of the materials normally should include the following procedures:

- a. Reviewing and evaluating the procedures established for developing and maintaining the materials.
- b. Reviewing and evaluating the procedures established for updating (including distributing) the materials to ensure that the materials remain current and relevant when the provider has undertaken the responsibility for updating the materials (and for communicating any relevant changes in professional standards to program participants if new professional standards are issued prior to updating the CPE programs).
- c. Reviewing the technical competence of the developer(s) or updater(s) of the materials.
- d. Obtaining evidence that the materials were reviewed for technical accuracy by qualified person(s) other than the developer(s) or updater(s).
- e. Determining whether the provider has appropriately communicated its policy regarding the period covered by the materials, the professional standards the materials purport to encompass, and the provider's intention to update the materials.
- f. Reviewing the system developed for soliciting and evaluating feedback from users of the materials.

**.169** A QCM or CPE review team should review the resultant materials, to the extent deemed necessary, to evaluate whether the materials are reliable aids to assist firms in conforming to those professional standards the materials purport to encompass.

## Reporting on QCM or CPE Reviews

### **General**

**.170** The QCM or CPE review team should furnish the provider with a written report and the final FFC forms within 30 days of the date of the exit conference or by the provider's review due date, whichever is earlier. A report on a review performed by a firm is to be issued on the letterhead of the firm performing the review. A report by a review team formed by an association of CPA firms is to be issued on the letterhead of the firm of the team captain performing the review. The report in a QCM or CPE review ordinarily should be dated as of the date of the exit conference. See interpretations for guidance on notification requirements and submission of peer review documentation to the administering entity.

### **Preparing the Report in a QCM or CPE Review**

**.171** The standard forms for a peer review report on QCM or CPE programs with a peer review rating of *pass*, *pass with deficiencies*, and *fail* are included in appendixes R, "Illustration of a Report With a Peer Review Rating of *Pass* in a Peer Review of Quality Control Materials or CPE Programs;" S, "Illustration of a Report with a Peer Review Rating of *Pass with Deficiencies* in a Peer Review of Quality Control Materials or CPE Programs;" and T, "Illustration of a Report

with a Peer Review Rating of *Fail* in a Peer Review of Quality Control Materials or CPE Programs," respectively. Additional paragraphs included for scope limitations follow the illustrations for System Reviews with scope limitations (see appendixes D, G, and K).

.172 A QCM or CPE report with a rating of *pass*, *pass with deficiencies*, or *fail* shall contain elements similar to those in a System Review report. As such, the written report in a QCM or CPE System Review should:

- a. State at the top of the page the title "Quality Control Materials Review Report" or "CPE Programs Review Report."
- b. State that the system of quality control for the development and maintenance of the materials and the resultant materials in effect at the year-end covered by the peer review were reviewed.
- c. State that the peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants.
- d. State that the organization is responsible for designing a system of quality control and complying with it to provide users of the materials with reasonable assurance that the materials are reliable aids to assist them in performing and reporting in conformity with applicable professional standards in all material respects those professional standards that the materials purport to encompass.
- e. State that the reviewer's responsibility is to express an opinion on the design of the system of quality control and the organization's compliance therewith based on the review.
- f. State that the nature, objectives, scope, limitations of, and procedures performed in a Quality Control Materials review or CPE review are described in the standards.
- g. Include a URL reference to the AICPA Web site where the standards are located.
- h. Identify the different peer review ratings that the organization could receive.
- i. In a report with a peer review rating of *pass*:
  - Express an opinion that the system of quality control for the development and maintenance of the quality control materials or CPE program was suitably designed and was being complied with during the year ended to provide users of the materials with reasonable assurance that the materials are reliable aids to assist them in conforming with those professional standards the materials purport to encompass.
  - Express an opinion that the quality control materials or CPE program were reliable aids at the year-end.
  - State at the end of the opinion paragraph that therefore the report reflects a peer review rating of *pass*.
  - In the event of a scope limitation, include an additional paragraph before the opinion paragraph that describes the scope limitation, including the relationship of the excluded steps to the full system, and the affect on the scope and results of the review.
  - Reports with a peer review rating of *pass* do not contain any findings, deficiencies, significant deficiencies, or recommendations.



- j.* In a report with a peer review rating of *pass with deficiencies*:<sup>20</sup>
- Express an opinion that, except for the deficiencies described above, the system of quality control for the development and maintenance of the quality control materials or CPE program was suitably designed and was being complied with during the year ended to provide users of the materials with reasonable assurance that the materials are reliable aids to assist them in conforming with those professional standards the materials purport to encompass.
  - State at the end of the opinion paragraph that therefore the report reflects a peer review rating of *pass with deficiencies*.
  - In the event of a scope limitation, include an additional paragraph before the deficiencies that describes the scope limitation, including the relationship of the excluded steps to the full system, and the affect on the scope and results of the review.
- k.* In a report with a peer review rating of *fail*:
- Express an opinion that as a result of the significant deficiencies described above, the system of quality control for the development and maintenance of the quality control materials or CPE program was not suitably designed and being complied with during the year ended to provide users of the materials with reasonable assurance that the materials are reliable aids to assist them in conforming with those professional standards the materials purport to encompass.
  - State at the end of the opinion paragraph that therefore the firm has received a peer review rating of *fail*.
  - In the event of a scope limitation, include an additional paragraph before the significant deficiencies that describes the scope limitation, including the relationship of the excluded steps to the full system, and the affect on the scope and results of the review.
- l.* Include, for reports with a peer review rating of *pass with deficiencies* or *fail*, systemically written descriptions of the deficiencies or significant deficiencies and the reviewing firm's recommendations (each of these should be numbered).
- m.* Identify, for any deficiencies or significant deficiencies included in the report with a peer review rating of *pass with deficiencies* or *fail* any that were also made in the report<sup>21</sup> issued on the organization's previous peer review. This should be determined based on the underlying systemic cause of the deficiencies or significant deficiencies.

### **Forming Conclusions on the Type of Report to Issue in a QCM or CPE Review**

.173 The following circumstances ordinarily would be considered deficiencies or significant deficiencies and would require a report with a peer review rating of *pass with deficiencies* or *fail*:

- a.* The scope of the review is limited by conditions that preclude the application of one or more review procedures considered necessary.

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<sup>20</sup> Reference to plural could also apply to a singular item within the standards. For instance, there could be deficiencies or a deficiency. The wording in the peer review report should be tailored as necessary.

<sup>21</sup> And/or the letter of comments, if applicable, for reviews commenced prior to January 1, 2009.

- b. The provider's system of quality control for the development and maintenance of QCM or CPE programs, as designed, did not provide user firms with reasonable assurance that reliable aids had been developed to assist them in conforming with those professional standards the materials purport to encompass.
- c. The degree of compliance with the provider's system of quality control for the development and maintenance of QCM or CPE programs was not sufficient to provide user firms with reasonable assurance that reliable aids had been developed to assist them in conforming with those professional standards the materials purport to encompass.
- d. The resultant QCM or CPE programs are not reliable aids to assist user firms in conforming to those professional standards the materials purport to encompass.

.174 In those instances in which the QCM or CPE review team determines that a report with a peer review rating of *pass with deficiencies* or *fail* is required, all the reasons should be disclosed, and the QCM or CPE review team should consult with the National PRC prior to the issuance of the report.

### Provider Responses on QCM and CPE Program Reviews

.175 If the provider receives a report with a peer review rating of *pass with deficiencies* or *fail*, then the provider should respond in writing to the deficiencies and significant deficiencies and related recommendations identified in the report, if applicable. The letter of response should be addressed to the AICPA Peer Review Board and should describe the action(s) planned (including timing) or taken by the provider with respect to each deficiency in the report. If the provider disagrees with one or more of the deficiencies or significant deficiencies, its response should describe the reasons for such disagreement. In the event that a material error or omission in the QCM or CPE programs is uncovered by the QCM or CPE review team, the response also should describe the provider's plan for notifying known users of that error or omission. The provider should submit the letter of response for review and comment to the team captain prior to submitting the response to the National PRC.

.176 The provider should submit a copy of the report and its letter of response to the National PRC within 30 days of the date it received the report or by the provider's peer review due date, whichever date is earlier. Prior to submitting the response to the National PRC, the reviewed firm should submit the response to the team captain for review, evaluation, and comment. If the provider receives a report with a peer review rating of *pass* or *pass (with a scope limitation)*, a letter of response is not applicable, and the provider does not submit a copy of the report to the National PRC.

.177 The provider should also respond on the FFC forms, if any are developed, to findings and related recommendations. These responses should describe the plan (including timing) the provider has implemented or will implement with respect to each finding. They should be submitted to the team captain no later than two weeks after the exit conference or by the peer review's due date, whichever is earlier. FFC forms are submitted by the team captain with the applicable working papers to the National PRC.

.178 If, after a discussion with the team captain, the provider disagrees with one or more of the findings, deficiencies, or significant deficiencies, the reviewed firm should contact the administering entity for assistance in the matter (see paragraph .93). If the provider still disagrees with one or more of the findings, deficiencies, or significant deficiencies, its response on either the

FFC form or in the letter of response, as applicable, should describe the reasons for such disagreement.

**Effective Date**

**.179** The effective date for these standards is for peer reviews commencing on or after January 1, 2009. Early implementation is not permitted.

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## Appendix A

### Summary of the Nature, Objectives, Scope, Limitations of, and Procedures Performed in System and Engagement Reviews and Quality Control Materials and Continuing Professional Education Program Reviews (as Referred to in a Peer Review Report)

(Effective for Peer Reviews Commencing on or After January 1, 2009.)

1. Firms (and individuals) enrolled in the AICPA Peer Review Program are required to have a peer review, once every three years, of their accounting and auditing practice related to non-Security and Exchange Commission (SEC) issuers covering a one-year period. The peer review is conducted by an independent evaluator, known as a peer reviewer. The AICPA oversees the program, and the review is administered by an entity approved by the AICPA to perform that role.
2. The peer review helps to monitor a CPA firm's accounting and auditing practice (*practice monitoring*). The goal of the practice monitoring, and the program itself, is to promote quality in the accounting and auditing services provided by the AICPA members and their CPA firms. This goal serves the public interest and enhances the significance of AICPA membership.
3. There are two types of peer reviews: System Reviews and Engagement Reviews. System Reviews focus on a firm's system of quality control, while Engagement Reviews focus on work performed on particular selected engagements. As noted in paragraphs .04 and .157, a further description of System and Engagement Reviews, and Quality Control Materials (QCM) and Continuing Professional Education (CPE) Reviews, as well as a summary of the nature, objectives, scope, limitations of, and procedures performed on them, is provided in the following sections.

#### System Reviews

4. A System Review is a type of peer review that is a study and appraisal by an independent evaluator(s), known as a peer reviewer, of a CPA firm's system of quality control to perform accounting and auditing work. The system represents the policies and procedures that the CPA firm has designed, and is expected to follow, when performing its work. The peer reviewer's objective is to determine whether the system is designed to ensure conformity with professional standards and whether the firm is complying with its system appropriately.
5. Professional standards are literature, issued by various organizations, that contain the framework and rules that a CPA firm is expected to comply with when designing its system and when performing its work. Professional standards include but are not limited to the Statements on Quality Control Standards issued by the American Institute of Certified Public Accountants (AICPA) that pertain to leadership responsibilities for quality within the firm (the "tone at the top"); relevant ethical requirements (such as independence, integrity, and objectivity;

acceptance and continuance of client relationships and specific engagements; human resources; engagement performance; and monitoring.

6. To plan a System Review, a peer reviewer obtains an understanding of (1) the firm's accounting and auditing practice, such as the industries of its clients, and (2) the design of the firm's system, including its policies and procedures and how the firm checks itself that it is complying with them. The reviewer assesses the risk levels implicit within different aspects of the firm's practice and its system. The reviewer obtains this understanding through inquiry of firm personnel and review of documentation on the system, such as firm manuals.
7. Based on the peer reviewer's planning procedures, the reviewer looks at a sample of the CPA firm's work, individually called engagements. The reviewer selects engagements for the period covered by the review from a cross section of the firm's practice with emphasis on higher risk engagements. The engagements selected include those performed under *Government Auditing Standards*, audits of employee benefit plans, and audits of depository institutions (with assets of \$500 million or greater), when applicable. The scope of a peer review only covers accounting and auditing engagements; it does not include the firm's SEC issuer practice, nor does it include tax or consulting services. The reviewer will also look at administrative elements of the firm's practice to test the elements listed previously from the Statements on Quality Control Standards.
8. The reviewer examines engagement working paper files and reports, interviews selected firm personnel, reviews representations from the firm, and examines selected administrative and personnel files. The objectives of obtaining an understanding of the system and then testing the system forms the basis for the reviewer's conclusions in the peer review report.
9. When a CPA firm receives a report from the peer reviewer with a peer review rating of *pass*, the report means that the system is appropriately designed and being complied with by the CPA firm in all material respects. If a CPA firm receives a report with a peer review rating of *pass with deficiencies*, this means the system is designed and being complied with appropriately by the CPA firm in all material respects, except in certain situations that are explained in detail in the peer review report. When a firm receives a report with a peer review rating of *fail*, the peer reviewer has determined that the firm's system is not suitably designed or being complied with, and the reasons why are explained in detail in the report.
10. There are inherent limitations in the effectiveness of any system and, therefore, noncompliance with the system may occur and not be detected. A peer review is based on selective tests. It is directed at assessing whether the design of and compliance with the firm's system provides the firm with reasonable, not absolute, assurance of conforming to applicable professional standards. Consequently, it would not necessarily detect all weaknesses in the system or all instances of noncompliance with it. It does not provide assurance with respect to any individual engagement conducted by the firm or that none of the financial statements audited by the firm should be restated. Projection of any evaluation of a system to future periods is subject to the risk that the system may become inadequate because of changes in conditions or because the degree of compliance with the policies or procedures may deteriorate.

Engagement Reviews

11. An Engagement Review is a type of peer review that is a study and appraisal by an independent evaluator(s), known as a peer reviewer, of a sample of a CPA firm's actual accounting work, including accounting reports issued and documentation prepared by the CPA firm, as well as other procedures that the firm performed.
12. By definition, CPA firms undergoing Engagement Reviews do not perform audits or other similar engagements but do perform other accounting work including reviews and compilations, which are a lower level of service than audits. The peer reviewer's objective is to evaluate whether the CPA firm's reports are issued and procedures performed appropriately in accordance with applicable professional standards. Therefore, the objective of an Engagement Review is different from the objectives of a System Review, which is more system oriented and involves determining whether the system is designed in conformity with applicable professional standards and whether the firm is complying with its system appropriately.
13. Professional standards represent literature, issued by various organizations, that contain the framework and rules that a CPA firm is expected to follow when performing accounting work.
14. The reviewer looks at a sample of the CPA firm's work, individually called engagements. The scope of an Engagement Review only covers accounting engagements; it does not include tax or consulting services. An Engagement Review consists of reading the financial statements or information submitted by the reviewed firm and the accountant's report thereon, together with certain background information and representations from the firm and, except for certain compilation engagements, the documentation required by applicable professional standards.
15. When the CPA firm receives a report with a peer review rating of *pass*, the peer reviewer has concluded that nothing came to his or her attention that the CPA firm's work was not performed and reported on in conformity with applicable professional standards in all material respects. A report with a peer review rating of *pass with deficiencies* is issued when the reviewer concludes that nothing came to his or her attention that the work was not performed and reported on in conformity with applicable professional standards in all material respects, except in certain situations that are explained in detail in the report. A report with a peer review rating of *fail* is issued when the reviewer concludes that as a result of the situations described in the report, the work was not performed and/or reported on in conformity with applicable professional standards in all material respects.
16. An Engagement Review does not provide the reviewer with a basis for expressing any assurance as to the firm's system of quality control for its accounting practice, and no opinion or any form of assurance is expressed on that system.

Quality Control Materials or CPE Program Reviews

17. A Quality Control Materials (QCM) or CPE Program Review is a type of peer review that is a study and appraisal by an independent evaluator(s), known as a *peer reviewer*, of an organization's (hereinafter referred to as *provider*) system of quality control to develop and maintain quality control materials ("materials"). The system represents

the provider's policies and procedures that the provider has designed, and is expected to follow, when developing the materials. The peer reviewer's objective is to determine whether the system is designed and whether the organization is complying with its system appropriately so that users of the materials, primarily CPA firms and their employees, know that they can rely on the materials. The materials can be part or all of a firm's documentation of their system, in the form of, for example, manuals, programs, and practice aids (forms and questionnaires). As such, the users rely on the materials to assist them in performing and reporting in conformity with professional standards (as described in the preceding paragraphs) in conducting their accounting and auditing practices.

18. A QCM or CPE review is similar to a System Review, however, the focus is on the system for developing the materials, instead of on the system for the performance of accounting and auditing work. A reviewer obtains an understanding of the design of the provider's system, including its policies and procedures and how the provider checks itself that it is complying with them. The reviewer obtains this understanding through inquiry of provider personnel and review of documentation on the system. The reviewer also reviews the materials to determine if they are reliable. The objectives of obtaining an understanding of the system and then reviewing the materials forms the basis for the reviewer's conclusions in the peer review report.
19. The extent of a provider's policies and procedures and the manner in which they are implemented will depend upon a variety of factors, such as the size and organizational structure of the provider and the nature of the materials provided to users. Variance in individual performance and professional interpretation affects the degree of compliance with prescribed quality control policies and procedures. Therefore, adherence to all policies and procedures in every case may not be possible.
20. When a provider receives a QCM or CPE review report from a peer reviewer with a peer review rating of *pass*, this means the system is designed and being complied with appropriately to provide users of the materials with reasonable assurance that the materials are reliable. If a provider receives a report with a peer review rating of *pass with deficiencies*, this means the system is designed and complied with appropriately to provide users of the materials with reasonable assurance that the materials are reliable, except in certain situations that are explained in detail in the peer review report. When a provider receives a report with a peer review rating of *fail*, the peer reviewer has determined that the provider's system is not suitably designed or being complied with to provide users of the materials with reasonable assurance that the materials are reliable, and the reasons why are explained in detail in the report.
21. There are inherent limitations in the effectiveness of any system and, therefore, noncompliance with the system may occur and not be detected. A QCM or CPE peer review is based on selective review of the materials. It is directed at assessing whether the design of and compliance with the provider's system provides the provider with reasonable, not absolute, assurance of the materials conforming with the professional standards they purport to encompass. Consequently, it would

not necessarily detect all weaknesses in the system, all instances of noncompliance with it, or that each aspect of the materials is accurate or reliable. Projection of any evaluation of a system to future periods is subject to the risk that the system may become inadequate because of changes in conditions or because the degree of compliance with the policies or procedures may deteriorate.



## Appendix B

### Considerations and Illustrations of Firm Representations

1. The team captain or review captain obtains written representations from management of the reviewed firm to describe matters significant to the peer review in order to assist in the planning and performance of and the reporting on the peer review. In connection with System and Engagement Reviews, specific representations should relate to the following matters, although the firm is not prohibited from making additional representations, and the firm may tailor the representation letter as it deems appropriate, as long as the minimum applicable representations are made to the team captain or review captain (see interpretations):
  - a. Situations or a summary of situations where management is aware that the firm or its personnel has not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies (including applicable firm and individual licensing requirements in each state in which it practices for the year under review) and, if applicable, how the firm has or is addressing and rectifying situations of noncompliance (see interpretations).
  - b. Communications or summary of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting, audit, or attestation engagement performed and reported on by the firm, whether the matter relates to the firm or its personnel, within the three years preceding the firm's current peer review year-end and through the date of the exit conference. The information should be obtained in sufficient detail to consider its effect on the scope of the peer review (see interpretations). In addition, the reviewer may inquire if there are any other issues that may affect the firm's practice.
  - c. Restrictions or limitations on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end.
  - d. Completeness and availability of the engagements with periods ending during the year under review. For engagements performed under the Statements on Standards for Attestation Engagements, including financial forecasts and projections, this includes those with report dates during the year under review.
  - e. Discussions of significant issues from reports or communications, or both, from other practice monitoring or external inspection programs, such as the Public Company Accounting Oversight Board's (PCAOB's) (see interpretations), with the team captain.
  - f. Other representations obtained by the team captain or review captain will depend on the circumstances and nature of the peer review.

2. The written representations should be obtained for the entire firm and not for each individual engagement the firm performs. Firm management's refusal to furnish written representations to the team captain or review captain constitutes a failure to cooperate with the reviewer and thus the administering entity and with the AICPA Peer Review Board, and the firm would be subject to fair procedures that could result in the firm's enrollment in the program being terminated (see interpretations).
3. On System Reviews, the written representations should be addressed to the team captain. Since the team captain is concerned with events occurring during the peer review period and through the date of his or her peer review report that may require an adjustment to the report or other peer review documents, the representations should be dated the same date as the peer review report. The written representations should be signed by those members of management whom the team captain believes are responsible for and knowledgeable about, directly or through others in the firm, the matters covered in the representations, the firm, and its system of quality control. Such members of management normally include the managing partner and partner or manager in charge of the firm's system of quality control. If a representation made by management is contradicted by other information obtained, the team captain should investigate the circumstances and consider the reliability of the representations made and any effect on the report.
4. On Engagement Reviews, the representations should be addressed to the review captain (for example, "To John Smith, CPA" or on committee-appointed review team reviews where appropriate, it may be addressed "To the Review Captain") and dated the same date that the firm submits the list of engagements to the reviewer or the administering entity. The written representations should be signed by those members of management whom the reviewer or the administering entity believes are responsible for and knowledgeable about, directly or through others in the firm, the matters covered in the representations, the firm, and its system of quality control (even though an Engagement Review). Such members of management normally include the managing partner and partner or manager in charge of the firm's system of quality control. If a representation made by management is contradicted by other information obtained, the reviewer should investigate the circumstances and consider the reliability of the representations made and any effect on the report.
5. **Illustration of a Representation Letter That has No Significant Matters to Report to the Team Captain or Review Captain**

(The firm may tailor the language in this illustration and may refer to attachments to the letter as long as adequate representations pertaining to the matters discussed above, as applicable, are included to the satisfaction of the team captain or review captain.)

October 31, 20XX

To the Team Captain or Review Captain

We are providing this letter in connection with the peer review of [name of firm] as of the date of this letter and for the year ended June 30, 20XX.

We understand that we are responsible for complying with the rules and regulations of state boards of accountancy and other regulators. We

confirm, to the best of our knowledge and belief, that there are no known situations in which [*name of firm*] or its personnel have not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements in each state in which it practices for the year under review. We have also provided a list of all engagements to the [*team captain, review captain, or administering entity*] with periods ending during the year under review. For attestation engagements, including financial forecasts or projections, the list included those engagements with report dates during the year under review. We have also provided the [*team captain or review captain*] with any other information requested, including communications by regulatory, monitoring, or enforcement bodies relating to allegations or investigations in the conduct of its accounting, audit, or attestation engagements performed and reported on by the firm, whether the matter relates to the firm or its personnel, within three years preceding the current peer review year-end. In addition, there are no known restrictions or limitations on the firm's or its personnel's ability to practice public accounting by regulatory, monitoring, or enforcement bodies within three years preceding the current peer review year-end. We have also discussed the content of our PCAOB inspection report with the [*team captain or review captain*] (if applicable).

Sincerely,

[*Name of reviewed firm*]

6. **Illustration of a Representation Letter That Has Been Tailored to Report to the Team Captain a Matter of Noncompliance With a Regulatory Requirement**

(The firm may tailor the language in this illustration and may refer to attachments to the letter as long as adequate representations pertaining to the matters discussed above, as applicable, are included to the satisfaction of the team captain or review captain.)

October 31, 20XX

To the Team Captain or Review Captain

We are providing this letter in connection with the peer review of [*name of firm*] as of the date of this letter and for the year ended June 30, 20XX.

We understand that we are responsible for complying with the rules and regulations of state boards of accountancy and other regulators. Other than the firm not having a practice unit license during the year under review in one state where the firm practices (which has been subsequently obtained), we confirm, to the best of our knowledge and belief, that there are no known situations in which [*name of firm*] or its personnel have not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies, including applicable firm and individual licensing requirements in each state in which it practices for the year under review. We have also provided a list of all engagements to the [*team captain, review captain, or administering entity*] with periods ending during the year under review. For attestation engagements, including financial forecasts or projections, the list included those engagements with report dates during the year under review. We have also provided the [*team captain*] with any other information requested, including communications by regulatory, monitoring, or enforcement bodies relating to allegations or investigations in the conduct of its accounting, audit, or attestation engagements performed and reported on by the firm, whether the matter relates to the firm or its personnel, within three years preceding the current peer review year-end. In addition, there are no known restrictions

or limitations on the firm's or its personnel's ability to practice public accounting within three years preceding the current peer review year-end. We have also discussed the content of our Public Company Accounting Oversight Board inspection report with the team captain (if applicable).

Sincerely,

*[Name of reviewed firm]*

## Appendix C

### Illustration of a Report With a Peer Review Rating of *Pass* in a System Review

[Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.]

#### System Review Report

October 31, 20XX

To the Partners of [or other appropriate terminology]

XYZ & Co.

and the Peer Review Committee of the [insert the name of the applicable administering entity]

We\* have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm) in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

As required by the standards, engagements selected for review included (engagements performed under the *Government Auditing Standards*; audits of employee benefit plans, and audits performed under FDICIA).\*\*

In our opinion, the system of quality control for the accounting and auditing practice of XYZ & Co. in effect for the year ended June 30, 20XX, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)* or *fail*. XYZ & Co. has received a peer review rating of *pass*.

Smith, Jones and Associates

[name of team captain's firm]

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\* The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

\*\* If the firm performs audits of employee benefit plans, engagements performed under *Government Auditing Standards*, audits of depository institutions with total assets of \$500 million or greater at the beginning of its fiscal year, or other engagements required to be selected by the board in interpretations, the engagement type(s) selected for review should be identified in the report using this paragraph, tailored as applicable. If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

## Appendix D

### Illustration of a Report With a Peer Review Rating of *Pass* (With a Scope Limitation) in a System Review

#### Limitation on Scope of Review

A report with a scope limitation should be issued when the scope of the review is limited by conditions (including those discussed in the standards) that preclude the application of one or more peer review procedure(s) considered necessary in the circumstances and the review team cannot accomplish the objectives of those procedures through alternate procedures. For example, a review team may be able to apply appropriate alternate procedures if one or more engagements have been excluded from the scope of the review. Ordinarily, however, the team would be unable to apply alternate procedures if the firm's only engagement in an industry that must be selected is unavailable for review and there isn't an earlier issued engagement that may be able to replace it, or when a significant portion of the firm's accounting and auditing practice during the year reviewed had been divested before the review began (see interpretation). A scope limitation may be included in a report with a peer review rating of *pass*, *pass with deficiency(ies)* or *fail*. In this example, the scope limitation was included in a report with a peer review rating of *pass*.

[Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.]

System Review Report

October 31, 20XX

To the Partners of [or other appropriate terminology]

XYZ & Co.

and the Peer Review Committee of the [insert the name of the applicable administering entity]

We\* have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm) in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

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\* The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

As required by the standards, engagements selected for review included (engagements performed under the *Government Auditing Standards*; audits of employee benefit plans, and audits performed under FDICIA).\*\*

In performing our review, the firm notified us that we would be unable to review the engagements performed by one of its former partners who left the firm during the peer review year. Accordingly, we were unable to include in our engagement selection any of the divested engagements. That partner's responsibility was concentrated in the construction industry. The engagements excluded from our engagement selection process included audit engagements and comprised approximately 15 percent of the firm's audit and accounting practice during the peer review year.

In our opinion, except for any deficiencies or significant deficiencies that might have come to our attention had we been able to review divested engagements, as described above, the system of quality control for the accounting and auditing practice of XYZ & Co. in effect for the year ended June 30, 20XX, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)* or *fail*. XYZ & Co. has received a peer review rating of *pass (with a scope limitation)*.

Smith, Jones and Associates

[name of team captain's firm]

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\*\* If the firm performs audits of employee benefit plans, engagements performed under *Government Auditing Standards*, audits of depository institutions with total assets of \$500 million or greater at the beginning of its fiscal year, or other engagements required to be selected by the board in interpretations, the engagement type(s) selected for review should be identified in the report using this paragraph, tailored as applicable. If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

.184

## Appendix E

### Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies* in a System Review

The deficiencies and related recommendations provided are examples provided for illustrative purposes only. Any one or more of the deficiencies, based on the relative importance of the deficiency to the system of quality control as a whole, could result in a report with a peer review rating of *pass with deficiencies* or *fail*.

[Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.]

#### System Review Report

August 31, 20XX

To the Partners of [or other appropriate terminology]

XYZ & Co.

and the Peer Review Committee of the [insert the name of the applicable administering entity]

We\* have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm) in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

As required by the standards, engagements selected for review included (engagements performed under the *Government Auditing Standards*; audits of employee benefit plans, and audits performed under FDICIA).\*\*

We noted the following deficiencies during our review:

1. **Deficiency**—The firm's quality control policies and procedures do not provide its staff with a means of ensuring that all necessary procedures are performed on

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\* The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

\*\* If the firm performs audits of employee benefit plans, engagements performed under *Government Auditing Standards*, audits of depository institutions with total assets of \$500 million or greater at the beginning of its fiscal year, or other engagements required to be selected by the board in interpretations, the engagement type(s) selected for review should be identified in the report using this paragraph, tailored as applicable. If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.



review and compilation engagements. As a result, the firm's review and compilation working papers did not include documentation of all procedures required by professional standards, in particular relating to accounts and notes payable. We were able to satisfy ourselves that, in each case, sufficient procedures had been performed, and the firm subsequently prepared the appropriate documentation.

Recommendation—The firm's quality control policies and procedures should be revised to ensure documentation of all procedures performed as required by professional standards. Although not required by professional standards, the firm should consider using the practice aids in the reference manuals available in the firm's library in order to accomplish this step.

2. Deficiency—The firm's quality control policies and procedures do not require partner involvement in the planning stage of audit engagements. Generally accepted auditing standards permit the auditor with final responsibility for the engagement to delegate some of this work to assistants, but the standards emphasize the importance of proper planning to the conduct of the engagement. We found several audits performed in which, as a result of a lack of involvement including timely supervision by the engagement partner in planning the audit, the work performed on contracts, contract provisions, and related receivables did not support the firm's opinion on the financial statements. The firm has subsequently performed the necessary additional procedures to provide a satisfactory basis for its opinion.

Recommendation—The firm's quality control policies and procedures should be revised to provide, at a minimum, for timely audit partner review of the preliminary audit plan and the audit program. The firm should ensure that this is addressed as part of its ongoing monitoring procedures.

3. Deficiency—The firm's quality control policies and procedures require that financial statement reporting and disclosure checklists appropriate to the industry of the engagement being performed be completed. Our review noted that these checklists were not being used on all audit engagements. As a result, on certain audit engagements in the construction industry, the financial statements were missing several significant disclosures specific to the industry as required by generally accepted accounting principles. The subject reports have been recalled, and the financial statements are being revised.

Recommendation—The firm should conduct a training session for all personnel to review the firm's policies and procedures for utilizing financial statement reporting and disclosure checklists that are appropriate to the industry of an engagement. The engagement partner should carefully review these checklists at the completion of an engagement to ensure that the appropriate checklists are utilized and to ensure their proper completion as required by firm policy. This can be accomplished by adding a procedure to the firm's engagement review checklist requiring the engagement partner to document his or her review of these checklists.

In our opinion, except for the deficiencies described above, the system of quality control for the accounting and auditing practice of XYZ & Co. in effect for the year ended June 30, 20XX, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co has received a peer review rating of *pass with deficiencies*.

Smith, Jones and Associates

[name of team captain's firm]

.185

## Appendix F

### Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies* in a System Review

The purpose of a letter of response is to describe the actions the firm has taken or will take, including the timing of the planned actions, to prevent a recurrence of each deficiency discussed in the report. If the reviewed firm disagrees with one or more of the deficiencies or recommendations in the report, the reviewed firm should contact the administering entity for assistance. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For more information related to disagreements, see paragraph .93 of the standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the team captain for review and comment prior to the firm submitting the response to the administering entity.

*[Reviewed firm's letterhead]*

September 21, 20XX

*[Addressed to the peer review committee of the administering entity]*

Ladies and Gentlemen:

This letter represents our<sup>\*</sup> response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended June 30, 20XX. The corrective actions discussed in this letter will be monitored to ensure that they are effectively implemented as part of our system of quality control.

- 1.\*\* The firm modified its quality control policies and procedures to require the use of practice aids to document procedures performed on review and compilation engagements, especially for accounts and notes payable. Partners were instructed to ensure that these aids were being utilized appropriately when reviewing engagements. This policy was discussed in a recent training session held in connection with a recent firm-wide staff meeting.
2. The firm also modified its quality control policies and procedures to place a greater emphasis on partner involvement in the planning stage of all audit engagements. The revised policies and procedures require the engagement owner to document his or her timely involvement in the planning process in the planning section of the written work program. The importance of proper planning, including timely partner involvement, to quality work was emphasized in the training session referred to above.

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\* The response should use the singular *I*, *me*, and *my* only when the reviewed firm is a sole practitioner.

\*\* The numbering of responses, to coincide with the numbered comments in the report, is optional.

3. In addition, at that training session, the importance of proper use of the firm's reporting and disclosure checklists appropriate to the industry of the engagement being performed was discussed. We discussed the proper resolution of points or topics unfamiliar to the individual completing the checklist or those reviewing its completion. The firm's CPE plan for partners and managers now includes annual updates on industry specific disclosure issues.

As mentioned above, these corrective actions will also be emphasized in our monitoring procedures and internal inspection.

We believe these actions are responsive to the findings of the review.

Sincerely,

[Name of Firm]<sup>\*\*\*</sup>

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<sup>\*\*\*</sup> Signed by an authorized partner of the firm.

.186

## Appendix G

### Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies (With a Scope Limitation)* in a System Review

The deficiencies and related recommendations provided are examples provided for illustrative purposes only. Any one or more of the deficiencies, based on the relative importance of the deficiency to the system of quality control as a whole, could result in a report with a peer review rating of *pass with deficiencies* or *fail*.

#### Limitation on Scope of Review

A report with a scope limitation should be issued when the scope of the review is limited by conditions (including those discussed in the standards) that preclude the application of one or more peer review procedure(s) considered necessary in the circumstances and the review team cannot accomplish the objectives of those procedures through alternate procedures. For example, a review team may be able to apply appropriate alternate procedures if one or more engagements have been excluded from the scope of the review. Ordinarily, however, the team would be unable to apply alternate procedures if the firm's only engagement in an industry that must be selected is unavailable for review and there isn't an earlier issued engagement that may be able to replace it, or when a significant portion of the firm's accounting and auditing practice during the year reviewed had been divested before the review began (see interpretation). A scope limitation may be included in a report with a peer review rating of *pass*, *pass with deficiency(ies)*, or *fail*. In this example, the scope limitation was included in a report with a peer review rating of *pass with deficiencies*, where one of the deficiencies related to the circumstances of the scope limitation.

[Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.]

System Review Report

October 31, 20XX

To the Partners of [or other appropriate terminology]

XYZ & Co.

and the Peer Review Committee of the [insert the name of the applicable administering entity]

We\* have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm) in effect for the year ended June 30, 20XX. Except as described below, our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The firm is responsible for designing a system of quality control and complying

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\* The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

As required by the standards, engagements selected for review included (audits of employee benefit plans and audits performed under FDICIA).\*\*

In performing our review, the firm notified us that we would be unable to select its only audit subject to *Government Auditing Standards* (Yellow Book). As a result, we were unable to review all of the types of engagements required to be selected by the standards established by the Peer Review Board of the AICPA.

We noted the following deficiencies during our review:

1. Deficiency—The firm's quality control policies and procedures do not require partner involvement in the planning stage of audit engagements. Generally accepted auditing standards permit the auditor with final responsibility for the engagement to delegate some of this work to assistants, but the standards emphasize the importance of proper planning to the conduct of the engagement. We found several audits performed in which, as a result of a lack of involvement, including timely supervision by the engagement partner in planning the audit, the work performed on contracts, contract provisions, and related receivables did not support the firm's opinion on the financial statements. The firm has subsequently performed the necessary additional procedures to provide a satisfactory basis for its opinion.

Recommendation—The firm's quality control policies and procedures should be revised to provide, at a minimum, for timely audit partner review of the preliminary audit plan and the audit program. The firm should ensure that this is addressed as part of its ongoing monitoring procedures.

2. Deficiency—As noted above, in performing our review, the firm notified us that we would be unable to select its only audit subject to *Government Auditing Standards* (Yellow Book). As a result, the firm was not in compliance with the Yellow Book peer review engagement selection requirements.

Recommendation—We recommend that the firm consider the importance of adhering to the Yellow Book requirements and the possible consequences of noncompliance.

In our opinion, except for the effects of the deficiency described above and any additional deficiencies or significant deficiencies that might have come to our attention had we been able to review the engagement as described above, the system of quality control for the accounting and auditing practice of XYZ & Co. in effect for the year ended June 30, 20XX, has been suitably designed and complied with to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co has received a peer review rating of *pass with deficiencies (with a scope limitation)*.

Smith, Jones and Associates

[name of team captain's firm]

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\*\* If the firm performs audits of employee benefit plans, engagements performed under *Government Auditing Standards*, audits of depository institutions with total assets of \$500 million or greater at the beginning of its fiscal year, or other engagements required to be selected by the board in interpretations, the engagement type(s) selected for review should be identified in the report using this paragraph, tailored as applicable. If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

.187

## Appendix H

### Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies (With a Scope Limitation)* in a System Review

The purpose of a letter of response is to describe the actions the firm has taken or will take, including the timing of the planned actions, to prevent a recurrence of each deficiency discussed in the report. If the reviewed firm disagrees with one or more of the deficiencies or recommendations in the report, the reviewed firm should contact the administering entity for assistance. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For more information related to disagreements, see paragraph .93 of the standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the team captain for review and comment prior to the firm submitting the response to the administering entity.

[Reviewed firm's letterhead]

November 30, 20XX

[Addressed to the peer review committee of the administering entity]

Ladies and Gentlemen:

This letter represents our\* response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended June 30, 20XX.

- 1.\*\* The firm also modified its quality control policies and procedures to place a greater emphasis on partner involvement in the planning stage of all audit engagements. The revised policies and procedures require the engagement owner to document his or her timely involvement in the planning process in the planning section of the written work program. The importance of proper planning, including timely partner involvement, to quality work was emphasized in a recent training session held in conjunction with a recent firm-wide staff meeting.
2. Due to circumstances that we deemed appropriate, we notified the peer reviewer that he would be unable to select our only audit subject to *Government Auditing Standards* in the peer review. This is the only governmental audit the firm has performed, so there were no previous audits for the reviewer to select. We suggested selecting an audit engagement in a different industry. We have considered the consequences of noncompliance related to this matter.

Sincerely,

[Name of Firm]\*\*\*

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\* The response should use the singular *I*, *me*, and *my* only when the reviewed firm is a sole practitioner.

\*\* The numbering of responses, to coincide with the numbered comments in the report, is optional.

\*\*\* Signed by an authorized partner of the firm.

## Appendix I

### Illustration of a Report With a Peer Review Rating of *Fail* in a System Review

The deficiencies and related recommendations provided are examples provided for illustrative purposes only. Any one or more of the deficiencies, based on the relative importance of the deficiency to the system of quality control as a whole, could result in a report with a peer review rating of *pass with deficiencies* or *fail*.

[*Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.*]

System Review Report

October 31, 20XX

To the Partners of [*or other appropriate terminology*]

XYZ & Co.

and the Peer Review Committee of the [*insert the name of the applicable administering entity*]

We\* have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm) in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

As required by the standards, engagements selected for review included (engagements performed under the *Government Auditing Standards*; audits of employee benefit plans, and audits performed under FDICIA).\*\*

We noted the following significant deficiencies\*\*\* during our review:

1. Deficiency—The firm's quality control policies and procedures do not require written audit programs as required by professional standards. As a result, we

\* The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

\*\* If the firm performs audits of employee benefit plans, engagements performed under *Government Auditing Standards*, audits of depository institutions with total assets of \$500 million or greater at the beginning of its fiscal year, or other engagements required to be selected by the board in interpretations, the engagement type(s) selected for review should be identified in the report using this paragraph, tailored as applicable. If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

\*\*\* When considered together, the deficiencies rise to the level of significant deficiencies.

noted several instances in which audit procedures were not adequately performed and documented in the areas of investments and expenses. As a result, the audit work performed for several audits did not support the opinion issued and was not performed in conformity with applicable professional standards. The firm has subsequently performed the omitted procedures to support the audit opinions.

Recommendation—The firm's quality control policies and procedures should require the use of audit programs on all audits. All audit programs should be retained with the engagement working papers.

2. Deficiency—The firm's quality control policies and procedures require consultation based upon the following factors: materiality, experience in a particular industry or functional area, and familiarity with the accounting principles or auditing requirements in a specialized area. We noted instances in which the firm did not consult during the year, either by use of the firm's technical reference material or by requesting assistance from outside the firm. As a result, financial statements on audits for development stage companies did not conform with applicable professional standards. The firm was not aware of the unique disclosure and statement presentations required until it was brought to its attention during the peer review. The firm intends to recall and reissue the financial statements and reports.

Recommendation—The firm should emphasize its consultation policies and procedures on those engagements that are new to the experience level of the firm's accounting and auditing personnel.

3. Deficiency—The firm's quality control policies and procedures do not provide its personnel with a means of ensuring that all necessary procedures are performed on Employee Retirement Income Security Act (ERISA) engagements. During our review, we noted that the firm failed to adequately perform, including appropriately documenting, procedures related to benefit payments on ERISA engagements. The firm has subsequently performed the testing and documented its procedures.

Recommendation—The firm should review and implement the requirements of specialized industries. This can be accomplished by the purchase and use of practice aids tailored to the industry.

4. Deficiency—The firm's quality control policies and procedures require that financial statement reporting and disclosure checklists be completed for all engagements. Our review noted that these checklists were not being used on all engagements. As a result, the reviewed financial statements in the construction industry were missing several significant disclosures as required by generally accepted accounting principles. The subject reports have been recalled, and the financial statements are being revised.

Recommendation—The firm should conduct a training session for all personnel to review the firm's policies and procedures for utilizing financial statement reporting and disclosure checklists specific to the industry of the engagement, when available. The engagement partner should carefully review these checklists at the completion of an engagement to ensure their proper completion as required by firm policy. This can be accomplished by adding a procedure to the firm's engagement review checklist requiring the engagement partner to document his or her review of these checklists.

In our opinion, as a result of the significant deficiencies described above, the system of quality control for the accounting and auditing practice of XYZ & Co. in effect for the year ended June 30, 20XX, was not suitably designed or



complied with to provide the firm with reasonable assurance of performing and/or reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co has received a peer review rating of *fail*.

Smith, Jones and Associates

[*name of team captain's firm*]

## Appendix J

### Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail* in a System Review

The purpose of a letter of response is to describe the actions the firm has taken or will take, including the timing of the planned actions, to prevent a recurrence of each of the significant deficiencies discussed in the report. If the reviewed firm disagrees with one or more of the significant deficiencies or recommendations in the report, the reviewed firm should contact the administering entity for assistance. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For more information related to disagreements, see paragraph .93 of the standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the team captain for review and comment prior to the firm submitting the response to the administering entity.

November 30, 20XX

*[Addressed to the peer review committee of the administering entity]*

Ladies and Gentlemen:

This letter represents our\* response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended June 30, 20XX. All issues have been brought to the attention of personnel at a meeting held on November 22, 20XX. In addition, steps have been added to our monitoring procedures to review the deficiencies noted in the report so that they will not happen again.

- 1.\*\* Several of the deficiencies noted by the review team included missing or incomplete audit and review documentation. All individuals with responsibility for managing audit and accounting engagements have been reminded of their responsibility to ensure the applicable professional standards for performing and documenting engagements are followed. In addition, we have implemented a concurring partner review on all audit and review engagements, and the quality of audit documentation will be a focus of the concurring partner's review.
2. The firm has contacted two other accounting firms with expertise in Employee Retirement Income Security Act (ERISA) audits, development stage companies, and other industries that are similar to ours. We have implemented a plan for consultation with these firms for guidance in situations with which we are unfamiliar.
3. We have purchased practice aids that are specific to the industries of our clients and have instructed staff and partners on their use.

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\* The response should use the singular *I*, *me*, and *my* only when the reviewed firm is a sole practitioner.

\*\* The numbering of responses, to coincide with the numbered comments in the report, is optional.

4. At the staff meeting mentioned above, the importance of proper use of the firm's reporting and disclosure checklist was discussed, including the use of checklists for specialized industries. We discussed the proper resolution of points or topics unfamiliar to the individual completing the checklist or those reviewing its completion. The firm's CPE plan for partners and managers now includes annual updates on disclosure issues.

The firm is committed to strengthening its monitoring policies and procedures, especially as they relate to a timely postissuance review of engagements. We have acquired quality control materials to guide the firm, and supervision of the monitoring process has been assigned to a partner. Additionally, outside assistance (as mentioned above) has been sought, and this individual will be available for consultation and guidance.

Sincerely,

*[Name of Firm]*<sup>\*\*\*</sup>

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<sup>\*\*\*</sup> Signed by an authorized partner of the firm.

.190

## Appendix K

### Illustration of a Report With a Peer Review Rating of *Fail* (With a Scope Limitation) in a System Review

The deficiencies and related recommendations provided are examples provided for illustrative purposes only. Any one or more of the deficiencies, based on the relative importance of the deficiency to the system of quality control as a whole, could result in a report with a peer review rating of *pass with deficiencies* or *fail*.

#### Limitation on Scope of Review

A report with a scope limitation should be issued when the scope of the review is limited by conditions (including those discussed in the standards) that preclude the application of one or more peer review procedure(s) considered necessary in the circumstances and the review team cannot accomplish the objectives of those procedures through alternate procedures. For example, a review team may be able to apply appropriate alternate procedures if one or more engagements have been excluded from the scope of the review. Ordinarily, however, the team would be unable to apply alternate procedures if the firm's only engagement in an industry that must be selected is unavailable for review and there is not an earlier issued engagement that may be able to replace it, or when a significant portion of the firm's accounting and auditing practice during the year reviewed had been divested before the review began (see interpretation). A scope limitation may be included in a report with a peer review rating of *pass*, *pass with deficiency(ies)*, or *fail*. In this example, the scope limitation was included in a report with a peer review rating of *fail*.

[Firm letterhead for a firm-on-firm review; team captain's firm letterhead for an association formed review team.]

System Review Report

October 31, 20XX

To the Partners of [or other appropriate terminology]

XYZ & Co.

and the Peer Review Committee of the [insert the name of the applicable administering entity]

We\* have reviewed the system of quality control for the accounting and auditing practice of XYZ & Co. (the firm) in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility

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\* The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

is to express an opinion on the design of the system of quality control and the firm's compliance therewith based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a System Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

As required by the standards, engagements selected for review included (engagements performed under the *Government Auditing Standards*; audits of employee benefit plans, and audits performed under FDICIA).\*\*

In performing our review, the firm notified us that we would be unable to review the engagements performed by one of the firm's four offices that divested from the firm during the peer review year. As a result, we were unable to include within our engagement selection any engagements issued by that office. The engagements excluded from our engagement selection process included audit engagements and composed approximately 20 percent of the firm's audit and accounting hours during the peer review year.

In addition, we noted the following significant deficiencies\*\*\* during our review:

1. Deficiency—The firm's quality control policies and procedures do not require written audit programs as required by professional standards. As a result, we noted several instances in which audit procedures were not adequately performed and documented in the areas of investments and expenses. As a result, the audit work performed for several audits did not support the opinion issued and was not performed in conformity with applicable professional standards. The firm has subsequently performed the omitted procedures to support the audit opinions.

Recommendation—The firm's quality control policies and procedures should require the use of audit programs on all audits. All audit programs should be retained with the engagement working papers.

3. Deficiency—The firm's quality control policies and procedures require consultation based upon the following factors: materiality, experience in a particular industry or functional area, and familiarity with the accounting principles or auditing requirements in a specialized area. We noted instances in which the firm did not consult during the year, either by use of the firm's technical reference material or by requesting assistance from outside the firm. As a result, financial statements on audits for development stage companies did not conform with applicable professional standards. The firm was not aware of the unique disclosure and statement presentations required until it was brought to its attention during the peer review. The firm intends to recall and reissue the financial statements and reports.

Recommendation—The firm should emphasize its consultation policies and procedures on those engagements that are new to the experience level of the firm's accounting and auditing personnel.

5. Deficiency—The firm's quality control policies and procedures do not provide its personnel with a means of ensuring that all necessary procedures are performed on Employee Retirement Income Security Act (ERISA) engagements. During our review, we noted that the firm failed to adequately perform, including appropriately documenting, procedures related to benefit payments on

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\*\* If the firm performs audits of employee benefit plans, engagements performed under *Government Auditing Standards*, audits of depository institutions with total assets of \$500 million or greater at the beginning of its fiscal year, or other engagements required to be selected by the board in interpretations, the engagement type(s) selected for review should be identified in the report using this paragraph, tailored as applicable. If the firm does not perform such engagements, this paragraph is not applicable and not included in the report.

\*\*\* When considered together, the deficiencies rise to the level of significant deficiencies.

ERISA engagements. The firm has subsequently performed the testing and documented its procedures.

Recommendation—The firm should review and implement the requirements of specialized industries. This can be accomplished by the purchase and use of practice aids tailored to the industry.

6. Deficiency—The firm's quality control policies and procedures require that financial statement reporting and disclosure checklists be completed for all engagements. Our review noted that these checklists were not being used on all engagements. As a result, the reviewed financial statements in the construction industry were missing several significant disclosures as required by generally accepted accounting principles. The subject reports have been recalled and the financial statements are being revised.

Recommendation—The firm should conduct a training session for all personnel to review the firm's policies and procedures for utilizing financial statement reporting and disclosure checklists specific to the industry of the engagement, when available. The engagement partner should carefully review these checklists at the completion of an engagement to ensure their proper completion as required by firm policy. This can be accomplished by adding a procedure to the firm's engagement review checklist requiring the engagement partner to document his or her review of these checklists.

In our opinion, as a result of the significant deficiencies described above, and any additional significant deficiencies that might have come to our attention had we been able to review engagements from the divested office as described above, the system of quality control for the accounting and auditing practice of XYZ & Co. in effect for the year ended June 30, 20XX was not suitably designed or complied with to provide the firm with reasonable assurance of performing and/or reporting in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co has received a peer review rating of *fail (with a scope limitation)*.

Smith, Jones and Associates

[*name of team captain's firm*]

.191

## Appendix L

### Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail (With a Scope Limitation)* in a System Review

The purpose of a letter of response is to describe the actions the firm has taken or will take including the timing of the planned actions, to prevent a recurrence of each of the significant deficiencies discussed in the report. If the reviewed firm disagrees with one or more of the significant deficiencies, or recommendations in the report, the reviewed firm should contact the administering entity for assistance. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For more information related to disagreements, see paragraph .93 of the standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140 "Accepting System and Engagement Reviews"). The letter of response should be submitted to the team captain for review and comment prior to the firm submitting the response to the administering entity.

November 30, 20XX

*[Addressed to the peer review committee of the administering entity]*

Ladies and Gentlemen:

This letter represents our\* response to the report issued in connection with the peer review of the firm's system of quality control for the accounting and auditing practice in effect for the year ended June 30, 20XX. All issues have been brought to the attention of personnel at a meeting held on November 22, 20XX. In addition, steps have been added to our monitoring procedures to review the deficiencies noted in the report so that they will not happen again.

We notified our peer reviewer that he would be unable to review the engagements performed by one of our firm's four offices that divested from our firm during the peer review year. We have considered the consequences of this scope limitation on the results of our peer review.

- 1.\*\* Several of the deficiencies noted by the review team included missing or incomplete audit and review documentation. All individuals with responsibility for managing audit and accounting engagements have been reminded of their responsibility to ensure the applicable professional standards for performing and documenting engagements are followed. In addition, we have implemented a concurring partner review on all audit and review engagements, and the quality of audit documentation will be a focus of the concurring partner's review.
2. The firm has contacted two other accounting firms with expertise in Employee Retirement Income Security Act (ERISA) audits, development stage companies, and other industries that are similar to ours. We have implemented a plan for consultation with these firms for guidance in situations with which we are unfamiliar.

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\* The response should use the singular *I*, *me*, and *my* only when the reviewed firm is a sole practitioner.

\*\* The numbering of responses, to coincide with the numbered comments in the report, is optional.

3. We have purchased practice aids that are specific to the industries of our clients and have instructed staff and partners on their use.
4. At the staff meeting mentioned above, the importance of proper use of the firm's reporting and disclosure checklist was discussed, including the use of checklists for specialized industries. We discussed the proper resolution of points or topics unfamiliar to the individual completing the checklist or those reviewing its completion. The firm's CPE plan for partners and managers now includes annual updates on disclosure issues.

The firm is committed to strengthening its monitoring policies and procedures, especially as they relate to a timely postissuance review of engagements. We have acquired quality control materials to guide the firm, and supervision of the monitoring process has been assigned to a partner. Additionally, outside assistance (as mentioned above) has been sought, and this individual will be available for consultation and guidance.

Sincerely,

*[Name of Firm]*\*\*\*

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\*\*\* Signed by an authorized partner of the firm.



## Appendix M

### Illustration of a Report With a Peer Review Rating of *Pass* in an Engagement Review

In the event of a scope limitation, include an additional paragraph (as described in paragraph 122j of the standards), and follow the illustrations for System Reviews with scope limitations (see appendixes D, G, and K).

*[Administering entity letterhead for a committee-appointed review team review; firm letterhead for a firm-on-firm review; review captain's firm letterhead for an association formed review team]*

#### Engagement Review Report

September 30, 20XX

To the Partners of *[or other appropriate terminology]*

XYZ & Co.

and the Peer Review Committee of the *[insert the name of the applicable administering entity]*

We\* have reviewed selected accounting engagements of XYZ & Co. (the firm) in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects. An Engagement Review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, we express no opinion or any form of assurance on that system. The nature, objectives, scope, limitations of, and the procedures performed in an Engagement Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

Based on our review, nothing came to our attention that caused us to believe that the engagements submitted for review by XYZ & Co. for the year ended June 30, 20XX, were not performed and reported on in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co has received a peer review rating of *pass*.

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\* The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

Smith, Jones and Associates

*[name of review captain's firm on firm-on-firm review or association formed review team]*

*[or]*

John Brown, Review Captain

*[committee-appointed review team review]*

## Appendix N

### Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies* in an Engagement Review

This illustration assumes that the firm had at least one other engagement that was reviewed that did not have a deficiency. Otherwise, this firm would have received a peer review rating of *fail*.

In the event of a scope limitation, include an additional paragraph (as described in paragraph 122j of the standards), and follow the illustrations for System Reviews with scope limitations (see appendixes D, G, and K).

*[Administering entity letterhead for a committee-appointed review team review; firm letterhead for a firm-on-firm review; review captain's firm letterhead for an association formed review team]*

#### Engagement Review Report

September 30, 20XX

To the Partners of *[or other appropriate terminology]*

XYZ & Co.

and the Peer Review Committee of the *[insert the name of the applicable administering entity]*

We\* have reviewed selected accounting engagements of XYZ & Co. (the firm) in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects. An Engagement Review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, we express no opinion or any form of assurance on that system. The nature, objectives, scope, limitations of, and the procedures performed in an Engagement Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

We noted the following deficiencies\*\* during our review:

1. Deficiency—On one review engagement of a manufacturing client, we noted that the accompanying accountant's report was not appropriately modified. The financial statements did not appropriately present or disclose matters in accordance with industry standards. The firm discussed the departure with the client

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\* The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

\*\* The deficiencies and related recommendations provided are examples provided for illustrative purposes only.

and decided to recall its report and restate the accompanying financial statements in order to report in conformity with applicable professional standards in all material respects.

Recommendation—We recommend that the firm establish a means of ensuring that financial statements present or disclose matters in accordance with industry standards. Such means might include continuing professional education in the industries of the firm's engagements and, although not required by professional standards, use of a comprehensive reporting and disclosure checklist on accounting engagements that is tailored for specialized industries, where applicable, or a cold review of reports and financial statements prior to issuance.

2. Deficiency—On a review engagement we reviewed, we noted that the firm failed to obtain a management representation letter, and its working papers failed to document the matters covered in the accountant's inquiry and analytical procedures. These deficiencies were identified on the firm's previous review.

Recommendation—The firm should review and implement the requirements for obtaining management representation letters and the content of the accountant's working papers on review engagements.

Based on our review, except for the deficiencies described above, nothing came to our attention that caused us to believe that the engagements submitted for review by XYZ & Co. for the year ended June 30, 20XX, were not performed and reported on in conformity with applicable professional standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co. has received a peer review rating of *pass with deficiencies*.

Smith, Jones and Associates

*[name of review captain's firm on firm-on-firm review or association formed review team]*

*[or]*

John Brown, Review Captain

*[committee-appointed review team review]*

.194

## Appendix O

### Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Pass With Deficiencies* in an Engagement Review

The purpose of a letter of response is to describe the actions the firm has taken or will take including the timing of the planned actions to prevent the recurrence of each deficiency discussed in the report. If the reviewed firm disagrees with one or more of the deficiencies or recommendations in the report, the reviewed firm should contact the administering entity for assistance in the matter. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For additional guidance on disagreements, see paragraph .116 of standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the reviewer for review and comment prior to the firm submitting the response to the administering entity.

October 31, 20XX

*[Addressed to the peer review committee of the administering entity]*

Ladies and Gentlemen:

This letter represents our\* response to the report on the Engagement Review of our firm's accounting practice for the year ended June 30, 20XX.

- 1.\*\* As recommended by the reviewer, the entire staff has participated in continuing professional education related to reporting and disclosures, with a particular focus on areas specific to the industries that we are engaged in. We will be performing a preissuance review by a partner not associated with the engagement to make sure that the accountant's report is appropriately modified when the financial statements depart from applicable professional standards.
2. Management representation letters will be obtained for all future review engagements issued by the firm. The firm has required that a manager review each engagement to ensure that the management representation letter is obtained and that all the required documentation, including the matters covered in the accountant's inquiry and analytical procedures, is included in the working papers.

We believe these actions address the matters noted by the reviewer.

Sincerely,

*[Name of firm]*\*\*\*

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\* The response should use the singular *I*, *me*, and *my* only when the reviewed firm is a sole practitioner.

\*\* The numbering of responses, to coincide with the numbered comments in the report, is optional.

\*\*\* Signed by an authorized partner of the firm.

.195

## Appendix P

### Illustration of a Report With a Peer Review Rating of *Fail* in an Engagement Review

The deficiencies in this illustration represent various examples and are not intended to suggest that the peer review would include this many engagements in the scope or require this number of deficiencies to warrant a report with a peer review rating of *fail*. However, each of the engagements reviewed would have one or more deficiencies in a report with a peer review rating of *fail*.

In the event of a scope limitation, include an additional paragraph (as described in paragraph 122j of the standards), and follow the illustrations for System Reviews with scope limitations (see appendixes D, G, and K).

*[Administering entity letterhead for a committee-appointed review team review; firm letterhead for a firm-on-firm review; review captain's firm letterhead for an association formed review team]*

#### Engagement Review Report

September 30, 20XX

To the Partners of *[or other appropriate terminology]*

XYZ & Co.

and the Peer Review Committee of the *[insert the name of the applicable Administering Entity]*

We\* have reviewed selected accounting engagements of XYZ & Co. (the firm) in effect for the year ended June 30, 20XX. Our peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The firm is responsible for designing a system of quality control and complying with it to provide the firm with reasonable assurance of performing and reporting in conformity with applicable professional standards in all material respects. Our responsibility is to evaluate whether the engagements submitted for review were performed and reported on in conformity with applicable professional standards in all material respects. An Engagement Review does not include reviewing the firm's system of quality control and compliance therewith and, accordingly, we express no opinion or any form of assurance on that system. The nature, objectives, scope, limitations of, and the procedures performed in an Engagement Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

We noted the following significant deficiencies\*\* during our review:

1. **Deficiency**—Our review disclosed several failures to adhere to applicable professional standards in reporting on material departures from generally accepted accounting principles (GAAP) and in conforming to standards for accounting

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\* The report should use the plural *we*, *us*, and *our* even if the review team consists of only one person. The singular *I*, *me*, and *my* are appropriate only if the reviewed firm has engaged another firm to perform its review and the reviewing firm is a sole practitioner.

\*\* The deficiencies and related recommendations provided are examples provided for illustrative purposes only.

and review services. Specifically, the firm did not disclose in certain compilation and review reports failures to conform with GAAP in accounting for leases, in accounting for revenue from construction contracts, and in disclosures made in the financial statements or the notes thereto concerning various matters important to an understanding of those statements. The compilation and review engagements were in the construction and manufacturing industries, respectively. In addition, the firm did not obtain management representation letters on review engagements.

Recommendation—We recommend the firm establish a means of ensuring its conformity with applicable professional standards. In addition, we recommend the firm review and implement the requirements for obtaining management representation letters on review engagements. The firm should either participate in continuing professional education in financial statement disclosures, use a reporting and disclosure checklist on accounting engagements (tailored if the financial statements are in a specialized industry), or conduct a preissuance review of the engagement by an individual not associated with the engagement prior to issuance.

2. Deficiency—During our review, we noted the firm did not modify its compilation reports on financial statements when neither the financial statements nor the footnotes noted that the statements were presented on a comprehensive basis of accounting other than generally accepted accounting principles. This deficiency was noted in the firm's previous peer reviews.

Recommendation—We recommend that the firm review the reports issued during the last year and identify those reports that should have been modified to reflect a comprehensive basis of accounting other than generally accepted accounting principles. A memorandum should then be prepared highlighting the changes to be made in the current year and placed in the files of the client for whom a report must be changed.

3. Deficiency—In the construction industry compilation engagements that we reviewed, disclosures of material lease obligations as required by generally accepted accounting principles were not included in the financial statements, and the omissions were not disclosed in the accountant's reports.

Recommendation—We recommend the firm review and disseminate information regarding the disclosure requirements on specialized industries to all staff involved in reviewing or compiling financial statements. In addition, we recommend that the firm establish appropriate policies to ensure that all lease obligations are disclosed in financial statements reported on by the firm. For example, a step might be added to compilation and review work programs requiring that special attention be given to these areas.

4. Deficiency—During our review of the financial statements for a compilation engagement prepared under Statement on Standards for Accounting and Review Services No. 8, for management use only, we noted that the engagement letter did not include all of the information required by applicable professional standards.

Recommendation—The firm should review the professional standards governing the information to be included in engagement letters for financial statements prepared for management use only and make sure it conforms to those standards.

As a result of the deficiencies described above, we believe that the engagements submitted for review by XYZ & Co. for the year ended June 30, 20XX, were not performed and reported on in conformity with applicable professional

standards in all material respects. Firms can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ & Co has received a peer review rating of *fail*.

Smith, Jones and Associates

[*name of review captain's firm on firm-on-firm review or association formed review team*]

[*or*]

John Brown, Review Captain

[*committee-appointed review team review*]



## Appendix Q

### Illustration of a Response by a Reviewed Firm to a Report With a Peer Review Rating of *Fail* in an Engagement Review

The purpose of a letter of response is to describe the actions the firm has taken or will take including the timing of the planned actions to prevent the recurrence of each of the significant deficiencies. If the reviewed firm disagrees with one or more of the significant deficiencies or recommendations in the report, the reviewed firm should contact the administering entity for assistance. If the firm still disagrees after contacting the administering entity, the firm's response should describe the reasons for such disagreement. For additional guidance on disagreements, see paragraph .116 of the standards. The letter of response should be carefully prepared because of the important bearing it may have on the decisions reached in connection with acceptance of the report on the review (see paragraphs .136–.140, "Accepting System and Engagement Reviews"). The letter of response should be submitted to the reviewer for review and comment prior to the firm submitting the response to the administering entity.

October 31, 20XX

*[Addressed to the peer review committee of the administering entity]*

Ladies and Gentlemen:

This letter represents our\* response to the report on the Engagement Review of our firm's accounting practice for the year ended June 30, 20XX.

\*\*To prevent the recurrence of the deficiencies noted by the reviewer and to prevent other such deficiencies from occurring, we will review the professional standards related to the deficiencies and ensure that the professional standards will be complied with on all future engagements.

Specifically, we have strengthened the engagement review to ensure that management representation letters are obtained for all review engagements performed by the firm.

All personnel who work on accounting engagements will be participating in continuing professional education in disclosures and reporting by December 31, 20XX, to address the disclosure and reporting deficiencies noted by the reviewer. In addition, we have started using a third-party reporting and disclosure checklist to ensure all reporting and disclosure matters are appropriately addressed. The reporting and disclosure checklist is tailored to specialized industries, where applicable.

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\* The response should use the singular *I*, *me*, and *my* only when the reviewed firm is a sole practitioner.

\*\* The numbering of responses, to coincide with the numbered comments in the report, is optional.

The firm is now using third-party practice aids for guidance in compilations of financial statements for management use only, and this includes engagement letters that conform to professional standards to document the client's understanding with respect to these engagements. We believe these actions are responsive to the deficiencies noted on the review.

Sincerely,

*[Name of firm]*\*\*\*

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\*\*\* Signed by an authorized partner of the firm.

.197

## Appendix R

### Illustration of a Report With a Peer Review Rating of *Pass* in a Peer Review of Quality Control Materials or Continuing Professional Education Programs

Quality Control Materials \* Review Report

April 30, 20XX

Executive Board

XYZ Organization

and the AICPA Peer Review Board's National Peer Review Committee

We have reviewed the system of quality control for the development and maintenance of [*identify each item covered by the opinion or refer to an attached listing*] (hereafter referred to as *materials*) of XYZ Organization (the organization) and the resultant materials in effect at December 31, 20XX. Our quality control materials\* peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The organization is responsible for designing a system of quality control and complying with it to provide users of the materials with reasonable assurance that the materials are reliable aids to assist them in conforming with those professional standards that the materials purport to encompass. Our responsibility is to express an opinion on the design of the system and the organization's compliance with that system based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a Quality Control Materials<sup>§</sup> Review are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

In our opinion, the system of quality control for the development and maintenance of the quality control materials\* of the XYZ Organization was suitably designed and was being complied with during the year ended December 31, 20XX, to provide users of the materials with reasonable assurance that the materials are reliable aids to assist them in conforming with those professional standards the materials purport to encompass. Also, in our opinion, the quality control materials\* referred to above are reliable aids at December 31, 20XX. Organizations can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ Organization has received a peer review rating of *pass*.

ABC &amp; Co.\*\*

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\* Or *Continuing Professional Education Programs*, if applicable.

\*\* The report should be signed in the name of the team captain's firm for firm on firm reviews or association formed review teams.

.198

## Appendix S

### Illustration of a Report With a Peer Review Rating of *Pass With Deficiencies* in a Peer Review of Quality Control Materials or Continuing Professional Education Programs

Quality Control Materials\* Review Report

April 30, 20XX

Executive Board

XYZ Organization

and the National Peer Review Committee

We have reviewed the system of quality control for the development and maintenance of [*identify each item covered by the opinion or refer to an attached listing*] (hereafter referred to as *materials*) of XYZ Organization (the organization) and the resultant materials in effect at December 31, 20XX. Our quality control materials\* peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The organization is responsible for designing a system of quality control and complying with it to provide users of the materials with reasonable assurance that the materials are reliable aids to assist them in conforming with those professional standards that the materials purport to encompass. Our responsibility is to express an opinion on the design of the system and the organization's compliance with that system based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a Quality Control Materials Review\* are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

We noted the following deficiencies\*\* during our review:

1. **Deficiency**—The organization's policies and procedures for the development and maintenance of quality control materials\* state that feedback on the materials is obtained by means of a questionnaire provided with the materials. The organization's policies and procedures do not specify the procedures to be followed for reviewing and analyzing returned questionnaires. As a result, our review of the questionnaires received by the organization during the review period indicated that several questionnaires that had significant feedback as to the accuracy of the information of certain materials were not being read, summarized, or analyzed to determine whether the quality control materials\* require change.

**Recommendation**—The organization should revise its policies and procedures for the development and maintenance of quality control materials\* to include procedures for reviewing, summarizing, and analyzing the feedback received on its quality control materials\* in order to determine whether the materials require change(s) to provide reasonable assurance that the materials are reliable aids to assist users in conforming with those professional standards the materials purport to encompass.

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\* Or *Continuing Professional Education Programs*, if applicable.

\*\* The deficiencies and related recommendations provided are examples provided for illustrative purposes only.

2. Deficiency—The organization's policies and procedures require that a technical review of all quality control materials\* be performed by a qualified person other than the developer to ensure that the materials are reliable aids to assist users in conforming to those professional standards the materials purport to encompass. During our review, we noted that such a technical review was performed on all of the materials we reviewed except for the current edition of the general financial statement disclosure and reporting checklist, construction contractor disclosure checklist, and the checklist for personal financial statements, which had cold reviews performed by the developer. However, we were satisfied that the checklists are reliable aids.

Recommendation—The organization should remind its personnel of the importance of complying with its technical review policy. In addition, the organization may wish to implement other controls to ensure compliance with this policy.

In our opinion, except for deficiencies described above, the system of quality control for the development and maintenance of the quality control materials\* of the XYZ Organization was suitably designed and was being complied with during the year ended December 31, 20XX, to provide users of the materials with reasonable assurance that the materials are reliable aids to assist them in conforming with those professional standards the materials purport to encompass. Also, in our opinion, the quality control materials\* referred to above are reliable aids at December 31, 20XX. Organizations can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ Organization has received a peer review rating of *pass with deficiencies*.

ABC & Co.\*\*\*

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\* See footnote \* in this paragraph.

\*\*\* The report should be signed in the name of the team captain's firm for firm on firm reviews or association formed review teams.

.199

## Appendix T

### Illustration of a Report With a Peer Review Rating of *Fail* in a Peer Review of Quality Control Materials or Continuing Professional Education Programs

The deficiencies and related recommendations provided are examples for illustrative purposes only. Any one or more of the deficiencies, based on the relative importance of the deficiency to the system of quality control as a whole, could result in a report with a peer review rating of *fail*.

Quality Control Materials\* Review Report

October 31, 20XX

Executive Board

XYZ Organization

and the National Peer Review Committee

We have reviewed the system of quality control for the development and maintenance of [identify each item covered by the opinion or refer to an attached listing] (hereafter referred to as *materials*) of XYZ Organization (the organization) and the resultant materials in effect at December 31, 20XX. Our quality control materials\* peer review was conducted in accordance with the Standards for Performing and Reporting on Peer Reviews established by the Peer Review Board of the American Institute of Certified Public Accountants. The organization is responsible for designing a system of quality control and complying with it to provide users of the materials with reasonable assurance that the materials are reliable aids to assist them in conforming with those professional standards that the materials purport to encompass. Our responsibility is to express an opinion on the design of the system and the organization's compliance with that system based on our review. The nature, objectives, scope, limitations of, and the procedures performed in a Quality Control Materials Review\* are described in the standards at [www.aicpa.org/prsummary](http://www.aicpa.org/prsummary).

We noted the following significant deficiencies\*\* during our review:

1. **Deficiency**—The organization's policies and procedures for the development and maintenance of quality control materials\* state that feedback on the materials is obtained by means of a questionnaire provided with the materials. The organization's policies and procedures do not specify the procedures to be followed for reviewing and analyzing returned questionnaires. As a result, our review of the questionnaires received by the organization during the review period indicated that several questionnaires that had significant feedback as to the accuracy of the information of certain materials were not being read, summarized, or analyzed to determine whether the quality control materials\* require change.

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\* Or *Continuing Professional Education Programs*, if applicable.

\*\* The deficiencies and related recommendations provided are examples provided for illustrative purposes only.

Recommendation—The organization should revise its policies and procedures for the development and maintenance of quality control materials\* to include procedures for reviewing, summarizing, and analyzing the feedback received on its quality control materials\* in order to determine whether the materials require change(s) to provide reasonable assurance that the materials are reliable aids to assist users in conforming with those professional standards the materials purport to encompass.

2. Deficiency—The organization's policies and procedures require that a technical review of all quality control materials\* be performed by a qualified person other than the developer to ensure that the materials are reliable aids to assist users in conforming to the professional standards the materials purport to encompass. During our review, we noted that such a technical review was not performed on the materials we reviewed. As a result, some of the materials were not up-to-date or were inaccurate, and thus were not reliable aids.

Recommendation—The organization should remind its personnel of the importance of complying with its technical review policy. In addition, the organization may wish to implement other controls to ensure compliance with this policy.

In our opinion, as a result of the deficiencies described above, the system of quality control for the development and maintenance of the quality control materials\* of XYZ Organization was not suitably designed and/or complied with during the year ended December 31, 20XX, to provide the users of the materials with reasonable assurance that the materials are reliable aids to assist them in conforming with those professional standards the materials purport to encompass. Also, in our opinion, the quality control materials\* referred to above are not reliable aids at December 31, 20XX. Organizations can receive a rating of *pass*, *pass with deficiency(ies)*, or *fail*. XYZ Organization has received a peer review rating of *fail*.

ABC & Co.\*\*\*

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\* See footnote \* in this paragraph.

\*\*\* The report should be signed in the name of the team captain's firm for firm on firm reviews or association formed review teams.

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\* Chair of Standards Task Force

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## PR Section 9100

# ***Standards for Performing and Reporting on Peer Reviews: Interpretations of Section 100***

[Originally issued March 2008; revised December 2008.]

### **NOTICE TO READERS**

Interpretations of the AICPA *Standards for Performing and Reporting on Peer Reviews* (section 100) are developed in open meetings by the AICPA Peer Review Board for peer reviews of firms enrolled in the AICPA Peer Review Program. Interpretations need not be exposed for comment and are not the subject of public hearings. These interpretations are applicable to firms (and individuals) enrolled in the program; individuals and firms who perform and report on peer reviews; entities approved to administer the peer reviews; associations of CPA firms, whose members are also AICPA members, authorized by the board to assist its members in forming review teams; and the AICPA program staff. Interpretations are effective upon issuance unless otherwise indicated.

The prefix of each interpretation refers first to the paragraph number in the standards and second to the number of the interpretation relating to that paragraph. For example, Interpretation No. 5-3 would be the third interpretation of paragraph .05 of the standards. Not every paragraph of the standards has an interpretation, and thus there could be gaps in the numbering sequence of the interpretations. If more than one paragraph of the standards refers to a particular interpretation, then the interpretation's prefix will refer to the first instance in the standards, and the interpretation would note what other paragraphs refer to the interpretation. Interpretations have been grouped by topic for reference purposes. For example, there are paragraph Interpretation Nos. 3-1 and 3-2 under the interpretation related to "Individual Enrollment in the Program."

To the extent that new interpretations are added before the next version of the standards is issued, an interpretation may not be referred to in the standards with the phrase (*see interpretations*).

**(Issued Through January 1, 2009)**

## **1. Use of the Standards**

**1-1 Question**—Paragraph .01 of the standards discusses that the standards are provided for those enrolled in the program. Who else may use these standards and who determines who enrolls in the program?

*Interpretation*—Although the standards are currently intended for AICPA members and their firms, state CPA societies, or other organizations that are approved by the AICPA Peer Review Board (board) to administer the program,

AICPA members may also use these standards, as applicable,<sup>1</sup> in administering peer reviews of non-AICPA firms (and individuals).

The board determines who is eligible for enrollment in the program.

There are professional organizations with peer review programs to assist government audit organizations in meeting their *Government Auditing Standards* peer review requirements. For example, the President's Council on Integrity and Efficiency (PCIE) peer review program arranges reviews for the Federal Inspector General; the National Association of State Auditors, Comptrollers and Treasurers (NASACT) program arranges reviews for state auditors; and the Association of Local Government Auditors (ALGA) program arranges reviews for local government auditors. Each of these programs have established their own set of standards for conducting peer reviews and should be contacted for additional information when a peer reviewer is considering performing a peer review for one of their members because these standards are not intended for those purposes.

**1-2 Question**—Who is currently eligible to enroll in the program?

*Interpretation*—CPA firms in which at least one partner is a member of the AICPA and, in certain circumstances, individual AICPA members may enroll.

**1-3 Question**—What other guidance is available to those who use the standards?

*Interpretation*—Users of the standards have a number of other sources of guidance they can refer to, depending on their role in the program. The standards are principles based and form the foundation for more detailed guidance, encompassed in these interpretations, other guidance in the *AICPA Peer Review Program Manual* (including Supplemental Guidance and the Report Acceptance Manual), the Oversight Handbook, Administrative Manual, and Peer Review Alerts. There is no hierarchical structure to the standards, interpretations, and other guidance; guidance in each is equally significant. However, in the event of a conflict in interpreting and implementing these sources of guidance, the standards and interpretations take precedence.

Peer review course manuals, conference materials, and other miscellaneous items are also available for reference purposes.

## 2. Individual Enrollment in the Program

**3-1 Question**—AICPA bylaws require individual CPAs (not the firm) to enroll in the program if they perform compilation services in firms or organizations not eligible to enroll in such a program. To reflect this requirement, paragraphs .03 and .05 of the standards refer to "firms and individuals in the program." What is meant by "firms or organizations not eligible to enroll," and can any AICPA member enroll in the program as an individual?

*Interpretation*—Under the AICPA Code of Professional Conduct ET appendix B, *Council Resolution Concerning Rule 505—Form of Organization and Name*, when the majority of the ownership of a firm, in terms of financial interests and voting rights, belongs to CPAs, it must enroll in the program. A firm or organization without CPA majority ownership (a non-CPA owned entity) would not be eligible to enroll in the program. The characteristics of such a firm are discussed in ET appendix B. Where the firm or organization is not eligible to

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<sup>1</sup> Although peer reviews performed under these circumstances are permissible, they are not currently considered as being performed under the auspices of the program, and such firms are not enrolled in the program because they are not subject to certain AICPA directed activities, including oversight and "fair procedures."

enroll, such as due to a lack of majority ownership by CPAs, and where the individual AICPA member performs compilation services in the firm or organization, the AICPA member is required to enroll individually in the program. Only AICPA members meeting these criteria are able to enroll individually. Individual AICPA members who are only practicing with a firm that is eligible to enroll in the program may not enroll in the program individually.

**3-2 Question**—The standards, interpretations, and guidance materials for the program use the term *firm* throughout the materials. When an individual is appropriately enrolled in the program, how does the term *firm* apply to the enrolled individual, and are there any situations in which the standards, interpretations, or guidance materials are intended to be directed at the actual firm or organization that was not eligible to enroll?

*Interpretation*—As an alternative to rewriting all of the standards to reflect individual enrollment, the term *firm* as it appears in the standards should be applied to the enrolled individual and not the firm or organization in which the individual is practicing public accounting that was not eligible to enroll. Under the characteristics of a firm not eligible to enroll in the program, there must be a CPA who has ultimate responsibility for any financial statement compilation services; non-CPA owners cannot assume ultimate responsibility for any such services. In addition, any compilation report must be signed individually by a CPA and may not be signed in the name of the firm or organization.

**3-3 Question**—When performing the peer review of an enrolled individual in the program, what type of peer review would be required, what peer review materials would be used, and what changes would be necessary to the peer review report?

*Interpretation*—As with any peer review, the types of engagements performed dictate the type of peer review required. Because the enrolled individual could only be performing compilation services, this would only require an Engagement Review, although the individual could undergo a System Review. The current peer review materials can still be used as long as the peer reviewer indicates that the peer review was that of an enrolled individual and not of a firm or organization. Similarly, the report and, if applicable, the letter of response, as well as other peer review documents and correspondences, should be tailored so that it is very clear that only the individual is being peer reviewed and not the firm or organization.

**3-4 Question**—If an individual enrolled in the program receives a report with a peer review rating of *pass* (previously referred to as an unmodified report) on his or her Engagement Review and meets all other individual qualifications for service as a peer reviewer including independence considerations, can that individual perform peer reviews?

*Interpretation*—Yes. However, the individual alone would be the peer reviewer and not the firm or organization that was not eligible to enroll in the program. The peer reviewer should make this fact evident.

**3-5 Question**—As discussed in paragraph .144 of the standards, can a hearing panel decide to terminate an individual's enrollment in the program?

*Interpretation*—Yes. The fair procedures related to hearings and appeals to the AICPA Joint Trial Board for individuals enrolled in the program would parallel the process for enrolled firms, including publication of termination in such form and manner as the AICPA Council may prescribe. If a hearing panel decides to terminate an individual's enrollment in the program, that individual can appeal to the AICPA Joint Trial Board. When the fact that an individual's enrollment has been terminated is published, the name of the firm or organization that was

not eligible to enroll in the program with which the individual was practicing is not published.

### 3. Acquisitions and Divestitures and Their Effect on Peer Review Scope

**5c-1 Question**—Paragraph .05(c) of the standards requires that enrolled firms have independent peer reviews of their accounting and auditing practices. What is the effect on the scope of a firm's peer review when there has been an acquisition of another practice or portion thereof, or a divestiture of a significant portion of the firm's practice, during or subsequent to the firm's peer review year?

*Interpretation*—When a reviewed firm has had an acquisition of another practice or a portion thereof or a divestiture of a significant portion of its practice during or subsequent to its peer review year, the reviewer, the reviewed firm, or both, should consult with AICPA staff prior to the commencement of the review to consider the appropriate scope of the review or other actions that should be taken.

A divestiture of a portion of the practice of a reviewed firm during the year under review may have to be reported as a scope limitation if the review team is unable to assess compliance with the system of quality control for reports issued under the firm's name during that year. If the review team is able to review engagements of the divested portion of the reviewed firm's practice, then the review team should review such engagements considered necessary to obtain an appropriate scope for the peer review. In such circumstances, an appropriate scope is one where a reasonable cross section of the firm's practice is covered and the review covers all partners and significant industry areas that existed before the divestiture. The review team should carefully assess the effects the divestiture has on the scope of the peer review. A team captain or review captain who is considering whether a peer review report should be issued with an additional paragraph for a scope limitation due to a divestiture should consult with the administering entity.

Illustrations of System Review reports with a peer review rating of *pass (with a scope limitation)*, *pass with deficiencies (with a scope limitation)*, and *fail (with a scope limitation)* are presented in appendix D, *Illustration of a Report With a Peer Review Rating of Pass (With a Scope Limitation) in a System Review*; appendix G, *Illustration of a Report With a Peer Review Rating of Pass With Deficiencies (With a Scope Limitation) in a System Review*; and appendix K, *Illustration of a Report With a Peer Review Rating of Fail (With a Scope Limitation) in a System Review*. Additional paragraphs included for scope limitations for engagement review reports follow the illustrations for System Reviews with scope limitations.

### 4. Resignations From and Reenrollment in the Program

**5g-1 Question**—Paragraph .05(g) of the standards discusses an enrolled firm's responsibility to understand the board's guidance on resignations from the program. Under what conditions may a firm resign from the program?

*Interpretation*—A firm whose peer review has not commenced may resign from the program by submitting a letter of resignation to the board. However, once a peer review commences, a firm will not be able to resign from the program except as stated in the following paragraph. A peer review commences when

the review team begins field work, ordinarily at the reviewed firm's office in a System Review, or begins the review of engagements in an engagement review. The submission by the firm of a request to resign from the program once its peer review has commenced is considered a failure to cooperate with the administering entity and may lead to the termination of the firm's enrollment in the program by a hearing panel of the board.

A firm will be permitted to resign once its peer review has commenced when the firm submits a letter pleading guilty, acknowledging its noncooperation with the program, waiving its right to a hearing, and agreeing to allow the AICPA to publish, in such form and manner as the AICPA Council may prescribe, the fact that the firm has resigned from the program before completion of its peer review, evidencing noncooperation with the program. In addition, if (a) the firm has been notified of the reviewer's or administering entity's intent to issue or require a report with a peer review rating of *pass with deficiencies* or *fail* (previously referred to as modified or adverse reports) or (b) the reviewer or administering entity has knowledge of the discovery of an engagement that was not conducted in accordance with professional standards on which the firm must take, or would likely be required to take, action in accordance with professional standards, then the fact that the situation in items (a) or (b) of the preceding existed would also be published.

A firm that has been terminated from the program, or resigned under the conditions previously described, may reenroll in the program once it completes the delinquent action that caused the firm to be terminated. The administering entity and the board make the determination of whether the action is satisfactorily completed. If the firm is past its next peer review due date, the firm will be required to complete its subsequent peer review within 90 days of reenrolling.

## 5. Cooperating in a Peer Review

**5h-1 Question**—Paragraph .05(h) of the standards notes that firms (and individuals) enrolled in the program have the responsibility to cooperate with the peer reviewer, administering entity, and the board in all matters related to the peer review including arranging, scheduling, and completing the review and taking remedial, corrective actions as needed (paragraph .143 of the standards). Under what circumstances will a firm (or individual) be not cooperating, and what actions can be taken by the board for noncooperation?

*Interpretation*—The board has issued a resolution regarding dropping a firm's enrollment from the program that is as follows:

### AICPA Peer Review Board Resolution

**(Adopted April 29, 1996 with amendments through January 1, 2009)**

WHEREAS, a firm enrolled in the AICPA Peer Review Program is required to have a peer review once every three years performed in conformity with the *AICPA Standards for Performing and Reporting on Peer Reviews*; and

WHEREAS, a firm enrolled in the AICPA Peer Review Program is required under the *AICPA Standards for Performing and Reporting on Peer Reviews* to cooperate with the peer reviewer, administering entity and the AICPA Peer Review Board in all matters related to the review;

NOW, THEREFORE, BE IT RESOLVED: A firm's enrollment in the AICPA Peer Review Program will be dropped by the AICPA Peer Review Board, without a hearing, thirty days after the AICPA Peer Review Program notifies the firm by certified mail that the firm has failed to:

- (1) Timely file requested information with the entity administering the firm's peer review concerning the arrangement or scheduling of that peer review, prior to the commencement of the peer review,
- (2) Timely submit requested information to the reviewer necessary to plan the firm's peer review, prior to the commencement of the peer review.
- (3) Have a peer review by the required date,
- (4) Timely pay in full the fees and expenses of the review team formed by an administering entity, or
- (5) Timely pay fees related to the administration of the program that have been authorized by the governing body of an administering entity.

The AICPA Peer Review Board may at its discretion decide to hold a hearing. Whether a hearing is held or not, a firm enrolled in the AICPA Peer Review Program has the right to appeal to the AICPA Joint Trial Board within 30 calendar days of being notified that the firm's enrollment has been dropped.

*Interpretation*—The AICPA Peer Review Board has issued a resolution regarding terminating a firm's enrollment from the AICPA Peer Review Program that is as follows:

#### **AICPA Peer Review Board Resolution**

**(Adopted April 29, 1996 with amendments through January 1, 2009)**

WHEREAS, a firm enrolled in the AICPA Peer Review Program is required to have a peer review once every three years performed in conformity with the AICPA *Standards for Performing and Reporting on Peer Reviews*; and

WHEREAS, a firm enrolled in the AICPA Peer Review Program is required under the AICPA *Standards for Performing and Reporting on Peer Reviews* to cooperate with the peer reviewer, administering entity and the AICPA Peer Review Board in all matters related to the review;

NOW, THEREFORE, BE IT RESOLVED: A firm is deemed as failing to cooperate once the review has commenced by:

- Not responding to inquiries,
- Withholding information significant to the peer review, for instance but not limited to failing to discuss communications received by the reviewed firm relating to allegations or investigations in the conduct of accounting, auditing or attestation engagements from regulatory, monitoring or enforcement bodies,
- Not providing documentation including but not limited to the representation letter, quality control documents, engagement working papers, all aspects of functional areas,
- Not responding to MFCs or FFCs timely,
- Limiting access to offices, personnel or other,
- Not facilitating the arrangement for the exit conference on a timely basis,
- Failing to timely file the report and the response thereto related to its peer review, if applicable,
- Failing to cooperate during oversight or,
- Failing to timely acknowledge and complete required corrective actions or implementation plans.

The firm will be advised by certified mail that the AICPA Peer Review Board will appoint a hearing panel to consider whether the firm's enrollment in the AICPA

Peer Review Program should be terminated. A firm enrolled in the AICPA Peer Review Program that has been notified that it is the subject of such a hearing may not resign until the matter causing the hearing has been resolved. After a hearing is held, a firm whose enrollment in the AICPA Peer Review Program has been terminated has the right to appeal the panel's decision to the AICPA Joint Trial Board within 30 calendar days of the hearing; and

BE IT FURTHER RESOLVED: That a firm's failure to cooperate with the administering entity would also include failing to receive a report with a rating of pass after (1) receiving at least two consecutive peer reviews prior to the third that had a report with a peer review rating of pass with deficiencies and/or fail (previously referred to as modified or adverse reports) AND (2) receiving notification via certified mail after the second consecutive report with a peer review rating of pass with deficiencies and/or fail (previously referred to as modified or adverse reports), that a third consecutive failure to receive a report with a peer review rating of pass (previously referred to as an unmodified report) may be considered a failure to cooperate with the administering entity. Report Reviews<sup>2</sup> containing significant comments are considered equivalent to failing to receive a report with a peer review rating of pass (previously referred to as an unmodified report) for the purposes of this resolution.

BE IT FURTHER RESOLVED: The administering entity has the authority to determine if a firm's response is substantive. If the administering entity determines that a response is not substantive, and the firm does not revise its response or submits additional responses that are not substantive as determined by the administering entity, this would also be deemed as a firm's failure to cooperate.

BE IT FURTHER RESOLVED: That a firm's failure to cooperate with the administering entity would also include failing to timely notify the administering entity that it is performing a type of engagement(s) or engagement(s) in an industry in which the firm had previously represented by written communication to the administering entity that it was no longer performing and had no plans to perform, in response to a related corrective action or implementation plan wherein the corrective action or implementation plan was eliminated by the administering entity based on the representation.

BE IT FURTHER RESOLVED: A firm's enrollment in the AICPA Peer Review Program will be terminated for failure to cooperate in any of the preceding situations, without a hearing, upon receipt of a plea of guilty from the firm; and BE IT FURTHER RESOLVED: That pursuant to the AICPA *Standards for Performing and Reporting on Peer Reviews*, the fact that a firm's enrollment in the AICPA Peer Review Program has been terminated, whether with or without a hearing, will be published in such form and manner as the AICPA Council may prescribe.

## **6. Compilations Performed Under the Statement on Standards for Accounting and Review Services No. 1, Amended by Statement on Standards for Accounting and Review Services No. 8, Where No Compilation Report Is Issued**

**6-1 Question**—Statement on Standards for Accounting and Review Services (SSARS) No. 1, *Compilation and Review of Financial Statements*, was

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<sup>2</sup> Although standards no longer permit the performance of Report Reviews as of January 1, 2009, a firm's last peer review could have been a Report Review.



amended by SSARS No. 8, *Amendment to Statement on Standards for Accounting and Review Services No. 1*, Compilation and Review of Financial Statements (AR sec. 100), to include compilations of financial statements where in very specific situations the accountant may document his or her understanding with the entity through the use of an engagement letter instead of issuing a compilation report. This approach is only available when the accountant submits unaudited financial statements to his or her client that are not expected to be used by a third party (in other words, compilation for management's use only). AICPA bylaws state that firms (or individuals in certain situations) are only required to enroll in the program if they perform services that are within the scope of the AICPA's practice-monitoring standards and issue reports purporting to be in accordance with AICPA *Professional Standards*. Therefore, for purposes of individual AICPA membership admission and retention, firms (or individuals) that only perform these types of compilations, where no report is issued and no other engagements within the scope of peer review as discussed in paragraph .06 of the standards, would not be required to enroll in the program. Would the compilations for management's use only be subject to peer review when the firm is already enrolled in the program because, for example, it performs services and issues reports on other engagements that are within the scope of the standards?

*Interpretation*—Yes. For firms enrolled in the program, compilations for management's use only as described in SSARS No. 8 would fall within the scope of peer review. The standards (and Statement on Quality Control Standards No. 7, *A Firm's System of Quality Control* [QC sec. 10]) include, within the definition of an accounting and auditing practice, all engagements covered by SSARSs except where SSARSs provide an exemption from those standards.

**6-2 Question**—The current standards and guidance materials are written referring to *reports* throughout and do not consider an engagement performed under SSARS No. 8 where a compilation report is not issued. What general guidance should be followed by peer reviewers?

*Interpretation*—For purposes of the program only, the required documentation of the understanding in the engagement letter, as detailed in SSARS No. 8, should be treated as though it was a *report* (as reports are discussed and referred to in the standards). This documentation would not be considered a *report* for bylaw purposes.

**6-3 Question**—Specifically, what should the peer reviewer be reviewing on such an engagement in a System or Engagement Review?

*Interpretation*—SSARS No. 8 requires the accountant to document the understanding of the engagement with the entity through the use of an engagement letter. The reviewer is to inquire about the engagement letter to determine that it documents that understanding. The reviewer should also review the financial statements to determine that the required restriction of their use is on each page. Except for the restriction of use, the reviewer should not be reviewing the financial statements, disclosures, or supplementary information for accuracy, appropriateness, or conformity with professional standards.

**6-4 Question**—Must a peer reviewer select such an engagement in a System or Engagement Review?

*Interpretation*—No. This engagement is not considered a different level of service. It is a compilation that either contains all disclosures required by generally accepted accounting principles (GAAP) or another comprehensive basis or the disclosures are omitted. The standards already discuss the engagement selection process for such engagements in an Engagement Review. In addition, a System Review requires the peer reviewer to use a risk-based approach when

selecting engagements. SSARS No. 8 does not change the existing engagement selection process.

**6-5 Question**—Should the standard language in the peer review report be tailored on a System or Engagement Review, if such engagement(s) are selected for review, to reflect the fact that these are compilations with documentation requirements and issued without a compilation report?

*Interpretation*—No.

## 7. Performing System Reviews at a Location Other Than the Reviewed Firm's Office

**8-1 Question**—Paragraph .08 of the standards states that the majority of the procedures in a System Review should be performed at the reviewed firm's office. What criteria have been established by the board for procedures to be performed at a location other than the reviewed firm's office?

*Interpretation*—If the review can reasonably be performed at the reviewed firm's office, it should be. Although certain planning procedures may be performed at the peer reviewer's office, it is expected that a majority of the peer review procedures, including the review of engagements, testing of functional areas, interviews, and concluding procedures should be performed at the reviewed firm's office.

However, it is recognized that there are some situations that make an on-site peer review cost prohibitive or extremely difficult to arrange, or both. In these situations, if the firm and reviewer mutually agree on the appropriateness and efficiency of an approach to the peer review such that it can be performed at a location other than the reviewed firm's office, then the reviewer can request the administering entity's approval to perform the review at a location other than the reviewed firm's office. This request should be made prior to the commencement of fieldwork, and the firm and reviewer should be prepared to respond to the administering entity's inquiries about various factors that could affect their determination. These factors, which are not mutually exclusive and will be considered judgmentally, include but are not limited to

- the availability of peer reviewers qualified to review the firm, including whether they have the experience in the industries and related levels of service for which the firm practices, whether they are independent of the firm and not, for instance, competitors within the same close geographic area, and whether the firm is reasonably accessible to those reviewers.
- whether the review conducted at the reviewer's office or another agreed-upon location can still achieve the objectives of a System Review.
- whether the results are expected to be the same as they would be if the peer review was performed at the reviewed firm's office.
- the size of the reviewed firm, including the number of personnel and where they perform their work (for instance, whether they work solely at clients' offices and the firm does not have its own office).
- the number of engagements covered by the Statements on Auditing Standards, *Government Auditing Standards*, examinations of prospective financial statements under the Statements on Standards for Attestation Engagements (SSAEs), or audits of non-Securities and

Exchange Commission (SEC) issuers performed pursuant to the standards of the Public Company Accounting Oversight Board (PCAOB).

- the ability of the reviewed firm and the peer reviewer to hold one or more effective meetings by telephone to discuss the firm's responses to the quality control policies and procedures questionnaire and other practice aid questionnaires (including various interviews), Engagement Review results, the reviewer's conclusions on the peer review, and any recommended corrective actions.
- the prior peer review results of the firm, including whether the firm received a report with a peer review rating of *pass with deficiencies* or *fail* (formerly known as modified or adverse reports) on its last System or Engagement Review (or a report review with significant comments), or if it is the firm's first System Review.
- whether the firm is able to effectively comply with the reviewer's requests for materials to be sent to the reviewer prior to the review (except as noted in the following list). Those requests should include, in addition to materials outlined in section 4100, *Instructions to Firms Having a System Review* (AICPA, *Peer Review Program Manual*), the following materials:
  - a. All documentation related to the resolution of independence questions (1) identified during the year under review with respect to any audit or accounting client or (2) related to any of the audit or accounting clients selected for review, no matter when the question was identified if the matter still exists during the review period
  - b. The most recent independence confirmations received from other firms of CPAs engaged to perform segments of engagements on which the firm acted as principal auditor or accountant
  - c. The most recent representations received from the sole practitioner concerning his or her conformity with applicable independence requirements
  - d. A written representation, dated the same as the peer review report, as described in paragraph .05(f) and appendix B of the standards
  - e. Documentation, if any, of consultations with outside parties during the year under review in connection with audit or accounting services provided to any client
  - f. A list of relevant technical publications used as research materials, as referred to in the quality control policies and procedures questionnaire
  - g. A list of audit and accounting materials, if any, identified in response to the questions in the "Engagement Performance" section of the quality control policies and procedures questionnaire
  - h. Continuing professional education (CPE) records sufficient to demonstrate compliance with state, AICPA, and other regulatory CPE requirements
  - i. The relevant accounting and auditing documentation and reports on the engagements selected for review
  - j. Documentation of the firm's monitoring results for each year since the last peer review or enrollment in the program
  - k. Any other evidential matter requested by the reviewer

The reviewed firm should understand that in the event that matters are noted during the review of selected engagements, the scope of the review may have to be expanded before the review can be concluded.

## 8. Peer Reviews to Be Administered by the National Peer Review Committee

**11-1 Question**—Paragraphs .11 and .128 of the standards note that peer reviews intended to meet the requirements of the program should be carried out in conformity with the standards under the supervision of a state CPA society, group of state CPA societies, the AICPA Peer Review Board's National Peer Review Committee (National PRC) or other entity (hereinafter, administering entity) approved by the board to administer peer reviews. Under what circumstances are peer reviews administered by the National PRC? What other criteria relate to the firms previously enrolled in the Center for Public Company Audit Firms Peer Review Program (CPCAF PRP) and to that program's peer reviewers?

*Interpretation*—Firms are required to have their review administered by the National PRC if they meet either or both of the following criteria:

- a. The firm is required to be registered with and inspected by the PCAOB.
- b. The firm performs audits of non-SEC issuers pursuant to the standards of the PCAOB.

Firms that are not required to have their review administered by the National PRC may choose to do so. However, such firms are subject to the National PRC's administrative fee structure and should familiarize themselves with that structure prior to making such a decision.

If corrective or monitoring actions were imposed by the CPCAF Peer Review Committee on a CPCAF PRP firm or peer reviewer, those actions will carryover to the firm's enrollment and the peer reviewer's involvement in the AICPA Peer Review Program, unless the actions were specific to the CPCAF PRP, as determined by the board.

## 9. Timing of Peer Reviews

**13-1 Question**—Paragraph .13 of the standards notes that a firm's due date for its initial peer review is ordinarily 18 months from the date it enrolled in the program or should have enrolled, whichever date is earlier. What is meant by "should have enrolled"? In addition, what is the due date for a firm that was previously enrolled in the CPCAF PRP?

*Interpretation*—When an individual becomes an AICPA member, and the services provided by his or her firm (or individual) fall within the scope of the AICPA's practice-monitoring standards, and the firm (or individual) issues reports purporting to be in accordance with AICPA *Professional Standards*, the firm (or individual) should enroll in the program. If the firm (or individual) does not initially provide services falling within the scope of the standards, when the firm (or individual) first performs an engagement that falls under the scope, the firm (or individual) is required to enroll in the program. In either case, the firm (or individual) should immediately notify the administering entity so that an appropriate due date may be determined. The administering entity will consider the firm's (or individual's) practice, the year-ends of their engagements, when the engagements were performed, and the number and type of engagements to be encompassed in the review, in determining an appropriate due

date. A firm's subsequent peer review ordinarily will be due three years and six months from this peer review year-end.

If a firm's most recent peer review was under the auspices of the CPCAF PRP, it may defer the due date for its next review until three years and six months from the year-end of that peer review.

**14-1 Question**—Paragraph .14 of the standards states that when a firm performs its first engagement requiring it to have a System Review, the firm's next due date will be 18 months from the year-end of the engagement. What does this mean?

*Interpretation*—When a firm, subsequent to the year-end of its Report or Engagement Review, performs an engagement under the SASs, *Government Auditing Standards*, examinations of prospective financial statements under the SSAEs, or an audit of a non-SEC issuer performed pursuant to the standards of the PCAOB that would have required the firm to have a System Review, the firm should (a) immediately notify the administering entity and (b) undergo a System Review. The System Review ordinarily will be due 18 months from the year-end of the engagement (for financial forecasts and projections 18 months from the date of report) requiring a System Review or by the firm's next scheduled due date, whichever is earlier. However, the administering entity will consider the firm's practice, the year-ends of engagements and when the procedures were performed, and the number of engagements to be encompassed in the review, as well as use its judgment, to determine the appropriate year-end and due date. Firms that fail to immediately inform the administering entity of the performance of an engagement previously described will be required to participate in a System Review with a peer review year-end that covers the engagement. A firm's subsequent peer review ordinarily will be due 3 years and 6 months from this peer review year-end.

**18-1 Question**—Paragraph .18 of the standards requires that a firm maintain the same year-end on subsequent peer reviews (which is 3 years from the previous year-end) and the same review due date (which is 3 years from the previous due date). What options does a firm have to change its year-end or extend the due date?

*Interpretation*—A firm is expected to maintain the same year-end on subsequent peer reviews. Nevertheless, circumstances may arise that may influence a firm to want to change its year-end. For instance, the nature of the firm's practice may change or they may reevaluate their current year-end and determine as a result that a different year-end is more practical. In such situations, a firm may change its year-end only with prior, written approval of the administering entity.

Administering entities will consider many factors including the nature of the firm's practice (for instance, when audits are being performed and issued so they will be available for the peer review, tax season, and so on). However, a change in year-end will usually not be approved when there is a public interest concern. This may occur when the firm is requesting the change in an attempt to have an Engagement Review rather than a System Review, or when a change in year-end would cause the firm's only engagement meeting the criteria described in Interpretation No. 63-1, (engagements conducted in accordance with *Government Auditing Standards* (GAS, also known as the Yellow Book), audits conducted pursuant to the Employee Retirement Income Security Act of 1974 (ERISA), or audits of an insured depository institution subject to the FDIC Improvement Act of 1991) to fall out of the peer review selection process.

Ordinarily, the firm's due date for the subsequent peer review will be three years and six months from the year-end of the current peer review.

A firm is expected to maintain the same review due date. Nevertheless, circumstances may arise that require the firm to extend its review due date. In such situations, a firm may do so only with prior, written approval of the administering entity, and the extended review due date only applies to the current review. Extensions for subsequent review's due dates must be reapplied for.

Extensions of a review due date by more than three months should be rare. However, in some situations, due to the size of the firm, the complexity of the peer review, and whether or not the review team is integrating peer review procedures with the firm's internal inspection procedures, it is not unusual for a peer review to occur over a number of months. In such situations, a firm whose peer review has oversight performed by the administering entity may extend its review due date by up to six months with prior, written approval of the administering entity.

In any of the situations previously described, it is the responsibility of the firm to ensure that any change in the review due date (or year-end) approved by the administering entity is recognized by any other organizations requiring it to have a peer review. This includes but is not limited to state boards of accountancy, the Government Accountability Office, and other regulators.

**18-2 Question**—Situations may arise where circumstances out of a firm's control, such as a natural disaster or other form of destruction, affect a firm's operations and thus its ability to comply with some or all of the peer review requirements, including timing of the peer review. What should a firm do in those circumstances?

*Interpretation*—The administering entity should be consulted, when possible, about how the firm believes the situation has affected or will affect their peer review. The administering entity will assist in determining whether there could be a possible scope limitation due to the exclusion of any affected engagements or offices, the need for a change in year-end or an extension of due date, and the effect on the firm's continuing peer review cycle. These situations will be considered on a case-by-case basis.

## 10. Independence, Integrity, and Objectivity

**21-1 Question**—Paragraph .21 of the standards states that independence in fact and in appearance should be maintained with respect to the reviewed firm by a reviewing firm, by review team members, and by any other individuals who participate in or are associated with the review and that the review team should perform all peer review responsibilities with integrity and maintain objectivity in discharging those responsibilities. What criteria have been established by the board?

*Interpretation*—The following criteria have been established:

### *a. Reciprocal Peer Reviews*

Reciprocal peer reviews are not permitted. This means that a firm may not perform a review of the firm that performed its most recent review. It also means that a reviewer may not serve on a review team carrying out a review of a firm whose personnel participated in the most recent review of that reviewer's firm.

*b. Relationships With Clients of the Reviewed Firm*

Review team members and, in the case of a review performed by a firm, the reviewing firm and its personnel are not precluded from owning securities in or having family or other relationships with clients of the reviewed firm. However, a review team member who owns securities of a reviewed firm's client shall not review the engagement of that client because that individual's independence would be considered to be impaired. In addition, the effect on independence of family and other relationships and the possible resulting loss of the appearance of independence must be considered when assigning team members to engagements.

*c. Relationships With the Reviewed Firm*

Reviewing firms should consider any family or other relationships between the management at organizational and functional levels of the reviewing firm and the firm to be reviewed and should assess the possibility of an impairment of independence.

If the fees for any services provided between firms, whether paid by the referring firm or by the client, involving the reviewed firm and the reviewing firm or the firm of any member of the review team are material to any of those firms, independence for the purposes of this program is impaired.

If arrangements exist between the reviewed firm and the reviewing firm or the firm of any member of the review team whereby expenses, office facilities, or personnel are shared, independence for the purposes of this program is impaired. Similarly, independence would be considered to be impaired by sharing arrangements involving, for example, frequent CPE programs, extensive consultation, preissuance reviews of financial statements and reports, or audit and accounting manuals. In such circumstances, the firms involved are sharing materials and services that are an integral part of their systems of quality control. However, the impairment would be removed if an independent peer review was made aware of the shared materials (such as CPE programs or an audit and accounting manual) before the peer review commenced and if that independent peer review was accepted by an approved body (determined by the board) before that date.

**21-2 Question**—Can an individual from Firm A be engaged by Firm B to conduct monitoring of Firm B's accounting and auditing practice or a consulting review and then be engaged to perform Firm B's subsequent peer review? What about another individual from Firm A?

*Interpretation*—In both cases, yes, except if the monitoring of Firm B's accounting and auditing practice or consulting review is performed for the year immediately preceding or during the peer review year.

**21-3 Question**—Firm A is engaged by Firm B to perform a quality control document review, a preliminary quality control procedures review, or both. Could Firm A then be engaged to perform a peer review of Firm B?

*Interpretation*—Yes, except if the quality control document review, preliminary quality control procedures review, or both are performed for the year immediately preceding or during the peer review year.

**21-4 Question**—Firm A is engaged to perform the peer review of Firm B. However, Firm A performed a preissuance review on one of Firm B's reports and accompanying financial statements for an accounting or auditing engagement during the period since the last peer review year-end. Can Firm A perform the peer review of Firm B?

*Interpretation*—Yes, unless the preissuance review(s) was performed on an engagement within the year immediately preceding or during the peer review year.

**21-5 Question**—Firm A audits the financial statements of Firm B's pension plan. Could either firm perform a peer review of the other?

*Interpretation*—Yes, provided that the fees incurred for the audit are not material to either of the firms. An audit of financial statements is a customary service of an accounting firm. However, reciprocal peer reviews are not permitted.

**21-6 Question**—A partner in Firm A serves as an expert witness for Firm B or for a party opposing Firm B. Are Firms A and B independent of each other?

*Interpretation*—Yes, provided that the fee is not material to either firm and provided that the outcome of the matter, if adverse to Firm B, would not have a material effect on its financial condition or its ability to serve clients.

**21-7 Question**—Firm A has an arrangement with Firm B whereby Firm A sends its staff to CPE programs developed by Firm B. Can Firm B perform a peer review of Firm A?

*Interpretation*—No, unless Firm B has had its CPE programs peer reviewed by an independent party (see standards for guidance in "Performing and Reporting on Peer Reviews of Quality Control Materials (QCM) and Continuing Professional Education (CPE) Programs"). If such a peer review is not undertaken and reported on before the peer review of Firm A commences, Firm B would not be considered independent for purposes of conducting the peer review of Firm A. However, occasional (infrequent and not part of Firm A's regular CPE training plan) attendance by representatives of Firm A at programs developed by Firm B would not preclude Firm B from reviewing Firm A.

**21-8 Question**—Firm A occasionally consults with Firm B with respect to specific accounting, auditing, or financial reporting matters. Are Firms A and B independent of each other?

*Interpretation*—Yes, unless the frequency and extent of the consultation is such that Firm B is an integral part of Firm A's consultation process.

**21-9 Question**—Firm B uses Firm A's accounting and auditing manual as its primary reference source. Can Firm A perform a peer review of Firm B, or can Firm B perform a peer review of Firm A?

*Interpretation*—No, unless Firm A has had its accounting and auditing manual and any other of its reference material used by Firm B as a primary reference source peer reviewed by an independent party. The peer review of the materials should be similar to the review of quality control materials in associations and should meet the same peer review performance and reporting standards. If such a peer review is not undertaken and reported on before the peer review commences, Firm A would not be considered independent for purposes of conducting the peer review. However, if the manual is used only as a part of the firm's overall reference library, independence would not be impaired. This interpretation also applies to providers of quality control materials or CPE programs.

**21-10 Question**—Firm A performs a peer review of Firm B. Subsequently, Firm C performs a peer review of Firm B, and Firm D of Firm A. Would the restriction against reciprocity be violated if Firm B were now to review Firm A?

*Interpretation*—No. Although the standards state that reciprocal peer reviews are not permitted, that provision is intended only to prohibit back-to-back peer reviews when each firm has not had an intervening peer review by another



firm or team. However, this may be a situation where the administering entity elects to perform oversight.

**21-11 Question**—A manager from Firm A served as a team member on the most recent peer review of Firm B. Can a reviewer from Firm B serve on the peer review team of Firm A?

*Interpretation*—No, because that would be considered a reciprocal review.

**21-12 Question**—Can an individual from Firm A be engaged by Firm B to perform a peer review of Firm B and subsequently be engaged the following year(s) to conduct an inspection of Firm B's accounting and auditing practice or a consulting review? What about another individual from Firm A?

*Interpretation*—In both cases, yes; however, individual(s) from Firm A would not be eligible to perform Firm B's subsequent peer review except as noted in Interpretation No. 21-2.

**21-13 Question**—Firm A included the qualifications of Firm B in a proposal for one or more specific engagements. Could either firm perform a peer review of the other following a successful proposal?

*Interpretation*—No, unless any fees paid to Firm B are not material to either of the firms; the firms do not share directly or indirectly, or participate in, the profits of the other; the firms do not share fees, office facilities, or personnel; the firms do not have joint ownership of a for-profit entity; and the firms do not exercise any direct or indirect management control over the professional or administrative functions of the other.

**21-14 Question**—A group of firms (whether or not it uses a common name) places an advertisement in a trade journal indicating that its members are "specialists" and provide the "best advice." Although the firms are not specifically identified in the advertisement, a toll-free telephone number or Internet site is provided for contact. Can one firm in the group perform the peer review of another member firm in the same group?

*Interpretation*—No, because the group is marketing or selling services to potential clients on behalf of the firms, where the representations about the firms and the quality of their services are not objective or quantifiable.

**21-15 Question**—A group of firms (whether or not it uses a common name) places an advertisement in a trade journal. The advertisement indicates the number and geographical location of the member firms and states that its members provide professional accounting and auditing services to over 2,500 industry clients nationwide and that each of the member firms passed its most recent peer review. A toll-free telephone number or Internet site is provided for contact. Can one firm in the group perform the peer review of another member firm in the same group?

*Interpretation*—Yes, provided the group has submitted the Association Information Form (AIF) to the board and has received notification that the AIF was accepted because the representations in the advertisement are objective or quantifiable.

**21-16 Question**—What would be *objective and quantifiable* with respect to representations made in advertisements by an association of CPA firms, such as in brochures, pamphlets, Web sites, and the like?

*Interpretation*—Representations made in advertisements by an association of CPA firms would be considered *objective and quantifiable* provided that the association of CPA firms maintains documentation to support the representations and such documentation is available for review by the board. For example, if an association of CPA firms advertises that its members provide professional

accounting and auditing services to a designated number of industry clients in a certain geographic area, some form of client listing should be maintained in support of the representation. If an association of CPA firms advertises that each of its member firms have passed peer review, letters from the entities accepting the peer review documents of those firms should be maintained. Representations should not be made by an association of CPA firms in their advertisements that designate themselves as "the best," "the finest," "uniquely qualified," "prestigious," "elite," or other similar language. These superlative descriptions are generic words and terms that are too subjective. Also, such representations in advertisements by an association of CPA firms cannot be readily supported by any form of documentation that can be reviewed.

**21-17 Question**—Certain members of an association (that is, parent association) may form a partnership or subassociation, which is a grouping of association member firms for the purpose of joint marketing of products or services. Can members of the subassociation perform peer reviews on firms of the parent association that are not involved in the activities of the subassociation?

*Interpretation*—Although a member of a subassociation cannot peer review another member of the same subassociation, the existence of a subassociation by itself should not disqualify members of the subassociation from performing peer reviews of nonaffiliated member firms of the parent association. However, members of a subassociation should not perform peer reviews on firms of the parent association that are not involved in the activities of the subassociation if there appears to be a lack of independence, such as the following:

- a. The parent association has a direct or material indirect financial interest in the subassociation.
- b. The subassociation has the same or a similar name of the parent association.
- c. The parent association and the subassociation share and use the same facilities, such as offices, telephone numbers, employees, letterhead, and marketing materials.

**21-18 Question**—Is independence impaired when the reviewers' firm and the firm subject to peer review have arrangements with the same non-CPA owned entity (including all entities owned or controlled by a common parent company) where the partners of both firms are also employees of that non-CPA owned entity and remit revenues or profits, or both, to the non-CPA owned entity for payment of the lease of employees, office facilities, equipment, or other services provided by the non-CPA owned entity?

*Interpretation*—Yes, independence is impaired, and the firms involved with the non-CPA owned entity are precluded from participating in the peer review of one another or of other firms related to the non-CPA owned entity.

**21-19 Question**—A state CPA society places an advertisement promoting the CPA profession without identifying any specific firms. May firms whose personnel belong to that state CPA society provide peer review for each other?

*Interpretation*—Yes.

**21-20 Question**—Firm A and Firm B have shared office facilities for the last several years. Due to the growth of both firms, Firm B moved into new offices on January 1, 2007. In March 2009, Firm A engaged Firm B to perform the peer review of Firm A. Firm A's peer review year-end is December 31, 2008. Can Firm A perform the peer review of Firm B?

*Interpretation*—Yes, because the firms did not share office facilities within the current peer review year and any subsequent periods thereafter.

## 11. Illegal Acts

**23-1 Question**—Paragraph .23 of the standards discusses the obligation for all those involved in carrying out the review to fulfill assigned responsibilities in a professional manner. What responsibilities do reviewers have to detect illegal acts during a peer review?

*Interpretation*—Reviewers have no responsibility to detect illegal acts that have either a direct or indirect effect on the firm's ability to practice public accounting. If a reviewer comes across an illegal act during a review, he or she should consider consulting with his or her attorney, and consult with appropriate AICPA staff.

## 12. Peer Review Documentation and Retention Policy

**24-1 Question**—Paragraph .24 of the standards notes peer review documentation should be prepared in sufficient detail to provide a clear understanding of its purpose, source, and the conclusions reached. How should the peer review be documented to comply with this requirement?

*Interpretation*—Among other things, peer review documentation includes records of the planning and performance of the work, the procedures performed, and conclusions reached by the peer reviewer. This includes documenting the risk assessment, the understanding of the firm's system of quality control, and tests of compliance (including checklists for the review of engagements and staff interviews when there are professional staff). The board has authorized the issuance of materials and checklists, including checklists for the review of engagements, to guide team captains, review captains, and other members of the review team in carrying out their responsibilities under these standards.

Ordinarily, materials and checklists developed and issued by the board are to be used by reviewers in carrying out their responsibilities under these standards. Based on its understanding of the reviewed firm's system of quality control and its assessment of peer review risk, the review team should determine if materials and checklists issued by the board are not sufficiently comprehensive to use on the review. In this event, other materials and checklists may be used; however, they must include the same elements as, and must be more comprehensive than those versions issued by the board. Reviews conducted utilizing alternate materials and checklists will require advance notice to the administering entity and the review must be subject to on-site oversight. It is the responsibility of the team captain or review captain to ensure that the materials and checklists used meet these standards. Failure to complete all relevant materials and checklists may create the presumption that the review has not been performed in conformity with these standards, and thus the administering entity should be consulted in advance of use of any equivalents to assist in reaching these conclusions.

**25-1 Question**—Paragraph .25 of the standards notes that all peer review documentation should not be retained for an extended period of time after the peer review's completion, with the exception of certain documents that are maintained until the subsequent peer review's acceptance and completion. What period of time should peer review documentation be retained and what documentation should be maintained until the subsequent peer review's acceptance and completion?

*Interpretation*—Peer review documentation prepared during System and Engagement Reviews, with the exception of those documents described in the following paragraphs, should be retained by the reviewing firm, the administering

entity, and the association in an association formed review team (if applicable) until 120 days after the peer review is completed (see Interpretation No. 146-1).

The reviewing firm and administering entities should retain the following documents until 120 days after the firm's subsequent peer review has been completed:

- a. Peer review report and the firm's response, if applicable
- b. Letter notifying the firm that its peer review has been accepted
- c. Letter indicating that the peer review documents have been accepted with the understanding that the firm agrees to take certain actions, if applicable. The administering entity should retain the version signed by the firm
- d. Letter notifying the firm that certain required actions have been completed, if applicable
- e. Finding for Further Consideration (FFC) forms, if applicable
- f. Letter requesting the reviewed firm's completion of an implementation plan, if applicable (the administering entity should retain the version signed by the firm)
- g. Letter notifying the firm that the implementation plan has been completed, if applicable

Administering entities may also retain the following administrative materials until the firm's subsequent peer review has been completed:

- a. Engagement letters
- b. Scheduling information
- c. Review team appointment acceptance letters
- d. Due date extension and year-end change requests and approvals
- e. Settlement agreements received by the administering entity from the AICPA Professional Ethics Division related to individual members' performance on accounting, auditing, or attestation engagements

The administering entity's peer review committee or the board may indicate that any or all documentation for specific peer reviews should be retained for a longer period of time than specified in the preceding paragraphs because, for example, the review has been selected for oversight. All peer review documentation is subject to oversight or review by the administering entity, the board, or other bodies the board may designate, including their staff. All peer review documentation prepared by the administering entities is subject to oversight.

If a firm has been enrolled in an institute-approved practice-monitoring program but has not undergone a peer review in the last three years and six months since its last peer review because the firm has not performed engagements and issued reports requiring it to have a peer review, the documents previously noted should still be retained. The administering entity may also choose to retain the administrative documents noted, as applicable. The documents for a firm that has not been enrolled in an Institute-approved practice-monitoring program for the last consecutive three years and six months are not required to be retained.

**25-2 Question**—The standards and interpretations refer to *acceptance* and *completion* of peer reviews in several contexts, such as in relation to the retention policy for peer review documentation (paragraph .25 of the standards), when a review can be publicized (paragraph .146) and the qualifications for service as a peer reviewer (paragraph .31[c]) and a report acceptance body member (Interpretation No. 132-1). Is there a difference between the acceptance and completion dates of a peer review?

*Interpretation*—There is no difference in those cases in which the report and letter of response thereto, if applicable (peer review documents), are presented to the administering entity's peer review committee, and the committee requires no additional corrective action(s) related to the deficiencies or significant deficiencies in a peer review report with a rating of *pass with deficiency(ies)* or *fail* by the reviewed firm, nor are there any revisions necessary to the peer review documents. In this circumstance, the date that the committee (or technical reviewer in most cases on an Engagement Review) makes this decision is defined as the acceptance date, and is also defined as the completion date of the peer review. The acceptance date is noted in a letter from the administering entity to the reviewed firm.

There is a difference between the acceptance and completion dates of a peer review when the peer review documents are presented to the committee and the committee does not require any revisions to the peer review documents but does require the reviewed firm to take corrective action(s) related to deficiencies or significant deficiencies in the report. In this circumstance, the acceptance date is defined as the date that the reviewed firm signs the letter from the administering entity agreeing to perform the required corrective action(s). The completion date is then defined as the date the committee decides that the reviewed firm has performed the agreed-to corrective action(s) to the committee's satisfaction and the committee requires no additional corrective action(s) by the reviewed firm. This date is noted in a final letter from the administering entity to the reviewed firm.

In either of the situations described in the preceding paragraphs, the committee may require revisions to any of the peer review documents or have other matters that require resolution. In those cases, a review may not be deemed as accepted nor completed until such date that the peer review document(s) is (are) revised or the matter is resolved to the satisfaction of the committee. When there are required revisions or other matters that require resolution and a follow up action has been requested by the committee, the date of acceptance is the later of the date the required revisions are made or the matters are resolved, OR the date the firm has agreed to the follow up action.

### 13. Associations of CPA Firms and Association Formed Review Teams

**26-1 Question**—Paragraph .26 of the standards states that a review team may be formed by a firm engaged by the firm under review (a firm-on-firm review) or an association of CPA firms authorized by the board to assist its members in forming review teams (an association formed review team). What criteria have been established by the board for association formed review teams?

*Interpretation*—Associations of CPA firms include any group, affiliations, or alliances of accounting firms. The term also applies to two or more firms or a group of firms (whether a formal or informal group) that jointly market or sell services.

A member firm of an association may conduct a peer review of another association-member firm enrolled in the program, provided that the association receives annual approval from the board. The National PRC administers this process on behalf of the board. The association must submit an AIF to the National PRC that must be approved by the board prior to any aspect of the review being planned, scheduled, or performed.

The AIF contains questions regarding general information about the association, independence matters, and whether the association requests to be

approved to assist its members in the formation of review teams, provide technical assistance to such review teams, or do both. All review teams must still be approved by the administering entity. The AIF is subject to oversight by the board.

The approval of the AIF specifically relates to AICPA members of an association having the ability to perform peer reviews of other AICPA members in the same association enrolled in the program. Furthermore:

- a. Annual approval of the AIF does allow, where the association has answered the specific questions making such a request, the association the ability to assist its members in the formation of review teams (association formed review teams) or to provide technical assistance to such review teams.
- b. The reviewed firm and administering entity, not the association, is ultimately responsible for ensuring that its peer review is scheduled, performed, and completed in a timely manner.
- c. Annual approval of the AIF does not grant the association the authority to administer the program; therefore, the association is not deemed an approved administering entity.
- d. Approval of the AIF is not an endorsement of, approval of, or has any applicability to a separate peer review program that an association may conduct or administer for non-AICPA members.
- e. If the association makes any representations (in brochures, directories, pamphlets, Web pages, or any marketing or selling materials regarding its member firms in obtaining engagements), such representations are objective and quantifiable.

For a member firm of an association to conduct peer reviews of another association-member firm enrolled in the program, in addition to other peer review independence requirements, the association and its member firms must meet the following independence criteria:

- a. The association, as distinct from its member firms, does not perform any professional services other than those it provides to its member firms or affiliates. For purposes of this requirement, *professional services* include accounting, tax, personal financial planning, litigation support, and professional services for which standards are promulgated by bodies designated by AICPA Council.
- b. The association does not make representations regarding the quality of professional services performed by its member firms to assist member firms in obtaining engagements unless the representations are objective or quantifiable. However, member firms may independently publicize their membership in the association. In addition, an association may respond to inquiries and prepare promotional materials that firms may use to obtain professional engagements on their own behalf.
- c. Referral or participating work among member firms is arranged directly by the firms involved.
- d. The association does not have any direct or material indirect financial interest or involvement in its member firms in sharing fees generated by members through the sale of products or services.
- e. The association does not exercise any direct or indirect management control over the professional or administrative functions of its member firms.

*Interpretation*—For a member firm of an association to conduct a peer review of another association-member firm enrolled in the program when quality control

materials or CPE used by its members constitute association materials, the association shall arrange for an independent triennial peer review of those materials (see paragraphs .154–.178 of the standards). Therefore, firms that share such materials are advised to consult with AICPA program staff if an independent review of the shared materials appears necessary.

An association formed review team

- a. requires that a majority of the review team members, including the team captain in a System Review and all members in an Engagement Review, be from association member firms.
- b. performs peer reviews in accordance with these standards, interpretations, and other guidance and the peer review report is issued on the letterhead of the team captain or review captain's firm and signed in the name of the team captain or review captain's firm (not the association).

Peer reviews performed by association-formed review teams are subject to oversight by the board and the administering entities and other bodies agreed upon by the board and the administering entity.

## 14. Organizing the System or Engagement Review Team

**30-1 Question**—Paragraph .30 of the standards states that a System Review team, a review captain on an Engagement Review, and, in unusual circumstances, any additional reviewers on an Engagement Review ordinarily should be approved by the administering entity prior to the planning and commencement of the review. How is this accomplished?

*Interpretation*—The firm and the reviewer should submit scheduling information as required by the administering entity, and the System Review team, a review captain on an Engagement Review, and, in unusual circumstances, any additional reviewers on an Engagement Review should be approved by the administering entity prior to the commencement of the review. The administering entity will consider various factors, including the industries of the engagements of the firm, its size, whether or not the review is administered by the National PRC, and other factors in relation to the knowledge and experience of the members of the review team to determine if the team has the appropriate qualifications and capability to perform the review.

## 15. Qualifying for Service as a Peer Reviewer

**31b-1 Question**—Paragraph .31(b) and (c) of the standards state that an individual serving as a peer reviewer should be currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in the program and the firm (or all firms if associated with more than one firm) that the member is associated with should have received a report with a peer review rating of *pass* (previously referred to as an unmodified report) for its most recent System Review or Engagement Review that was accepted timely, ordinarily within the last 3 years and 6 months. Does this apply to all firms the individual is associated with? Is the individual still qualified to serve as a reviewer if the individual starts, or becomes associated with, a newly formed firm (or a firm that has not had a peer review)?

*Interpretation*—If the individual is associated as a partner with more than one firm, then each of the firms the individual is associated with should have received a report with a peer review rating of *pass* (previously referred to as an

unmodified report) for its most recent System Review or Engagement Review that was accepted timely, ordinarily within the last three years and six months.

An individual who was previously a System Review team captain, a reviewer in a System Review, or a review captain in an Engagement Review that starts or becomes associated with a newly formed firm (or a firm that has not had a peer review) may continue to serve in such capacity during a transition period. The transition period begins with the earlier of the dates of disassociation from the previous firm or when the individual starts or becomes associated with a new firm. The transition period ends with the earlier of 18 months from the beginning date or the peer review due date of the new firm. In no circumstances will the transition period exceed 18 months. The previous firm should have received a report with a peer review rating of *pass* (previously referred to as an unmodified report) on its most recently accepted peer review, and the individual should meet all of the other qualifications for service as a team captain or reviewer in a System Review or review captain in an Engagement Review. An individual who was previously a team captain or reviewer in a System Review qualified to perform peer reviews administered by the National PRC or CPCAF PRP that starts or becomes associated with a newly formed firm (or a firm that has not had a peer review), or a firm enrolled in the program that has undergone a peer review administered by another administering entity, may serve as a team captain or a reviewer on a review administered by the National PRC under the same conditions and requirements mentioned previously.

**31b-2 Question**—What if the individual was a sole practitioner that has given up his or her own accounting and auditing practice, but is now serving in the capacity of an external quality control or concurring reviewer for other enrolled firms?

*Interpretation*—If the individual was a sole practitioner that has given up his or her own accounting and auditing practice, but is now serving in the capacity of an external quality control or concurring reviewer for other enrolled firms, he or she would meet many of the minimum requirements in paragraph .31(b) of the standards, except for being a professional employee of the firm the work is being performed for, and therefore he or she would not meet the qualification requirements to serve in the capacity of a peer reviewer.

**31b-3 Question**—If the individual is associated with a firm who received a report with a peer review rating of *pass* with scope limitation on its most recent System Review or Engagement Review, does this meet the qualification requirements to be a peer reviewer?

*Interpretation*—There are three different grades which can be considered "passing": *pass*, *pass with scope limitation*, and *pass with deficiencies*. Only the first two (*pass* and *pass with scope limitation*) are acceptable grades in order to qualify as a peer reviewer.

Scope limitations under the previous standards were included only in modified or adverse reports. If the individual is associated with a firm who received a report which was *modified for a scope limitation* or *adverse for a scope limitation* on its most recent System Review or Engagement Review, this does not meet the qualification requirements to be a peer reviewer.

**31b-4 Question**—What further qualifications are necessary to perform a peer review of a firm whose review is required to be administered by the National PRC?

*Interpretation*—In order to be qualified to perform a peer review of a firm required to be administered by the National PRC, ordinarily a peer reviewer must currently be with a firm whose most recent review was administered by the National PRC or the CPCAF PRP. This is not a requirement for a peer reviewer



on a review of a firm that elects (but is not required) to have their peer review administered by the National PRC.

**31d-1 Question**—Paragraph .31(d) of the standards states that an individual serving as a peer reviewer should possess current knowledge of professional standards applicable to the kind of practice to be reviewed, including quality control and peer review standards. This includes recent experience in and knowledge about current rules and regulations appropriate to the level of service applicable to the industries of the engagements the individual will be reviewing. How may such knowledge be obtained, and is there a minimum amount of CPE required to be a peer reviewer?

*Interpretation*—Such knowledge may be obtained from on-the-job training, training courses, or a combination of both.

If the administering entity determines that the peer reviewer does not have such experience, the peer reviewer may be called upon to justify why he or she should be permitted to review engagements in that industry. The administering entity has the authority to decide whether a reviewer or review team's experience is sufficient and whether they have the capability to perform a particular review whether related to high-risk engagements or other factors.

The fundamental purpose of CPE is to maintain or increase, or both, professional competence. AICPA members are required to participate in 120 hours of CPE every 3 years. In order to maintain current knowledge of accounting, auditing, and quality control standards, peer reviewers should obtain at least 40 percent of the AICPA required CPE in subjects relating to accounting, auditing, and quality control. Peer reviewers should obtain at least 8 hours in any 1 year and 48 hours every 3 years. The terms *accounting*, *auditing*, and *quality control* should be interpreted as CPE that would maintain current knowledge of accounting, auditing, and quality control standards for engagements that fall within the scope of peer review as described in paragraphs .06–.07 of the standards.

Peer reviewers have the responsibility of documenting their compliance with the CPE requirement. They should maintain detailed records of CPE completed in the event they are requested to verify their compliance. The reporting period will be the same as that maintained for the AICPA.

**31f-1 Question**—Paragraph .31(f) of the standards states that an individual serving as a peer reviewer on a System or Engagement Review should have provided the administering entity with information that accurately reflects the qualifications of the reviewer, including recent industry experience, and is updated timely. How is this accomplished?

*Interpretation*—Ordinarily, an individual serving as a reviewer on a System or Engagement Review should have completed a peer reviewer resume in accordance with guidance issued by the board that is updated timely and accurately reflects the qualifications of the reviewer, including recent industry experience. This may also be accomplished by providing similar information to those performing an on-site oversight under the direction of a National PRC panel.

**32-1 Question**—Paragraph .32 of the standards states that a team captain, or the review captain in limited circumstances, is required to ensure that all team members possess the necessary capabilities and competencies to perform assigned responsibilities and that team members are adequately supervised. The team captain or review captain has the ultimate responsibility for the review, including the work performed by team members. What do those responsibilities include?

*Interpretation*—Team members should be brought on to a team when the team captain, or the review captain in limited circumstances, does not possess the

adequate qualifications necessary in order to perform the review of engagements within certain industries or type of engagement in the reviewed firm's practice. In addition, there may be reasons, for instance depending on the size of the firm and its practice, that team members may be brought onto a team to assist the team captain in performing the review in an efficient and effective manner. Whether the team member is brought onto the team to cover certain industries or types of engagement, or just to assist the team captain in performing the review, it is still the responsibility of the team captain or review captain to ensure the team member selected has the appropriate qualifications and to supervise and review the work of the team member. The team captain or review captain is essentially relying on the work of the team member and accepting it as his/her own. The team captain or review captain should ensure that all of the workpapers (engagement questionnaires, MFCs, etc) completed by the team member are reviewed by the team captain or another appropriately qualified team member, and follow up with the reviewed firm or team member as necessary. By signing off on the Team Captain Checklist or Review Captain Checklist, the team captain or review captain is approving the team member's workpapers and accepting responsibility for the work of the team member.

Team members may review their engagements prior to the team captain or review captain beginning their field work. Reviews of engagements that are performed by team members at locations other than the reviewed firm's office are acceptable, but the quality of work must be at the same level as it would be had the review been performed at the reviewed firm's office. In these situations, a review is considered to have commenced when the team member begins the review of engagements (if this is prior to the team captain or review captain beginning their fieldwork). All engagement checklists, MFC and FFC forms should be signed off by the team member prior to the exit conference. The team captain or review captain should consider if the team member should participate in the exit conference.

**33-1 Question**—Paragraph .33 of the standards states that a team captain in a System Review or a review captain in an Engagement Review should "have completed peer review training that meets the requirements established by the board." Interpretation No. 132-1 states that each report acceptance body member should be trained in the standards, interpretations, and guidance of the program by completing a course that meets the team captain training requirements established by the board within 3 years prior to serving on the committee or during the first year of service on the committee. Interpretation No. 132-1 also states that a technical reviewer charged with the responsibility for performing technical reviews should meet the requirements of the team captain or review captain training requirements established by the board. What specific type of course or courses, if any, should be completed?

*Interpretation*—To initially qualify as a team captain on a System Review, an individual should complete the AICPA two-day introductory reviewer training course, "How to Conduct a Review Under the AICPA Practice-Monitoring Program."

To qualify initially as a review captain in an Engagement Review, an individual should have completed the first day of the AICPA two-day introductory training course. The first day of the two-day course does not, however, fulfill the initial or CPE requirements for service as a System Review team captain.

In order to maintain the qualifications of a team captain or review captain, individuals should participate in 8 hours of CPE in peer review training within 3 years prior to the commencement of a review. The team captain or review captain should complete a combination of the following courses that combined total the 8 hour requirement: the AICPA 2-day introductory training course

(for review captains, only the first day needs to be attended); the AICPA 1-day advanced reviewer training course, "Advanced Training Course for Reviewers: Current Issues in Practice Monitoring;" the annual AICPA Peer Review Conference; or other courses approved by the AICPA Peer Review Board. If a reviewer's course selection includes 1 or more 4 hour courses, the course hours must be combined and the timing of taking the courses coordinated so that the minimum requirement of 8 hours within 3 years prior to commencement of a review is met.

**33-2 Question**—Paragraph .33 of the standards discusses the qualifications necessary to serve as a team captain in a System Review. Are there any other qualifications to be met to serve as a team captain?

*Interpretation*—For firms with greater than 400 professionals, with a *professional* defined as an individual who spends more than 25 percent of his or her time on accounting and auditing work that meets the criteria for a peer review, an individual who serves as the reviewed firm's team captain or review captain for 2 successive peer reviews may not serve in that capacity for the reviewed firm's next peer review.

**34-1 Question**—Paragraph .34 of the standards discusses that a peer reviewer or reviewing firm may have received communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of the peer reviewer or reviewing firm's accounting and auditing practice, or notifications of limitations or restrictions on the peer reviewer or reviewing firm's ability to practice. How do these communications or notifications affect the reviewer or reviewing firm's ability and qualifications to perform the peer review?

*Interpretation*—An individual may not serve as a peer reviewer if his or her ability to practice public accounting has been limited or restricted in any way by a regulatory, monitoring, or enforcement body until the limitation or restriction has been removed. If the limitation or restriction has been placed on the reviewer's firm, or one or more of its offices, then the administering entity must carefully consider the specific circumstances concerning whether any of the individuals associated with the firm, or the portion thereof, may serve as reviewers. Reviewers should immediately notify the administering entity of any such limitations or restrictions. In addition, reviewers should immediately notify the administering entity of communications relating to allegations or investigations from regulatory, monitoring, or enforcement bodies in the conduct of accounting, audit, or attestation engagements performed by the reviewer. The fact that a reviewer has received such communication(s) does not automatically mean that he or she is ineligible to perform peer reviews. The administering entity will consider the matter, including whether any action, including performing oversight on the reviewer, is appropriate. This decision can only initially be appealed to the administering entity's peer review committee. For actions previously appealed to the committee, if the individual or reviewed firm disagrees with the action(s), he or she may appeal the decision by writing the board, explaining why he or she believes that the action(s) are unwarranted. The board will review and consider the request and respond to it as necessary and appropriate.

The objective of the reviewer informing such communications to the administering entity is to enhance the program's oversight process, which includes ensuring that peer reviewers are appropriately qualified to perform reviews.

**34-2 Question**—What if a reviewer fails to immediately notify the administering entity of any such communications relating to the conduct of his or her performance of accounting, audit, or attestation engagements?

*Interpretation*—If a reviewer fails to immediately notify the administering entity of such communications, the administering entity's peer review committee or the board, or both, will consider what actions should be taken in the specific circumstances. These actions may include, but are not limited to, on-site oversight at the reviewer's expense or removal from the list of qualified peer reviewers. The administering entity is under no obligation to accept a peer review report performed by a reviewer or reviewing firm that has been limited or restricted from practice.

**34-3 Question**—What are some types of communications that are appropriately related to meeting the objectives described in this interpretation?

*Interpretation*—There are many types of communications that are appropriately related to meeting the objectives described in this interpretation. See Interpretation No. 181-1b for a list, which is not intended to be all-inclusive, that represents examples of the types of organizations where communications would be relevant to meeting the objectives of the requirement.

## 16. Other Planning Considerations and Reporting of PCAOB Inspection Results

**40-1 Question**—Paragraph .40 of the standards notes that the peer reviewer should inquire of the firm regarding the areas to be addressed in the written representation. What should be discussed with the firm regarding the PCAOB's report as referred to in paragraph .181 of the standards (paragraph 1(e) of appendix B, "Considerations and Illustrations of Firm Representations")?

*Interpretation*—If the firm has undergone a PCAOB inspection or inspections, the team captain should discuss with appropriate firm personnel the reports submitted by the PCAOB or in the absence of such reports, any findings that may have been communicated orally. The discussion should cover the reports or findings from the PCAOB's most recent inspections, both immediately prior to or during the peer review year and subsequent to the peer review year covered, if applicable. The team captain should inquire about any open PCAOB inspections, the status of those inspections, and the firm's corrective action plans. These discussions should focus on the results of the PCAOB's inspection related to the firm's system of quality control. The review team should consider what effects, if any, the matters contained in the reports could have on the planning or other procedures to be performed on the peer review. Although the PCAOB's inspection only covers the firm's SEC issuer practice, the PCAOB's inspection reports may contain information related to offices, partners, or other matters that could assist the reviewer in assessing risk and planning peer review procedures. Discussion of these findings should not be interpreted to permit the peer reviewer to request the confidential portions of the PCAOB's reports. Rather, relevant matters in the PCAOB's reports are required to be discussed with the peer reviewer.

## 17. Understanding the Firm's System of Quality Control

**42-1 Question**—Paragraph .42 of the standards requires the review team to obtain a sufficient understanding of the reviewed firm's system of quality control. How should the review team address elements of the system that reside outside of the firm?

*Interpretation*—The review team should inquire of the firm regarding elements of the system of quality control residing outside of the firm, for instance, membership in associations, joint ventures, non-CPA owned entities, alternative

practice structures, arrangements with outside consultants, third party quality control materials (QCM), or CPE (including whether they are peer reviewed), and other. The inquiries should include how they influence the firm's system of quality control, for instance by providing consultation opportunities, CPE, and monitoring services. These elements should be considered and documented within the risk assessment.

## 18. Considering the Firm's Monitoring Procedures

**45-1 Question**—Paragraph .45 of the standards notes that the review team should obtain a sufficient understanding of the reviewed firm's monitoring policies and procedures since its last peer review, and their potential effectiveness, to plan the current peer review. In doing so, the review team may determine that the current year's internal monitoring procedures could enable the review team to reduce, in a cost-beneficial manner, the number of offices and engagements selected for review or the extent of the functional area review. What are some factors to consider in obtaining an understanding of the firm's monitoring procedures? If the review team plans to consider the current year's internal inspection procedures to reduce the scope of the peer review, what procedures are necessary?

*Interpretation*—Factors to consider in obtaining the understanding of the firm's monitoring procedures include:

- a. the qualifications of personnel performing the monitoring procedures
- b. the scope of the monitoring procedures (coverage of functional areas and engagements and the criteria for selecting offices and engagements for review)
- c. the appropriateness of the materials used for monitoring procedures (for example, questionnaires or checklists and instructions)
- d. the depth of the review of individual engagements, particularly with respect to the review of working papers and coverage of significant areas
- e. the findings of the monitoring procedures, including internal inspections
- f. the nature and extent of reporting and communicating the results of the monitoring procedures
- g. the follow-up of findings resulting from the monitoring procedures

In making a judgment about the effects that the firm's current year's internal inspection procedures will have on the selection of offices and engagements to be reviewed, the review team should consider the size of the firm and the potential effectiveness of the internal inspection procedures.

If internal inspection procedures were not, or will not be, performed to cover the review year, the review team may not consider the prior year's internal inspection procedures to reduce the scope of the peer review.

If the review team does not plan to consider the reviewed firm's current year's internal inspection procedures to reduce the scope of the peer review, the review team need not necessarily perform the review of any of the engagements on which internal inspection procedures were performed by the reviewed firm. However, the review team may still wish to reperform the review of a few such engagements to assist the review team in obtaining a better understanding of the effectiveness of the internal inspection procedures performed by the reviewed firm.

If the review team plans to consider the current year's internal inspection procedures to reduce the scope of the peer review, the review team should test

the firm's internal inspection procedures at selected offices and on selected engagements. These tests should be sufficient to provide the review team with a basis for determining whether (a) the reviewed firm's internal inspection procedures were applied properly in the reviews of individual practice offices and engagements, (b) the practice office and Engagement Reviews were carried out conscientiously by competent persons with appropriate expertise and objectivity, and (c) the findings from the reviewed firm's internal inspection procedures are indicative of the work performed in the particular office and therefore can be considered by the review team to reach an overall conclusion regarding the reviewed firm's compliance with its quality control policies and procedures. The testing of internal inspection procedures can be performed (a) contemporaneously with the reviewed firm's internal inspection procedures (commonly called *piggyback reviews*) or (b) after the internal inspection procedures are completed. Because of the insight gained from observing the performance of internal inspection procedures, a review team testing the effectiveness of internal inspection procedures contemporaneously is generally in a better position to assess the effectiveness of the procedures.

When the review team tests the effectiveness of the internal inspection procedures contemporaneously with the performance by the internal inspection team performing the procedures, the review team should visit selected practice offices during the performance of the internal inspection procedures to (a) reperform the review of a sample of engagements subjected to internal inspection procedures and (b) reperform the review of a sample of the quality control policies and procedures (functional elements) subjected to internal inspection procedures in the office. During the visits, the review team should compare its findings to the internal inspection team's findings and resolve any differences. In addition, if applicable, the review team should attend discussions of engagement findings and the overall office findings.

When the review team tests the effectiveness of the internal inspection procedures after the procedures have been completed, the review team should reperform the review of a sample of engagements and the quality control policies and procedures (functional elements) subjected to internal inspection procedures in the office(s). The review team should compare its findings to the internal inspection team's findings and resolve any differences.

**45-2 Question**—Is there more guidance regarding the extent that scope may be reduced, and what factors must be considered and steps performed in order to conclude on the effectiveness? In addition, may a review team apply this same guidance to the involvement of and results from regulatory oversight?

*Interpretation*—Peer reviewers should refer to guidance on reducing scope included in section 3100 *Supplemental Guidance*. If, after considering that guidance, the peer reviewer plans on significantly reducing the scope of the procedures he or she will be performing, he or she is required to inform AICPA technical staff during peer review planning.

## 19. Understanding, Assessing, and Documenting Peer Review Risk Factors and Risk Assessment

**52-1 Question**—Paragraphs .46–.52 discuss peer review risk factors and risk assessment. What other guidance should be considered?

*Interpretation*—Reviewers must assess peer review risk and use a risk-based approach in the selection of engagements and offices for review. Reviewers should formalize the risk assessment before arriving on-site in the reviewed

firm's office and before selecting one or more engagements for review, otherwise they should expect ineffectiveness and, at the very least, inefficiency.

#### *Inherent Risk Factors*

In assessing inherent risk factors, the reviewer should consider

- circumstances arising within the firm (for example, the firm or individual partners have engagements in several specialized industries);
- circumstances outside the firm that impact the firm's clients (for example, new professional standards or those being applied initially for one or more clients, changes in regulatory requirements, adverse economic developments in an industry in which one or more of the firm's clients operate, or significant developments in the client's organization); and
- variances that may occur from year to year, engagement to Engagement or, perhaps, from partner to partner, within the firm (for example, inherent risk will always be higher for an audit of a company or organization operating in a high-risk industry than for a compilation of financial statements without disclosure for a company operating in a non-complex industry; and there are many situations between these two extremes).

#### *Control Risk Factors*

Assessing control risk requires reviewers to evaluate the effectiveness of the reviewed firm's quality control policies and procedures in preventing the performance of engagements that do not comply with professional standards. When assessing control risk, the review team should evaluate the reviewed firm's quality control policies and procedures and discuss with the firm if it considered the guidance in AICPA Accounting and Auditing Practice Aid *Establishing and Maintaining A System of Quality Control for a CPA Firm's Accounting and Auditing Practice*. The reviewer should evaluate whether the reviewed firm has adopted appropriately comprehensive and suitably designed policies and procedures for each of the elements of quality control in the context of the firm's overall control environment and the inherent risk embodied in its accounting and auditing practice.

The assessed levels of risk are the key considerations in deciding the number and types of engagements to review and, where necessary, offices to visit. Through the assessment of risk, the reviewer determines the coverage of the firm's accounting and auditing practice that will result in an acceptably low peer review risk. Engagements selected should provide a reasonable cross-section of the firm's accounting and auditing practice, with a greater emphasis on those engagements in the practice with higher assessed levels of peer review risk.

Reviewers must document, as part of the Summary Review Memorandum (SRM), the risk assessment of the firm's accounting and auditing practice and its system of quality control, the number of offices and engagements selected for review, and the basis for that selection in relation to the risk assessment. To effectively assess risk of the firm's accounting and auditing practice and its quality control policies, risk assessment documentation should not only address the engagements selected and the reasoning behind that selection, but also the environment of the firm and its system of quality controls. Some factors that should be considered in assessing risk include the following:

- The relationship of the firm's audit hours to total accounting and auditing hours
- Size of the firm's major engagement(s), relative to the firm's practice as a whole

- Initial engagements and their impact on the firm's practice
- The industries in which the firm's clients operate, especially the firm's industry concentrations
- The results of the prior peer review
- Owners' CPE policies and the firm's philosophy toward continuing education—Accumulate the necessary hours or maintain the needed skills and improve delivery of professional services?)
- The firm's monitoring policies
- Adequacy of the firm's professional library
- Risk level of the engagements performed (for example, does the firm perform audits of employee benefit plans, entities subject to Circular A-133, and others under *Government Auditing Standards*, HUD-regulated entities, and others with high-risk features or complex accounting or auditing applications?)
- Have there been any major changes in the firm's structure or personnel since the prior peer review?

### *Detection Risk*

Inherent risk and control risk directly relate to the firm's accounting and auditing practice and its system of quality control, respectively, and should be assessed in planning the review. Based on the combined assessment, the reviewer selects engagements for review and determines the scope of other procedures to reduce the peer review risk to an acceptable level. The lower the combined inherent and control risk, the higher the detection risk that can be tolerated. Conversely, a high combined inherent and control risk assessment results in a low detection risk and the resulting increase in the scope of review procedures. See section 3100, *Supplemental Guidance*, for an example of an appropriately documented risk assessment in the SRM.

## 20. Planning and Performing Compliance Tests of Requirements of Voluntary Membership Organizations

**54d-1 Question**—Paragraph .54(d) discusses the peer reviewer's requirement in a System Review to review other evidential material as appropriate, including selected administrative or personnel files. Should the reviewer test the firm's compliance with requirements of voluntary membership organizations?

*Interpretation*—Voluntary membership requirements that are not directly imbedded into the firm's written system of quality control for its accounting and auditing practice are not tested as a part of the peer review. In addition, voluntary membership requirements, even those included in the firm's written system of quality control, that do not directly contribute to the firm's compliance with the requirements of the SQCSs are not tested, addressed, or reported on in the peer review process. Those membership requirements that are specifically imbedded into the firm's written system of quality control and directly contribute to the firm's compliance with the SQCSs are within the scope of peer review, but not because they are a membership requirement, but rather because they are an integral part of the firm's system of quality control for the firm to comply with the SQCSs. In this instance, any matters, findings, or deficiencies noted in these areas would only be addressed as they relate to the firm's system of quality control and they would not be described as related to the voluntary membership requirements.



## 21. Inclusion of Engagements and Aspects of Functional Areas in the Scope of the Peer Review

**55-1 Question**—Paragraph .55 of the standards notes that there is a presumption that all engagements and all aspects of functional areas otherwise subject to the peer review will be included in the scope of the review. Could a firm have a legitimate reason for an exclusion, and what is the effect on the performance of the review?

*Interpretation*—In rare situations a reviewed firm may have legitimate reasons for excluding certain engagements or certain aspects of functional areas, for example when an Engagement or an employee's personnel records are subject to pending litigation. In those instances a reviewer should carefully consider the implication of such exclusions. Those considerations should include assessing the reasonableness of the reasons for the exclusions and assessing the affect on peer review risk assessments and scope, including whether alternate procedures can be performed. To reduce the potential for disagreement about such matters among the reviewed firm, the reviewer, and the administering entity, ordinarily, when the reviewed firm contemplates excluding engagement(s) or aspect(s) of functional area(s), it should notify the team captain in a timely manner and submit a written statement to the administering entity, ordinarily prior to the commencement of the review, indicating (a) it plans to exclude an engagement(s) or aspect(s) of functional area(s) from the peer review selection process, (b) the reasons for the exclusion, and (c) it is requesting a waiver for the exclusion. The administering entity should satisfy itself concerning the reasonableness of the explanation before agreeing to the exclusion.

For peer reviews overseen by a panel preassigned by the administering entity for on-site oversight purposes, the reviewed firm should notify the team captain in advance that it is probable that engagement(s) or aspect(s) of functional area(s) will be excluded from the review, the general reasons for such exclusion, and a detailed description of the procedures used to identify and assess those situations. The panel as previously described should determine that those procedures are appropriate in light of the circumstances. They should consider the level of oversight to which the review may be subject and the level of involvement that members of the board have in that oversight. In addition, they should consider the practicality of selecting a replacement and the availability of other engagement(s) or aspect(s) of functional area(s) as appropriate replacements. Ordinarily, the greater the population to select from, the more there is an opportunity to find an appropriate replacement, and the less there is a risk that there is a scope limitation.

The administering entity (or panel as previously described) should approve the request to exclude engagement(s) or aspect(s) of functional area(s) as the situation arises only when it is satisfied that, based on the reasonableness of the procedures used to identify and assess the situations and the other factors described in the preceding, there will be no limitations on the scope of the review.

Regardless of the approach used to notify the administering entity of exclusions, the reasons for the exclusions and the risk assessment implications should be fully documented in the peer review working papers, and the peer review committee should consider those factors as part of its evaluation and acceptance process.

An administering entity may conclude that scope has been limited due to circumstances beyond the firm's control and the review team cannot accomplish the objectives of those procedures through alternate procedures, thus

precluding the application of one or more peer review procedure(s) considered necessary in the circumstances. For example, ordinarily, the team would be unable to apply alternate procedures if the firm's only engagement in an industry that must be selected is unavailable for review and there isn't an earlier issued engagement that may be able to replace it, or when a significant portion of the firm's accounting and auditing practice during the year reviewed had been divested before the review began. In these circumstances, the team captain or review captain should consider issuing a report with a peer review rating of *pass (with a scope limitation)*, *pass with deficiency (with a scope limitation)*, or *fail (with a scope limitation)*, as applicable. The existence of a scope limitation in and of itself does not result in a report with a peer review rating of pass with deficiencies or fail; it is in addition to the grade that was determined to be issued (which is why it is possible to have a report with a grade of pass (with a scope limitation) to which there would be no letter of response).<sup>3</sup>

If the administering entity (or panel as previously described) concludes that there is not a legitimate reason for the requested exclusion and the firm continues to insist on the exclusion, it should be evaluated whether this is a matter of noncooperation (see Interpretation No. 5h-1).

## 22. Office and Engagement Selection in System Reviews

**56-1 Question**—Paragraph .56 of the standards provides factors to consider when assessing peer review risk at the office level. What are some other examples of factors to consider?

*Interpretation*—Other examples of factors to consider when assessing peer review risk at the office level follow. This list is for illustrative purposes only, and does not include all possible inherent and control risk factors, nor is the peer reviewer required to consider every item on the list when assessing inherent and control risk:

- Offices with one or a few engagements comprising a significant portion of the office's accounting and auditing practice
- Offices with concentrations of high risk engagement
- Offices with a pattern of litigation or regulatory actions
- Offices identified in the preceding peer review or through monitoring procedures as operating at a level significantly below the firm's quality standards
- Offices with an unreasonably large number of accounting and auditing hours per engagement partner
- Offices with only one or a few engagements in a specialized industry
- Offices not subjected to monitoring procedures or not scheduled to be subject to monitoring procedures since the last peer review
- Offices where individual partners practice in many industries
- Offices in geographic areas that are experiencing economic hardships
- Offices with numerous clients in industries experiencing economic hardships

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<sup>3</sup> This is different than the current standards whereby a scope limitation is treated as a modified peer review report.

**58-1 Question**—Paragraph .58 of the standards provides guidance on steps to follow if a current year's engagement has not been completed and issued. What is the impact, if any, for audit engagements subject to professional standards, statutes, regulations, or the firm's quality control policies, which may allow a specified time for an assembly process after issuance?

*Interpretation*—Professional guidance indicates that auditors should not date the audit report until they have obtained sufficient appropriate audit evidence to support the opinion. At that point audit documentation should have been reviewed, financial statements should have been prepared, and management should have asserted its responsibility for them. Document completion dates specify a date certain by which assembly of the audit file must be completed. During the period leading up to that date, changes can be made to the audit documentation to complete the documentation and assembly of audit evidence, perform routine file-assembling procedures, sign off on file completion checklists and add information received after the date of the auditor's report; for example, an original confirmation that was previously faxed. However, the sufficient appropriate audit evidence would have already been required to be in place when the report was dated and thus would be in place when it was issued. Thus, there is no impact on the process of selecting engagements for review.

**58-2 Question**—What if the incomplete engagement is an initial engagement and there is no comparable engagement?

*Interpretation*—If there is an incomplete engagement (which is an initial engagement) and there is no comparable engagement, the firm should request an extension from the administering entity. The administering entity will consider the circumstances and evaluate whether there is actually a matter of noncooperation (see Interpretation No. 5h-1). Although the administering entity will otherwise likely grant the extension, the firm needs to consider if it will be meeting the requirements of its state board of accountancy or other regulatory bodies. If an extension is not possible, the peer review should be performed and the report should include a scope limitation.

If the situation arose due to a permanent change in the nature of the firm's business, the firm should consider requesting a change in its peer review year-end date. If there is any uncertainty concerning how the situation should be handled, the administering entity should be contacted. See section 3100, *Supplemental Guidance*, for an example when there is an initial engagement performed under *Government Auditing Standards* (GAS, also known as the Yellow Book) meeting the preceding criteria.

**58-3 Question**—Paragraph .58 of the standards indicates that if the subsequent year's engagement has been completed and issued, the review team should consider, based on its assessment of peer review risk, whether the more recently completed and issued engagement should be reviewed instead. What are some factors to be considered and implications on the peer review?

*Interpretation*—Other than consideration of the firm's risk assessment and the factors that contributed to it, the reviewer may consider if the subsequent engagement was performed during or after the peer review year. In addition, the reviewer should consider the number of subsequent engagements available and selected for review, as well as the differences in issues encountered in the engagements whether the year-end was within the peer review year or subsequent to it. The greater the number of subsequent year engagements selected, the greater the risk that the results of the review are not appropriate or matched in relation to the peer review year covered by the report and the related peer review results. In some situations, the team captain should consider whether it is more appropriate to issue the peer review report on the subsequent year.

However, this should be a rare situation, would require advance approval from the administering entity, and that entity may request that the next review be accelerated to put the firm back on cycle. If many of the subsequent engagements have been issued, the reviewer should discuss the timing of the peer review with the firm so that future reviews may benefit from the results of the peer review before the subsequent engagements are issued.

**59-1 Question**—Paragraph .59 of the standards requires that engagements selected for review should provide a reasonable cross section of the reviewed firm's accounting and auditing practice, with greater emphasis on those engagements in the practice with higher assessed levels of peer review risk, and the guidance provides examples of factors to consider when assessing peer review risk at the engagement level. What are some other considerations?

*Interpretation*—A reasonable cross section of a firm's accounting and auditing practice, not only includes consideration of the specific industries that are required to be selected, but other industries that have a significant public interest. The reviewer also needs to carefully consider the industries that the firm has identified in the category of "other audits" when determining whether to select such an engagement(s). In addition, a reasonable cross-section takes into account the number of partners, the number of practice offices, and materiality thresholds of accounting and auditing hours.

A reasonable cross section does not always require that at least one engagement from every level of service provided by the firm be selected for review; however, it often may be appropriate in the circumstances. Therefore, there is a relationship between a risk-based approach and a reasonable cross section when selecting engagements, and in that regard each peer review needs to be considered on a case-by-case basis.

The reviewer should explain and document in the *Summary Review Memorandum* key decisions that he or she made when they chose not to select any one or more of the following: a level of service, an engagement where there is a significant public interest, industries where the firm performs a significant number of engagements, and so on. This does not give authority to the reviewer to avoid selecting an engagement(s) by simply documenting the reason(s) why he or she did not select certain engagement(s). Decisions for not selecting certain engagements must make sense, and must not conflict with the standards. The reviewer should anticipate questions regarding engagement selection from the administering entity.

**59-2 Question**—Paragraph .59 of the standards provides factors to consider when assessing peer review risk at the engagement level. What are some other examples of factors to consider?

*Interpretation*—Other examples of factors to consider when assessing peer review risk at the engagement level follow. This list is for illustrative purposes only, and does not include all possible inherent and control risk factors, nor is the peer reviewer required to consider every item on the list when assessing inherent and control risk:

- Engagement size, in terms of the hours required to plan and perform it
- Engagements involving experienced personnel hired from other firms, and partners who also have office, regional or firm-wide management, administrative, or functional responsibilities
- Engagements where work on segments has been referred to other firms, foreign offices, domestic or foreign affiliates, or correspondents

- Engagements where one or more affiliated entities (for example, parent companies and subsidiaries or brother and sister companies) constitute a large portion of the firm's overall clientele
- Engagements identified in the firm's quality control System or guidance material as having a high degree of risk
- Engagements where departures from professional standards and failure to comply with the firm's quality control policies and procedures were noted in the preceding year's monitoring procedures
- Engagements in industries where the firm has experienced high instances of litigation, proceedings, or investigations
- Engagements affected by recently implemented revisions of the firm's quality control policies and procedures
- Engagements affected by newly effective professional standards
- Clients in industries in poor financial condition
- Clients in industries with complex or sophisticated transactions
- Engagements from merged-in practices
- Engagements subject to *Government Auditing Standards*
- Engagements subject to the Employee Retirement Income Security Act of 1974 (ERISA)
- Engagements subject to the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA)

**61-1 Question**—Paragraph .61 of the standards requires that at least one engagement from the initial selection to be reviewed should be provided to the firm once the review commences and not provided to the firm in advance (the surprise engagement). What steps should be followed when making the selection of the surprise engagement?

*Interpretation*—The following steps should be followed:

1. Complete the risk assessment as described in paragraphs .46–.52 of the standards.
2. Plan the compliance tests as described in paragraphs .53–.63 of the standards and determine which engagements should be selected for the review, independent of any surprise selections.
3. Based on those engagements selected for review, determine which engagement should be the surprise engagement. If the risk assessment warrants, more than one surprise engagement may be selected.

Although the standards indicate that the engagement should be the firm's highest level of service (which ordinarily means an audit), in situations where the audit cannot be the surprise selection (for instance, if there is only one audit required to be selected or the only audit is a must select engagement), an engagement from the next highest level of service should be selected. It is not always possible for the reviewer to know whether a reviewed firm expects a certain engagement to be selected. Reviewers are asked to use their professional judgment in these situations. The selection should be based on the risk assessment performed in step 1 and the engagement should be from the list of engagements determined in step 2. The team captain should not increase the original scope of the selection whether another audit or another level of service is selected as the surprise engagement.

See section 3100, *Supplemental Guidance*, for several examples for selecting surprise engagements.

**61-2 Question**—How does the requirement to select a surprise engagement apply for a System Review performed at a location other than the reviewed firm's offices (Interpretation No. 8-1)?

*Interpretation*—For System Reviews approved by the administering entity to be performed at a location other than a reviewed firm's offices, engagements selected to be reviewed are submitted to the reviewer by the firm. As a result, the requirement to select a surprise engagement on a System Review performed at a location other than the reviewed firm's offices is not applicable.

**62-1 Question**—Paragraph .62 of the standards requires that the team captain consult with the administering entity about the selection of engagements for review if the team captain finds that meeting all of the criteria in the related guidance results in the selection of an inappropriate scope of the firm's accounting and auditing practice. What items should the team captain consider to determine if the selection is appropriate?

*Interpretation*—The team captain should carefully consider whether

- a. significant risk areas have appropriate coverage (see paragraph .65 of the standards).
- b. appropriate weight has been given to reviewing work performed by all or most supervisory personnel.
- c. adequate consideration has been given to engagement selection based on peer review risk on a firm-wide basis. For example, if two offices are selected for review and each has a large client in the same specialized industry, peer review risk should be considered in determining whether more than one of these engagements should be selected for review.

If an engagement(s) within the team captain's selection is not available for review, a comparable engagement within the peer review year-end is also not available, nor is there a prior year's engagement that may be reviewed; the team captain should consult with the administering entity to determine the effects on the timing or year-end of the peer review, if any, and whether a report with a peer review rating with a scope limitation should be issued.

**63-1 Question**—Paragraph .63 of the standards requires that specific types or number of engagements must be selected in a System Review as well as specific audit areas. In a System Review, what specific types and number of engagements, if any, should be included in the sample of engagements selected for review or assessed at a higher level of peer review risk?

*Interpretation*—At least one of each of the following types of engagements is required to be selected for review in a System Review:

- a. *Governmental*—*Government Auditing Standards*, issued by the U.S. Government Accountability Office, requires auditors conducting engagements in accordance with those standards to have a peer review that includes the review of at least one engagement conducted in accordance with those standards. If a firm performs an engagement of an entity subject to GAS and the peer review is intended to meet the requirements of those standards, at least one engagement conducted pursuant to those standards should be selected for review.
- b. *Employee Benefit Plans*—Regulatory and legislative developments have made it clear that there is a significant public interest in, and a higher risk associated with, audits conducted pursuant to ERISA. Therefore, if a firm performs the audit of one or more entities subject to ERISA, at least one such audit engagement conducted pursuant to ERISA should be selected for review.

- c. *Depository Institutions*—The 1993 FDIC guidelines implementing the FDICIA require auditors of federally insured depository institutions having total assets of \$500 million or greater at the beginning of its fiscal year to have a peer review that includes the review of at least one audit of an insured depository institution subject to the FDICIA. If a firm performs an audit of a federally insured depository institution subject to the FDICIA and the peer review is intended to meet the requirements of the FDICIA, at least one engagement conducted pursuant to the FDICIA should be selected for review. The review of that engagement should also include a review of the reports on internal control if applicable because those reports are required to be issued under the FDICIA when total assets exceed \$1 billion.

In complying with the requirements in the previous list, peer reviewers should also ensure that the engagements selected include a reasonable cross section of the firm's accounting and auditing engagements, appropriately weighted considering risk. Thus, the peer reviewer may need to select greater than the minimum of one engagement from these industries in order to attain this risk weighted cross section.

For benefit plans under ERISA, the peer reviewer should also consider whether the engagement selection process has adequately addressed the risks involved in limited versus full scope audits and in different types of benefit plans such as defined benefit, defined contribution, and voluntary health and welfare plans. Similar considerations should be made on GAS and FDICIA engagements.

The team captain's consideration of this coverage should be discussed in his or her risk assessment documentation. This discussion should include any factors considered when the reviewed firm has a significant number of engagements in one of these high risk areas and it is not otherwise evident why only one engagement from the industry has been included in the scope of the review.

## 23. Concluding on the Review of an Engagement

**66-1 Question**—Paragraphs .66, .67, and .109 of the standards requires the review team to conclude on the review of an engagement by determining whether the engagement was performed or reported on in conformity with applicable professional standards in all material respects. How should this conclusion be made?

*Interpretation*—The review team should use practice aids that document, for each Engagement Reviewed, whether anything came to the review team's attention that caused it to believe the following, as applicable:

- a. The financial statements were not in conformity with GAAP in all material respects or, if applicable, with an other comprehensive basis of accounting and the auditor or accountant's report was not appropriately modified.
- b. The firm did not perform or report on the engagement in all material respects in accordance with generally accepted auditing standards and other applicable standards, for example, *Governmental Auditing Standards*.
- c. The firm did not perform or report on the engagement in all material respects in accordance with SSARs.
- d. The firm did not perform or report on the engagement in all material respects in accordance with SSAEs or any other applicable standards not encompassed in the preceding.

In Engagement Reviews, these results should be considered by the review captain in determining the type of report to issue.

**67-1 Question**—Paragraphs .67 and .109 of the standards notes that the team captain or review captain should promptly inform the firm when an engagement is not performed or reported on in conformity with applicable professional standards and remind the firm of its obligations under professional standards to take appropriate actions. How is this communication made and what other responsibilities does the team captain or review captain have in regard to the effected engagements?

*Interpretation*—If the reviewer answers *yes* with respect to any of the preceding items, the team captain or review captain should promptly inform an appropriate member of the reviewed firm on an MFC form. The team captain or review captain should remind the reviewed firm of its obligations under professional standards to take appropriate actions as addressed in the section of AU section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*, or SSARS No. 11, *Standards for Accounting and Review Services* (AR sec. 50), as applicable, or, if the firm's work does not support the report issued, as addressed in AU section 390, *Consideration of Omitted Procedures After the Report Date*. The reviewed firm should investigate the issue questioned by the review team and determine what timely action, if any, should be taken, including actions planned or taken to prevent unwarranted continued reliance on its previously issued reports. The reviewed firm should then advise the team captain or review captain of the results of its investigation, including parties consulted, and document on the MFC form prepared by the reviewer the actions planned or taken or its reasons for concluding that no action is required.

Reviewers or administering entities should not instruct reviewed firms to recall accounting or auditing reports, to have them reissued, or to revise previously issued financial statements because those are decisions for the firm and its client to make. However, the firm's actions may affect other corrective actions the administering entity's peer review committee may impose.

If the firm has taken action, the review team should review documentation of such actions (for example, reissued report and financial statements or letter recalling previously issued reports) and consider whether the action is appropriate. If the firm has not taken action, the review team should consider whether the planned actions are appropriate.

## 24. Determining the Cause for a Finding in a System Review

**83-1 Question**—Paragraph .83 of the standards notes that when a review team is faced with an indication that the firm failed to perform or report in conformity with applicable professional standards in all material respects, the review team's first task in such circumstances is to determine the cause of the failure. Why?

*Interpretation*—The evaluation of a firm's system of quality control is the primary objective of System Review and the basis for the peer review report.

As such, when a reviewer in a System Review discovers an engagement that was not performed or reported in conformity with applicable professional standards in all material respects, he or she should avoid considering the type of report to issue until the underlying cause of the engagement deficiency is identified.

Reviewers in a System Review must think of engagement deficiencies as symptoms of weaknesses in the firm's system of quality control. Reliable methods for



identifying the systemic cause of engagement deficiencies are to require complete answers on the MFC forms instead of merely a check mark for the "yes we agree" response, and surveying firm personnel about causes of identified engagement deficiencies. Reviewers should consider that separate engagement deficiencies that are exactly the same may result from completely different quality control weaknesses in the firm.

Furthermore, without understanding the underlying cause, a reviewer cannot make recommendations that are appropriate to reducing the likelihood of the deficiency recurring. Reviewers should avoid assuming that the recommendation of the use of standard forms and checklists will improve a firm's system of quality control. Although forms and checklists are helpful in many circumstances, their use will not cure all deficiencies. For example, checklists will not help firms that lack overall knowledge of accounting and auditing matters or knowledge in the specific area in which the deficiency arose. Nor will standard checklists help firms in which policies and procedures for the review of engagements are routinely overridden.

## 25. Isolated Matters in a System Review

**84-1 Question**—Paragraph .84 refers to isolated matters in a System Review. What is an isolated matter and what further guidance is there to address isolated matters?

*Interpretation*—An isolated matter occurs when there is an incident (or limited incidents) of noncompliance with professional standards or the firm's quality control policies and procedures on one or more engagements (or aspect of a functional area) and the identical standards or policies and procedures were complied with on the remaining engagements or aspect of a functional area.

Reviewers should follow the guidance in paragraph .68, "Expansion of Scope," and paragraphs .84–.85, "Determining the Cause for a Finding," of the standards. The reviewer needs to evaluate the pervasiveness of the issue, including expanding scope if necessary. In some instances the team captain should expand scope to other engagements or aspects of functional areas, and determine that such matters did not occur elsewhere, thus evidencing that the noncompliance with the firm's system of quality control was truly isolated. In these situations, team captains should focus on the underlying cause of the matter when analyzing if it is isolated and may consider a key area approach when expanding scope to other engagements or aspects of functional areas to determine if the matter is isolated. The reviewer's ability to conclude a matter is isolated may be dependent on his or her ability to expand scope to engagements or aspects of functional areas that are classified by common characteristics such as, but not limited to, the industry, level of service, the practitioners in charge, or engagements that must be selected in a peer review.

The reviewer should consider that a single disclosure matter and a single documentation matter may be isolated when taken individually but they may have resulted from the same underlying systemic cause. They should further consider that an isolated matter may be materially significant in amount or nature or both.

Reviewers should document their consideration of an isolated matter and the conclusions reached in the MFC form. Team captains should document the same in the Summary Review Memorandum. The documentation should include the details of the matter noted, how the reviewer expanded scope, if applicable, and why the reviewer concluded the matter was isolated. The documentation should provide enough information for the administering entity's peer review committee to determine if the team captain's conclusion is appropriate.

## 26. Communicating Conclusions at the Exit Conference

**91-1 Question**—Paragraph .91 of the standards instructs a team captain on communicating conclusions at the exit conference in a System Review. What other guidelines should be followed?

**Interpretation**—**The team captain should consider the need to have the team member(s) participate (in person or via teleconference) in the exit conference or be available for consultation during the exit conference, especially when, in unusual circumstances, the team captain does not have the experience to review the industry of an engagement that was reviewed by the team member.** Furthermore, the exit conference is not the appropriate place or time to surprise the firm with the intention of issuing a pass with deficiency or fail Report or to discuss any unresolved accounting and auditing issues. It is expected that the team captain will have an open means of communication with various levels of personnel leading up to the exit conference, having at a minimum and as applicable, promptly informed them when an engagement is not performed or reported on in conformity with applicable professional standards, having discussed MFC and FFC forms including the systemic causes and related recommendations for any matters, findings, deficiencies, and significant deficiencies in advance, and having followed up on open questions and issues.

## 27. Notification and Submission of Peer Review Documentation to the Administering Entities by the Team Captain or Review Captain

**94-1 Question**—Paragraphs .94, .120, and .170 of the standards instruct a reviewer to see the interpretations for guidance on notification requirements and submission of peer review documentation to the administering entity. What materials should be submitted by the team captain or review captain, and when should they be submitted by?

**Interpretation**—The team captain or review captain should notify the administering entity that the review has been performed and should submit to that administering entity within 30 days of the exit conference date in a System Review (or the review captain's discussions with the reviewed firm regarding the results of the review in an Engagement Review) or by the firm's peer review due date, whichever date is earlier, a copy of the report, and the following documentation required by the administering entities at a minimum (consider sending by an insured carrier or retaining or sending copies, or both):

*For System and Engagement Reviews:* The firm-wide Summary Review Memorandum (including the Disposition of MFC), Team Captain Checklist or Review Captain Checklist (as applicable), and MFC and FFC forms, as applicable. Note that other working papers on these peer reviews (including the representation letter) are subject to oversight procedures and may be requested at a later date.

*For:*

- *Committee-appointed review team engagement reviews*
- *All System Reviews, engagement reviews, and quality control materials and continuing professional education program reviews administered by the National PRC*

In addition to the preceding, include all other working papers incorporated by reference, as applicable, including engagement checklists; quality control

documents and related practice aids; staff interview, focus group, and other interview sessions; planning documents; and any other relevant documents.

## 28. Reporting on System and Engagement Reviews When a Report With a Peer Review Rating of *Pass With Deficiency or Fail* is Issued

**96m-1 Question**—Paragraphs .96(m) and .122(m) of the standards instruct a team captain in a System Review (or review captain on an Engagement Review), to include, for reports with a peer review rating of *pass with deficiency(ies)* or *fail*, descriptions (systemically written, in a System Review) of the deficiencies or significant deficiencies and the reviewing firm's recommendations. What is the treatment of FFCs, if any, when these reports are issued, and how are deficiencies treated for reports with a peer review rating of fail?

*Interpretation*—Any findings that are only raised to the level of an FFC remain in an FFC and are not included in a report with a peer review rating of *pass with deficiency or fail*.<sup>4</sup>

A *significant deficiency* in a System Review is one or more deficiencies that the peer reviewer has concluded results from a condition in the reviewed firm's system of quality control or compliance with it such that the reviewed firm's system of quality control taken as a whole does not provide the reviewed firm with reasonable assurance of performing or reporting in conformity with applicable professional standards in all material respects. Such *deficiencies* are communicated in a report with a peer rating of *fail*. Therefore, this is a systemic approach to determining whether the *deficiencies* identified meet this *significant deficiency* threshold. If they do, then a report with a peer review rating of *fail* is issued and *all* of the *deficiencies* are considered *significant deficiencies* and are identified as such. Such a report would not have a section with "Significant Deficiencies" and another section for "Deficiencies," as they would all be categorized as *Significant Deficiencies*.

A *significant deficiency* on an Engagement Review exists when the review captain concludes that *deficiencies* are evident on all of the engagements submitted for review (with the exception of when more than one engagement has been submitted for review, the exact same deficiency occurs on each of those engagements, and there are no other deficiencies, which ordinarily would result in a report with a peer review rating of *pass with deficiencies*). Such *deficiencies* are communicated in a report with a peer review rating of *fail*. Therefore, on an Engagement Review, all of the engagements reviewed are considered concerning whether *deficiencies* were noted when determining if the *significant deficiency* threshold is met. If they do, then a report with a peer review rating with *fail* is issued and *all* of the *deficiencies* are considered *significant deficiencies* and are identified as such. Such a report would not have a section with "Significant Deficiencies" and another section for "Deficiencies," as they would all be categorized as *Significant Deficiencies*.

**96n-1 Question**—Paragraphs .96(n) and .122(n) of the standards instruct a team captain in a System Review (or review captain on an Engagement Review) to identify, for any deficiencies or significant deficiencies included in the report with a peer review rating of *pass with deficiencies* or *fail*, any that were also

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<sup>4</sup> Previously, when a determination was made to issue an adverse report, then any matters that ordinarily would have only been included in a letter of comment were placed in the adverse report and no letter of comment was issued.

made in the report issued on the firm's previous peer review. What further guidance is available in regards to this requirement?

*Interpretation*—On System Reviews, a repeat is a deficiency or significant deficiency noted during the current review that was caused by the same system of quality control weakness noted in the prior review's report.<sup>5</sup> The review team should read the prior report and letter of response and evaluate whether corrective actions discussed have been implemented to determine whether the systemic cause is the same. The deficiency or significant deficiency should note that "This deficiency [or significant deficiency, as applicable] was noted in the firm's previous peer review."

If the corrective actions have been implemented and the same deficiency or significant deficiency is occurring, the review team should determine the weakness in the firm's system of quality control that is causing the deficiency or significant deficiency to occur. In this case, if the prior corrective actions appear to be effective, the deficiency or significant deficiency may be caused by some other weakness in the firm's system of quality control. If the underlying cause of the deficiency or significant deficiency is different, it would not be a repeat.

The preceding also applies when the deficiency or significant deficiency noted during the current review was caused by the same system of quality control weakness noted on an FFC form in the prior review. Under these circumstances, it would still be appropriate to use the same wording as previously described "This deficiency [or significant deficiency, as applicable] was noted in the firm's previous peer review."

See section 3100, *Supplemental Guidance*, for an example of identifying repeat deficiencies and significant deficiencies in a System Review.

On Engagement Reviews, a repeat is one in which the identified engagement deficiency or significant deficiency is substantially the same (that is, the same kind or very similar) as noted in the prior review's report<sup>6</sup> as it relates to reporting, presentation, disclosure or documentation. For example, if a reviewer notes an engagement that had a disclosure or a financial statement presentation deficiency in a prior review's report, the disclosure or financial statement presentation deficiency noted in the current review would need to be substantially the same disclosure or financial statement presentation deficiency to qualify as a repeat.

The preceding also applies when the deficiency or significant deficiency noted during the current review was substantially the same as was noted on an FFC form in the prior review. Under these circumstances, it would still be appropriate to use the same wording as previously described: "This deficiency [or significant deficiency, as applicable] was noted in the firm's previous peer review."

On reviews in which there are repeat deficiencies or significant deficiencies that have occurred on two or more prior reviews the reviewer should state in the current report that, "this deficiency [or significant deficiency, as applicable] was noted on previous reviews."

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<sup>5</sup> Or the letter of comments, or both, if applicable, for reviews commenced prior to January 1, 2009. Although the repeat was not classified as a deficiency or significant deficiency in that review, this is an appropriate approach because the finding was included in the peer review reporting package at that time.

<sup>6</sup> Or the letter of comments, or both, if applicable, for reviews commenced prior to January 1, 2009. Although the repeat was not classified as a deficiency or significant deficiency in that review, this is an appropriate approach because the finding was included in the peer review reporting package at that time.

A firm that repeatedly receives peer reviews with consistent deficiencies or significant deficiencies that are not corrected may be deemed as a firm refusing to cooperate. For such firms that fail to cooperate, the AICPA Peer Review Board may decide, pursuant to fair procedures that it has established, to appoint a hearing panel to consider whether the firm's enrollment in the AICPA peer review program should be terminated or some other action taken. Therefore, it is critical that peer reviewers appropriately identify the underlying causes of deficiencies and significant deficiencies on System Reviews and that reporting on all peer reviews is appropriate.

## 29. Firm Responses in a System or Engagement Review

**97-1 Question**—Paragraphs .97 and .123 of the standards discuss the team captain or review captain's responsibility to review, evaluate, and comment on the reviewed firm's letter of response prior to its submission to the administering entity. What should be considered during that review?

*Interpretation*—The purpose of the letter of response is for a firm to stipulate, in writing, the specific action(s) that will be taken to correct deficiencies noted by the reviewer and, on a System Review, to enhance the current system of quality control. The description of the action(s) the firm has taken or will take should ensure prevention of recurrence of the deficiency or significant deficiency discussed in the report. The action(s) should be feasible, genuine, and comprehensive. The letter of response should not be vague or repetitive of the deficiency or significant deficiency in the report, because then it is difficult to determine if the planned action will be appropriately implemented to ensure prevention; or if the action is inappropriate for correcting the deficiency or significant deficiency. The letter of response should not be used as a place to indicate justification for the firm's actions that related to the deficiency or significant deficiency.

## 30. Submission of FFC Forms to the Administering Entities by the Team Captain or Review Captain

**99-1 Question**—Paragraphs .99 and .125 of the standards instruct a team captain or review captain to review and evaluate the firm's responses to all findings and recommendations not rising to the level of a deficiency or significant deficiency as reflected on the related FFC forms before they are submitted to the administering entity. When should the FFC forms be submitted to the administering entity and who should submit them?

*Interpretation*—Ordinarily, the FFC forms should be responded to by the reviewed firm during the peer review; for example, during or immediately following the exit conference (in a System Review) or before or immediately following the review captain's discussions with the reviewed firm regarding the results of the review (in an Engagement Review). This would allow the team captain or review captain to assist the firm in developing its responses and obtaining the necessary signatures on the FFC forms and allow the team captain or review captain to review the responses at that time, all of which will expedite the process. In some cases, the reviewed firm will choose to check the box on the FFC form that it agrees with the finding and will implement the reviewer's recommendation, and they should provide the date of the action(s) taken or planned to be taken. If the reviewed firm prefers to provide a description of the actions(s) taken or planned to be taken (and timing), the team captain or review captain can provide assistance in ensuring that the responses are appropriate and comprehensive. However, it is also recognized that the reviewed

firm may prefer to provide its final responses after it has had the opportunity to discuss them further internally, develop a plan of action and/or more formally respond. In either case, the completed FFC forms should be submitted to the team captain or review captain no later than two weeks after the exit conference (in a System Review) or the review captain's discussions with the reviewed firm regarding the results of the review (in an Engagement Review), or by the peer review's due date, whichever is earlier. FFC forms are then submitted by the team captain or review captain with the applicable working papers to the administering entity.

## 31. Election to Have a System Review

**103-1 Question**—Paragraph .103 of the standards notes that firms eligible to have an Engagement Review may elect to have a System Review. What modifications are required to the peer review report under these circumstances?

*Interpretation*—Under these circumstances, any references in the peer review report to "the accounting and auditing practice" should be modified to refer only to "the accounting practice." In addition, the sentence "Firm XYZ & Co. has represented to us that the firm performed no services under the SASs; *Government Auditing Standards*; examinations of prospective financial statements under the Statements on Standards for Attestation Engagements (SSAEs); or audits of non-SEC issuers performed pursuant to the standards of the Public Company Accounting Oversight Board (PCAOB)" should be added.

## 32. Impact of SQCS No. 7 on Engagement Reviews

**109-1 Question**—Paragraph .109 of the standards notes that an Engagement Review does not include a review of other documentation prepared on the engagements submitted for review (other than the documentation referred to in paragraphs .107–.108), tests of the firm's administrative or personnel files, interviews of selected firm personnel, or other procedures performed in a System Review. Should or may a firm's written quality control policies and procedures be inquired about, obtained by, or reviewed by the review captain on an Engagement Review? Would a firm's failure to have its quality control policies and procedures documented result in an individual engagement being deemed not performed or reported on in conformity with applicable professional standards, even if there are no other matters, findings, or deficiencies noted on the engagement?

*Interpretation*—SQCS No. 7 states that firms should document their quality control policies and procedures and that the size, structure, and nature of the practice of the firm are important considerations in determining the extent of the documentation of established quality control policies and procedures.

However, the objective of an Engagement Review is to evaluate whether engagements submitted for review are *performed and reported on* in conformity with applicable professional standards in all material respects. An Engagement Review consists of reading the financial statements or information submitted by the reviewed firm and the accountant's report thereon, together with certain background information and representations and, except for compilation engagements performed under SSARS, the applicable documentation required by professional standards. An Engagement Review does not provide the review captain with a basis for expressing any form of assurance on the firm's system of quality control (which is what the documentation requirements are related to).

Further, AR section 100 paragraph .72 states, "deficiencies in or instances of noncompliance with a firm's quality control policies and procedures do not, in and of themselves, indicate that a particular review or compilation engagement was not performed in accordance with SSARS." This is also consistent with the SSAEs (and SASs).

Therefore, if reading the firm's documented quality control policies and procedures or the inability for the review captain to do so has no impact on whether the actual engagements submitted for review are performed and reported on in conformity with SSARS and the SSAEs in all material respects, reading the documented quality control policies and procedures would only appear to give a review captain the insight concerning the *underlying cause* concerning why a matter, finding, or deficiency occurred. Although this may be useful information in preparing MFCs or FFCs, the systemic reasons for these items are beyond the scope of an Engagement Review.

Therefore, obtaining or reviewing a firm's documented quality control policies and procedures would not be applicable to Engagement Reviews.

Although the standards allow for "reading the applicable documentation required by professional standards," and the SQCSs are a part of professional standards, it might appear that the standards do not prohibit the reviewer from obtaining and reading the firm's documented quality control policies and procedures (except as specifically discussed in the standards for compilation engagements performed under SSARSs); however, it is deemed as beyond the scope of an Engagement Review.

SQCS No. 7 also states that at least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent by the requirements set forth in Rule 101, *Independence*, and its related interpretations and rulings of the AICPA Code of Professional Conduct (ET sec. 101) and the rules of state boards of accountancy and applicable regulatory agencies. Written confirmation may be in paper or electronic form. Analogous to the preceding situation, obtaining or reviewing a firm's written independence confirmations would not be applicable to Engagement Reviews because the requirement is imbedded in the SQCSs and not a procedure required by SSARSs or the SSAEs.

### **33. Qualifying for Service as a Peer Review Committee Member, Report Acceptance Body Member, or Technical Reviewer**

**132-1 Question**—Paragraphs .132 and .136 of the standards note that minimum requirements must be met to be a peer review committee member, a report acceptance body member, or a technical reviewer. What are those requirements?

*Interpretation* —

*Peer Review Committee Member*

A majority of the peer review committee members and the chairperson charged with the overall responsibility for administering the program at the administering entity should possess the qualifications required of a team captain in a System Review.

*Report Acceptance Body Member*

Each member of an administering entity's report acceptance body charged with the responsibility for acceptance of peer reviews should be:

- a. currently active in public practice at a supervisory level in the accounting or auditing function of a firm enrolled in the program, as a partner of the firm, or as a manager or person with equivalent supervisory responsibilities. To be considered currently active in the accounting or auditing function, a reviewer should be presently involved in the accounting or auditing practice of a firm supervising one or more of the firm's accounting or auditing engagements or carrying out a quality control function on the firm's accounting or auditing engagements.
- b. associated with a firm (or all firms if associated with more than one firm) that has received a report with a peer review rating of *pass* (previously referred to as an unmodified report) on its most recently accepted System or Engagement Review that was accepted timely, ordinarily within the last 3 years and 6 months<sup>7</sup> (see Interpretation No. 31b-1).
- c. trained in the standards, interpretations, and guidance of the program by completing a course that meets the team captain training requirements established by the board within 3 years prior to serving on the committee or during the first year of service on the committee (see Interpretation No. 33-1).

A majority of the report acceptance body members and the chairperson charged with the responsibility for acceptance of System Reviews should possess the qualifications required of a System Review team captain.

#### *Technical Reviewers*

Each technical reviewer charged with the responsibility for performing technical reviews should:

- a. be trained in the standards, interpretations, and guidance of the program by completing within the three-year period preceding the commencement of the technical review one or more training courses that are applicable to the type of peer reviews being evaluated and that meet the requirements of the team captain or review captain training requirements established by the board (see Interpretation No. 14).
- b. participate in at least one peer review each year, which may include participation in an on-site oversight of a System Review.
- c. have an appropriate level of accounting and auditing knowledge and experience suitable for the work performed. Such knowledge may be obtained from on-the-job training, training courses, or a combination of both. Technical reviewers are to obtain a minimum amount of CPE to maintain the appropriate level of accounting and auditing knowledge.

If a technical reviewer does not have such knowledge and experience, the technical reviewer may be called upon to justify why he or she should be permitted to perform technical reviews or oversights. The administering entity has the authority to decide whether a technical reviewer's knowledge and experience is sufficient and whether he or she has the capability to perform a particular technical review or oversight whether there are high-risk engagements involved or other factors.

The fundamental purpose of CPE is to maintain or increase, or both, professional competence. AICPA members are required to participate in 120 hours of CPE every 3 years. In order to maintain current knowledge of accounting, auditing, and quality control standards, technical reviewers should obtain at least 40 percent of the AICPA-required CPE in subjects relating to accounting, auditing, and quality control. Technical reviewers should obtain at least

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<sup>7</sup> If a committee member firm's most recent review was a report review, then the member is not eligible to be charged with the responsibility for acceptance of any peer reviews.



8 hours in any 1 year and 48 hours every 3 years in subjects relating to accounting, auditing, and quality control. The terms *accounting*, *auditing*, and *quality control* should be interpreted as CPE that would maintain current knowledge of accounting, auditing, and quality control standards for engagements that fall within the scope of peer review as described in paragraphs .06–.07 of the standards.

Technical reviewers have the responsibility of documenting their compliance with the CPE requirement. They should maintain detailed records of CPE completed in the event they are requested to verify their compliance. The reporting period will be the same as that maintained for the AICPA.

## 34. Accepting Engagement Reviews by the Technical Reviewer

**137-1 Question**—The standards and interpretations indicate that the technical reviewer should be delegated the authority from the committee to accept Engagement Reviews in certain circumstances. What are those circumstances?

*Interpretation*—The technical reviewer should be delegated the authority from the committee to accept Engagement Reviews on the committee's behalf when the technical reviewer determines that any MFC forms prepared only relate to compilations under SSARs, that no MFC forms should have been prepared except as related to compilations under SSARs, and there are no other issues associated with the peer review warranting committee consideration or action that could potentially affect the results of the peer review.

*Interpretation*—The technical reviewer may identify reviewer feedback that should be considered and approved by the peer review committee prior to issuance. The technical reviewer should still be delegated the authority from the committee to accept Engagement Reviews on the committee's behalf when such feedback may be provided to the review captain unless the circumstances leading up to the feedback may have affected the results of the review. Accordingly, if the feedback being provided to the review captain involves issues which could potentially affect the results of the peer review, the technical reviewer should not accept the Engagement Review but present it to the committee for consideration.

## 35. Cooperating in a Peer Review—Implementation Plans and Correction Action Plans

**143-1 Question**—Paragraph .143 of the standards notes that an implementation plan in addition to or as an affirmation of those described by the firm in its responses on the FFC form may be requested by the administering entity's peer review committee. Can this plan only be requested when a report with a rating of *pass* has been issued?

*Interpretation*—No, an implementation plan may be requested whether a report with a rating of *pass*, *pass with deficiency*, or *fail* is issued for any findings that were only raised to the level of an FFC and did not get elevated further. Thus, it is possible to have a required corrective action as a condition of acceptance of the peer review stemming from a report with a rating of *pass with deficiencies* or *fail* and a required implementation plan as a condition of cooperation (unrelated to the acceptance of the review) for the findings included in the FFCs.

## 36. Publicizing Peer Review Information

**146-1 Question**—Paragraph .146 of the standards discusses that neither the administering entity nor the AICPA shall make the results of the review available to the public, except as authorized or permitted by the firm under certain circumstances. What are examples of those circumstances?

*Interpretation*—A firm may be a voluntary member of one of the AICPA's audit quality centers or sections that has a membership requirement such that certain peer review documents be open to public inspection. Other firms may elect not to opt out of the program's process for voluntary disclosure of peer review results to state boards of accountancy where the firm's main office is located. Also, firms may voluntarily instruct their administering entity to make the peer review results available to certain other state boards of accountancy. In these cases, the firm permits the AICPA or administering entities to make their peer review results available to the public or to state boards of accountancy, respectively.

## 37. Firm Representations

**181-1-1 Question**—Paragraph .181-(1) (appendix B) of the standards advises that the firm is not prohibited from making additional representations beyond the required representations, in its representation letter to the team captain or review captain. What parameters should be used in expanding the representation letter?

*Interpretation*—The representation letter is not intended to be onerous for the reviewed firm. Allowing reviewers to add whatever they want to the representation letter would make it very difficult to maintain consistency in the program. In addition, this becomes a very important issue because a firm's failure to sign the representation letter may be considered a scope limitation.

However, at a minimum the representation letter should comply with the spirit of the guidance, there is value to the reviewer of obtaining certain representations in writing. Thus, if during the review, something comes to the reviewer's attention whereby the reviewer believes the reviewed firm is providing contradicting or questionable information, the reviewer should investigate the matter further and may consider having the firm include the matter in the representation letter.

## 38. Firm and Individual Licenses

**181-1a-1 Question**—Paragraph .181 (paragraph (1)(a) of appendix B) of the standards advises that firms include representations to the team captain or review captain concerning when management is aware that the firm or its personnel has not complied with the rules and regulations of state board(s) of accountancy or other regulatory bodies (including applicable firm and individual licensing requirements in each state in which it practices for the year under review). What further guidance should be followed in regards to firm and individual licenses?

*Interpretation*—Firms are required to comply with the rules and regulations of state boards of accountancy and other regulatory bodies in the states where they practice. As a part of the peer review, firms should submit written representations from the firm's management indicating compliance with such required rules and regulations. If the reviewed firm is aware of any situation whereby they are not in compliance with the rules and regulations of the state boards of

accountancy or other regulatory bodies, they should tailor the representation letter to provide information on the areas of non-compliance.

Reviewers should continue to make inquiries of the firm to determine if it is appropriately licensed as required by the state boards of accountancy in the state or states in which it practices. In addition, a reviewer is not prohibited, as a part of a System or Engagement Review, from verifying the *practice unit* license (firm license) in the state in which the practice unit is domiciled (main office is located). A reviewer is also not prohibited from verifying an out-of-state *practice unit* license on an individual engagement basis when that engagement is selected for review and was performed by the reviewed firm in another state requiring a firm license.

Testing *individual* licenses should be limited to inquiry and should not extend to verification unless there is evidence obtained as a part of the peer review that the firm is not accurately representing its compliance with individual licensure requirements.

The reviewer must analyze the information obtained through inquiry and in the written representation letter to determine the impact on the peer review.

#### *Communication of Report Acceptances*

The state board of accountancy may be sent a list of firms with *accepted* peer reviews ("accepted" as defined in the Interpretations to the standards) in a given period which would allow the state board of accountancy to verify that firms undergoing peer review are licensed in that state.

Entities administering the AICPA Peer Review Program are not prohibited outside of the peer review process from gathering information from firms and communicating to the state boards of accountancy on licensure compliance matters.

## **39. Communications Received by the Reviewed Firm Relating to Allegations or Investigations in the Conduct of Accounting, Auditing, or Attestation Engagements From Regulatory, Monitoring, or Enforcement Bodies**

**181-1b-1 Question**—Paragraph .181 (paragraph 1(b) and (e) of appendix B) of the standards discusses the reviewed firm's requirement to inform the reviewer of communications or summaries of communications from regulatory, monitoring, or enforcement bodies relating to allegations or investigations of deficiencies in the conduct of an accounting, auditing, or attestation engagement performed and reported on by the firm. What are the objectives of this requirement and what are some examples, although not an all inclusive list, of such communications?

*Interpretation*—The objective of the firm informing its reviewer of such communications or summaries of communications is to enhance the risk-based approach to peer review by allowing the reviewer to better plan and perform the review, including engagement, industry, office, and owner selection that should be given greater emphasis in the review. It is expected that the reviewer and the firm will discuss these communications and that the firm will be able to submit the actual documentation to the reviewer in those circumstances that the reviewer deems appropriate. The reviewed firm is not required to submit confidential documents to the reviewer but should be able to discuss the relevant matters and answer the reviewer's questions.

There are many types of communications that are appropriately related to meeting the objectives described in this interpretation. The following list, which is not intended to be all inclusive, represents examples of the types of organizations where communications would be relevant to meeting the objectives of the requirement:

- a. AICPA or State CPA Society Ethics Committees
- b. AICPA Joint Trial Board
- c. State boards of accountancy
- d. SEC
- e. PCAOB
- f. State auditor
- g. Department of Labor
- h. Employee Benefits Security Administration
- i. Government Accountability Office
- j. Office of Management and Budget
- k. Department of Housing and Urban Development
- l. FDIC
- m. Office of Thrift and Supervision
- n. Federal or State Inspector General's Offices
- o. Rural Utility Service
- p. Other governmental agencies or other organizations that have the authority to regulate accountants (in connection with the firm's accounting, auditing, or attestation engagements)

**181-1b-2 Question**—What if a reviewed firm chooses not to discuss or make such communications available to the reviewer during the review?

*Interpretation*—If a firm fails to discuss such communications with the reviewer, the reviewer should immediately consult with the administering entity because this constitutes a failure to cooperate, and the firm would be subject to fair procedures that could result in the firm's enrollment in the program being terminated (see interpretations).

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**TS Section  
TAX SERVICES**

**STATEMENTS ON  
STANDARDS FOR TAX SERVICES**

*The Statements on Standards for Tax Services (SSTSs) and Interpretations, promulgated by the Tax Executive Committee, reflect the AICPA's standards of tax practice and delineate members' responsibilities to taxpayers, the public, the government, and the profession. The Statements are intended to be part of an ongoing process that may require changes to and Interpretations of current SSTSs in recognition of the accelerating rate of change in tax laws and the continued importance of tax practice to members. Interpretation No. 1-2 was approved by the Tax Executive Committee on August 21, 2003; its effective date is December 31, 2003.*

*The SSTSs have been written in as simple and objective a manner as possible. However, by their nature, ethical standards provide for an appropriate range of behavior that recognizes the need for Interpretations to meet a broad range of personal and professional situations. The SSTSs recognize this need by, in some sections, providing relatively subjective rules and by leaving certain items undefined. These terms and concepts are generally rooted in tax concepts, and therefore should be readily understood by tax practitioners. It is, therefore, recognized that the enforcement of these rules, as part of the AICPA's Code of Professional Conduct Rule 201, General Standards, and Rule 202, Compliance With Standards, will be undertaken with flexibility in mind and handled on a case-by-case basis. Members are expected to comply with them.*

TABLE OF CONTENTS

Section		Paragraph
100	Tax Return Positions	.01-.12
	Introduction .....	.01
	Statement .....	.02-.04
	Explanation .....	.05-.12
9100	Tax Return Positions: Tax Services Interpretations of Section 100	.01-.93
	1-1. Realistic Possibility Standard (8/00) .....	.01-.41
	1-2. Tax Planning (12/03) .....	.42-.93

<i>Section</i>		<i>Paragraph</i>
200	Answers to Questions on Returns	.01-.06
	Introduction .....	.01
	Statement .....	.02
	Explanation .....	.03-.06
300	Certain Procedural Aspects of Preparing Returns	.01-.09
	Introduction .....	.01
	Statement .....	.02-.04
	Explanation .....	.05-.09
400	Use of Estimates	.01-.07
	Introduction .....	.01
	Statement .....	.02
	Explanation .....	.03-.07
500	Departure From a Position Previously Concluded in an Administrative Proceeding or Court Decision	.01-.06
	Introduction .....	.01-.03
	Statement .....	.04
	Explanation .....	.05-.06
600	Knowledge of Error: Return Preparation	.01-.09
	Introduction .....	.01-.02
	Statement .....	.03-.04
	Explanation .....	.05-.09
700	Knowledge of Error: Administrative Proceedings	.01-.08
	Introduction .....	.01-.02
	Statement .....	.03-.04
	Explanation .....	.05-.08
800	Form and Content of Advice to Taxpayers	.01-.11
	Introduction .....	.01
	Statement .....	.02-.04
	Explanation .....	.05-.11
900	Appendix: Cross-Reference of Previous and Revised Statements	

## Preface

Practice standards are the hallmark of calling one's self a professional. Members should fulfill their responsibilities as professionals by instituting and maintaining standards against which their professional performance can be measured. Compliance with professional standards of tax practice also confirms the public's awareness of the professionalism that is associated with CPAs as well as the AICPA.

This Publication sets forth ethical tax practice standards for members of the AICPA: Statements on Standards for Tax Services (SSTs or Statements). Although other standards of tax practice exist, most notably Treasury Department Circular No. 230 and penalty provisions of the Internal Revenue Code (IRC), those standards are limited in that (1) Circular No. 230 does not provide the depth of guidance contained in these Statements, (2) the IRC penalty provisions apply only to income-tax return preparation, and (3) both Circular No. 230 and the penalty provisions apply only to federal tax practice.

The SSTs have been written in as simple and objective a manner as possible. However, by their nature, ethical standards provide for an appropriate range of behavior that recognizes the need for interpretations to meet a broad range of personal and professional situations. The SSTs recognize this need by, in some sections, providing relatively subjective rules and by leaving certain terms undefined. These terms and concepts are generally rooted in tax concepts, and therefore should be readily understood by tax practitioners. It is, therefore, recognized that the enforcement of these rules, as part of the AICPA's Code of Professional Conduct Rule 201, *General Standards* [ET section 201.01], and Rule 202, *Compliance With Standards* [ET section 202.01], will be undertaken with flexibility in mind and handled on a case-by-case basis. Members are expected to comply with them.

## History

The SSTs have their origin in the Statements on Responsibilities in Tax Practice (SRTPs), which provided a body of advisory opinions on good tax practice. The guidelines as originally set forth in the SRTPs had come to play a much more important role than most members realized. The courts, Internal Revenue Service, state accountancy boards, and other professional organizations recognized and relied on the SRTPs as the appropriate articulation of professional conduct in a CPA's tax practice. The SRTPs, in and of themselves, had become de facto enforceable standards of professional practice, because state disciplinary organizations and malpractice cases in effect regularly held CPAs accountable for failure to follow the SRTPs when their professional practice conduct failed to meet the prescribed guidelines of conduct.

The AICPA's Tax Executive Committee concluded that appropriate action entailed issuance of tax practice standards that would become a part of the Institute's Code of Professional Conduct. At its July 1999 meeting, the AICPA Board of Directors approved support of the executive committee's initiative and placed the matter on the agenda of the October 1999 meeting of the Institute's governing Council. On October 19, 1999, Council approved designating the Tax Executive Committee as a standard-setting body, thus authorizing that committee to promulgate standards of tax practice. These SSTs, largely mirroring the SRTPs, are the result.

The SRTPs were originally issued between 1964 and 1977. The first nine SRTPs and the Introduction were codified in 1976; the tenth SRTP was issued in 1977. The original SRTPs concerning the CPA's responsibility to sign



the return (SRTPs No. 1, *Signature of Preparers*, and No. 2, *Signature of Reviewer: Assumption of Preparer's Responsibility*) were withdrawn in 1982 after Treasury Department regulations were issued adopting substantially the same standards for all tax return preparers. The sixth and seventh SRTPs, concerning the responsibility of a CPA who becomes aware of an error, were revised in 1991. The first Interpretation of the SRTPs, Interpretation 1-1, "Realistic Possibility Standard," was approved in December 1990. The SSTs and Interpretation supersede and replace the SRTPs and their Interpretation 1-1 effective October 31, 2000. Although the number and names of the SSTs, and the substance of the rules contained in each of them, remain the same as in the SRTPs, the language has been edited to both clarify and reflect the enforceable nature of the SSTs. In addition, because the applicability of these standards is not limited to federal income-tax practice, the language has been changed to mirror the broader scope.

## Ongoing Process

The following Statements on Standards for Tax Services [sections 100–800] and Interpretations No. 1-1, "Realistic Possibility Standard," and No. 1-2, "Tax Planning," [section 9100] to Statement No. 1, *Tax Return Positions* [section 100] reflect the AICPA's standards of tax practice and delineate members' responsibilities to taxpayers, the public, the government, and the profession. The Statements are intended to be part of an ongoing process that may require changes to and interpretations of current SSTs in recognition of the accelerating rate of change in tax laws and the continued importance of tax practice to members.

The Tax Executive Committee promulgates SSTs. Even though the 1999-2000 Tax Executive Committee approved this version, acknowledgment is also due to the many members whose efforts over the years went into the development of the original statements.

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## TS Section 100

### *Tax Return Positions*

Issue date, unless  
otherwise indicated:  
August, 2000

#### Introduction

**.01** This Statement sets forth the applicable standards for members when recommending tax return positions and preparing or signing tax returns (including amended returns, claims for refund, and information returns) filed with any taxing authority. For purposes of these standards, a *tax return position* is (a) a position reflected on the tax return as to which the taxpayer has been specifically advised by a member or (b) a position about which a member has knowledge of all material facts and, on the basis of those facts, has concluded whether the position is appropriate. For purposes of these standards, a *taxpayer* is a client, a member's employer, or any other third-party recipient of tax services.

#### Statement

**.02** The following standards apply to a member when providing professional services that involve tax return positions:

- a. A member should not recommend that a tax return position be taken with respect to any item unless the member has a good-faith belief that the position has a realistic possibility of being sustained administratively or judicially on its merits if challenged.
- b. A member should not prepare or sign a return that the member is aware takes a position that the member may not recommend under the standard expressed in paragraph .02a.
- c. Notwithstanding paragraph .02a, a member may recommend a tax return position that the member concludes is not frivolous as long as the member advises the taxpayer to appropriately disclose. Notwithstanding paragraph .02b, the member may prepare or sign a return that reflects a position that the member concludes is not frivolous as long as the position is appropriately disclosed.
- d. When recommending tax return positions and when preparing or signing a return on which a tax return position is taken, a member should, when relevant, advise the taxpayer regarding potential penalty consequences of such tax return position and the opportunity, if any, to avoid such penalties through disclosure.

**.03** A member should not recommend a tax return position or prepare or sign a return reflecting a position that the member knows—

- a. Exploits the audit selection process of a taxing authority.
- b. Serves as a mere arguing position advanced solely to obtain leverage in the bargaining process of settlement negotiation with a taxing authority.

**.04** When recommending a tax return position, a member has both the right and responsibility to be an advocate for the taxpayer with respect to any position satisfying the aforementioned standards.

## Explanation

**.05** Our self-assessment tax system can function effectively only if taxpayers file tax returns that are true, correct, and complete. A tax return is primarily a taxpayer's representation of facts, and the taxpayer has the final responsibility for positions taken on the return.

**.06** In addition to a duty to the taxpayer, a member has a duty to the tax system. However, it is well established that the taxpayer has no obligation to pay more taxes than are legally owed, and a member has a duty to the taxpayer to assist in achieving that result. The standards contained in paragraphs .02, .03, and .04 recognize the members' responsibilities to both taxpayers and to the tax system.

**.07** In order to meet the standards contained in paragraph .02, a member should in good faith believe that the tax return position is warranted in existing law or can be supported by a good-faith argument for an extension, modification, or reversal of existing law. For example, in reaching such a conclusion, a member may consider a well-reasoned construction of the applicable statute, well-reasoned articles or treatises, or pronouncements issued by the applicable taxing authority, regardless of whether such sources would be treated as *authority* under Internal Revenue Code section 6662 and the regulations thereunder. A position would not fail to meet these standards merely because it is later abandoned for practical or procedural considerations during an administrative hearing or in the litigation process.

**.08** If a member has a good-faith belief that more than one tax return position meets the standards set forth in paragraph .02, a member's advice concerning alternative acceptable positions may include a discussion of the likelihood that each such position might or might not cause the taxpayer's tax return to be examined and whether the position would be challenged in an examination. In such circumstances, such advice is not a violation of paragraph .03a.

**.09** In some cases, a member may conclude that a tax return position is not warranted under the standard set forth in paragraph .02a. A taxpayer may, however, still wish to take such a position. Under such circumstances, the taxpayer should have the opportunity to take such a position, and the member may prepare and sign the return provided the position is appropriately disclosed on the return or claim for refund and the position is not frivolous. A frivolous position is one that is knowingly advanced in bad faith and is patently improper.

**.10** A member's determination of whether information is appropriately disclosed by the taxpayer should be based on the facts and circumstances of the particular case and the authorities regarding disclosure in the applicable taxing jurisdiction. If a member recommending a position, but not engaged to prepare or sign the related tax return, advises the taxpayer concerning appropriate disclosure of the position, then the member shall be deemed to meet these standards.

**.11** If particular facts and circumstances lead a member to believe that a taxpayer penalty might be asserted, the member should so advise the taxpayer

and should discuss with the taxpayer the opportunity to avoid such penalty by disclosing the position on the tax return. Although a member should advise the taxpayer with respect to disclosure, it is the taxpayer's responsibility to decide whether and how to disclose.

**.12** For purposes of this Statement, preparation of a tax return includes giving advice on events that have occurred at the time the advice is given if the advice is directly relevant to determining the existence, character, or amount of a schedule, entry, or other portion of a tax return.

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## TS Section 9100

### ***Tax Return Positions: Tax Services Interpretations of Section 100***

#### **1-1. Realistic Possibility Standard**

##### ***Background***

**.01** Statement on Standards for Tax Services (SSTS) No. 1, *Tax Return Positions* [section 100], contains the standards a member should follow in recommending tax return positions and in preparing or signing tax returns. In general, a member should have a good-faith belief that the tax return position being recommended has a realistic possibility of being sustained administratively or judicially on its merits, if challenged. The standard contained in SSTS No. 1, paragraph 2a [section 100.02a], is referred to here as the realistic possibility standard. If a member concludes that a tax return position does not meet the realistic possibility standard:

- a. The member may still recommend the position to the taxpayer if the position is not frivolous, and the member recommends appropriate disclosure of the position; or
- b. The member may still prepare or sign a tax return containing the position, if the position is not frivolous, and the position is appropriately disclosed.

**.02** A *frivolous position* is one that is knowingly advanced in bad faith and is patently improper (see SSTS No. 1, paragraph 9 [section 100.09]). A member's determination of whether information is appropriately disclosed on a tax return or claim for refund is based on the facts and circumstances of the particular case and the authorities regarding disclosure in the applicable jurisdiction (see SSTS No. 1, paragraph 10 [section 100.10]).

**.03** If a member believes there is a possibility that a tax return position might result in penalties being asserted against a taxpayer, the member should so advise the taxpayer and should discuss with the taxpayer the opportunity, if any, of avoiding such penalties through disclosure (see SSTS No. 1, paragraph 11 [section 100.11]). Such advice may be given orally.

##### ***General Interpretation***

**.04** To meet the realistic possibility standard, a member should have a good-faith belief that the position is warranted by existing law or can be supported by a good-faith argument for an extension, modification, or reversal of the existing law through the administrative or judicial process. Such a belief should be based on reasonable interpretations of the tax law. A member should not take into account the likelihood of audit or detection when determining whether this standard has been met (see SSTS No. 1, paragraphs 3a and 8 [section 100.03a and .08]).

**.05** The realistic possibility standard is less stringent than the substantial authority standard and the more likely than not standard that apply under the Internal Revenue Code (IRC) to substantial understatements of liability by taxpayers. The realistic possibility standard is stricter than the reasonable basis standard that is in the IRC.

**.06** In determining whether a tax return position meets the realistic possibility standard, a member may rely on authorities in addition to those evaluated when determining whether substantial authority exists under IRC section 6662. Accordingly, a member may rely on well-reasoned treatises, articles in recognized professional tax publications, and other reference tools and sources of tax analyses commonly used by tax advisers and preparers of returns.

**.07** In determining whether a realistic possibility exists, a member should do all of the following:

- Establish relevant background facts
- Distill the appropriate questions from those facts
- Search for authoritative answers to those questions
- Resolve the questions by weighing the authorities uncovered by that search
- Arrive at a conclusion supported by the authorities

**.08** A member should consider the weight of each authority to conclude whether a position meets the realistic possibility standard. In determining the weight of an authority, a member should consider its persuasiveness, relevance, and source. Thus, the type of authority is a significant factor. Other important factors include whether the facts stated by the authority are distinguishable from those of the taxpayer and whether the authority contains an analysis of the issue or merely states a conclusion.

**.09** The realistic possibility standard may be met despite the absence of certain types of authority. For example, a member may conclude that the realistic possibility standard has been met when the position is supported only by a well-reasoned construction of the applicable statutory provision.

**.10** In determining whether the realistic possibility standard has been met, the extent of research required is left to the professional judgment of the member with respect to all the facts and circumstances known to the member. A member may conclude that more than one position meets the realistic possibility standard.

### ***Specific Illustrations***

**.11** The following illustrations deal with general fact patterns. Accordingly, the application of the guidance discussed in the General Interpretation section to variations in such general facts or to particular facts or circumstances may lead to different conclusions. In each illustration there is no authority other than that indicated.

**.12** *Illustration 1*—A taxpayer has engaged in a transaction that is adversely affected by a new statutory provision. Prior law supports a position favorable to the taxpayer. The taxpayer believes, and the member concurs, that the new statute is inequitable as applied to the taxpayer's situation. The statute is constitutional, clearly drafted, and unambiguous. The legislative history discussing the new statute contains general comments that do not specifically address the taxpayer's situation.

**.13** *Conclusion*—The member should recommend the return position supported by the new statute. A position contrary to a constitutional, clear, and unambiguous statute would ordinarily be considered a frivolous position.

**.14 Illustration 2**—The facts are the same as in Illustration 1 except that the legislative history discussing the new statute specifically addresses the taxpayer's situation and supports a position favorable to the taxpayer.

**.15 Conclusion**—In a case where the statute is clearly and unambiguously against the taxpayer's position but a contrary position exists based on legislative history specifically addressing the taxpayer's situation, a return position based either on the statutory language or on the legislative history satisfies the realistic possibility standard.

**.16 Illustration 3**—The facts are the same as in Illustration 1 except that the legislative history can be interpreted to provide some evidence or authority in support of the taxpayer's position; however, the legislative history does not specifically address the situation.

**.17 Conclusion**—In a case where the statute is clear and unambiguous, a contrary position based on an interpretation of the legislative history that does not explicitly address the taxpayer's situation does not meet the realistic possibility standard. However, because the legislative history provides some support or evidence for the taxpayer's position, such a return position is not frivolous. A member may recommend the position to the taxpayer if the member also recommends appropriate disclosure.

**.18 Illustration 4**—A taxpayer is faced with an issue involving the interpretation of a new statute. Following its passage, the statute was widely recognized to contain a drafting error, and a technical correction proposal has been introduced. The taxing authority issues a pronouncement indicating how it will administer the provision. The pronouncement interprets the statute in accordance with the proposed technical correction.

**.19 Conclusion**—Return positions based on either the existing statutory language or the taxing authority pronouncement satisfy the realistic possibility standard.

**.20 Illustration 5**—The facts are the same as in Illustration 4 except that no taxing authority pronouncement has been issued.

**.21 Conclusion**—In the absence of a taxing authority pronouncement interpreting the statute in accordance with the technical correction, only a return position based on the existing statutory language will meet the realistic possibility standard. A return position based on the proposed technical correction may be recommended if it is appropriately disclosed, since it is not frivolous.

**.22 Illustration 6**—A taxpayer is seeking advice from a member regarding a recently amended statute. The member has reviewed the statute, the legislative history that specifically addresses the issue, and a recently published notice issued by the taxing authority. The member has concluded in good faith that, based on the statute and the legislative history, the taxing authority's position as stated in the notice does not reflect legislative intent.

**.23 Conclusion**—The member may recommend the position supported by the statute and the legislative history because it meets the realistic possibility standard.

**.24 Illustration 7**—The facts are the same as in Illustration 6 except that the taxing authority pronouncement is a temporary regulation.

**.25 Conclusion**—In determining whether the position meets the realistic possibility standard, a member should determine the weight to be given the regulation by analyzing factors such as whether the regulation is legislative or



interpretative, or if it is inconsistent with the statute. If a member concludes that the position does not meet the realistic possibility standard, because it is not frivolous, the position may nevertheless be recommended if the member also recommends appropriate disclosure.

**.26 Illustration 8**—A tax form published by a taxing authority is incorrect, but completion of the form as published provides a benefit to the taxpayer. The member knows that the taxing authority has published an announcement acknowledging the error.

**.27 Conclusion**—In these circumstances, a return position in accordance with the published form is a frivolous position.

**.28 Illustration 9**—A taxpayer wants to take a position that a member has concluded is frivolous. The taxpayer maintains that even if the taxing authority examines the return, the issue will not be raised.

**.29 Conclusion**—The member should not consider the likelihood of audit or detection when determining whether the realistic possibility standard has been met. The member should not prepare or sign a return that contains a frivolous position even if it is disclosed.

**.30 Illustration 10**—A statute is passed requiring the capitalization of certain expenditures. The taxpayer believes, and the member concurs, that to comply fully, the taxpayer will need to acquire new computer hardware and software and implement a number of new accounting procedures. The taxpayer and member agree that the costs of full compliance will be significantly greater than the resulting increase in tax due under the new provision. Because of these cost considerations, the taxpayer makes no effort to comply. The taxpayer wants the member to prepare and sign a return on which the new requirement is simply ignored.

**.31 Conclusion**—The return position desired by the taxpayer is frivolous, and the member should neither prepare nor sign the return.

**.32 Illustration 11**—The facts are the same as in Illustration 10 except that a taxpayer has made a good-faith effort to comply with the law by calculating an estimate of expenditures to be capitalized under the new provision.

**.33 Conclusion**—In this situation, the realistic possibility standard has been met. When using estimates in the preparation of a return, a member should refer to SSTS No. 4, *Use of Estimates* [section 400].

**.34 Illustration 12**—On a given issue, a member has located and weighed two authorities concerning the treatment of a particular expenditure. A taxing authority has issued an administrative ruling that required the expenditure to be capitalized and amortized over several years. On the other hand, a court opinion permitted the current deduction of the expenditure. The member has concluded that these are the relevant authorities, considered the source of both authorities, and concluded that both are persuasive and relevant.

**.35 Conclusion**—The realistic possibility standard is met by either position.

**.36 Illustration 13**—A tax statute is silent on the treatment of an item under the statute. However, the legislative history explaining the statute directs the taxing authority to issue regulations that will require a specific treatment of the item. No regulations have been issued at the time the member must recommend a position on the tax treatment of the item.

**.37 Conclusion**—The member may recommend the position supported by the legislative history because it meets the realistic possibility standard.

**.38 Illustration 14**—A taxpayer wants to take a position that a member concludes meets the realistic possibility standard based on an assumption regarding an underlying nontax legal issue. The member recommends that the taxpayer seek advice from its legal counsel, and the taxpayer's attorney gives an opinion on the nontax legal issue.

**.39 Conclusion**—A member may in general rely on a legal opinion on a non-tax legal issue. A member should, however, use professional judgment when relying on a legal opinion. If, on its face, the opinion of the taxpayer's attorney appears to be unreasonable, unsubstantiated, or unwarranted, a member should consult his or her attorney before relying on the opinion.

**.40 Illustration 15**—A taxpayer has obtained from its attorney an opinion on the tax treatment of an item and requests that a member rely on the opinion.

**.41 Conclusion**—The authorities on which a member may rely include well-reasoned sources of tax analysis. If a member is satisfied about the source, relevance, and persuasiveness of the legal opinion, a member may rely on that opinion when determining whether the realistic possibility standard has been met.

[Issue Date: August, 2000.]

## 1-2. Tax Planning

### **Background**

**.42** SSTs are enforceable standards that govern the conduct of members of the AICPA in tax practice. A significant area of many members' tax practices involves assisting taxpayers in tax planning. Two of the eight SSTs issued as of the date of this Interpretation's release directly set forth standards that affect the most common activities in tax planning. Several other SSTs set forth standards related to specific factual situations that may arise while a member is assisting a taxpayer in tax planning. The two SSTs that are most typically relevant to tax planning are SSTS No. 1, *Tax Return Positions* [section 100], including Interpretation No. 1-1, "Realistic Possibility Standard" (paragraphs .01–.41), and SSTS No. 8, *Form and Content of Advice to Taxpayers* [section 800].

**.43** Taxing authorities, courts, the AICPA, and other professional organizations have struggled with defining and regulating *tax shelters* and *abusive transactions*. Crucial to the debate is the difficulty of clearly distinguishing between transactions that are abusive and transactions that are legitimate. At the same time, it must be recognized that taxpayers have a legitimate interest in arranging their affairs so as to pay no more than the taxes they owe. It must be recognized that tax professionals, including members, have a role to play in advancing these efforts.

**.44** This Interpretation is part of the AICPA's continuing efforts at self-regulation of its members in tax practice. It has its origins in the AICPA's desire to provide adequate guidance to its members when providing services in connection with tax planning. The Interpretation does not change or elevate any level of conduct prescribed by any standard. Its goal is to clarify existing standards. It was determined that there was a compelling need for a comprehensive Interpretation of a member's responsibilities in connection with *tax planning*, with the recognition that such guidance would clarify how those standards would apply across the spectrum of tax planning, including those situations involving *tax shelters*, regardless of how that term is defined.

### **General Interpretation**

**.45** The realistic possibility standard (see SSTS No. 1, paragraph 2a [section 100.02a], and Interpretation No. 1–1 [paragraphs .01–.41]) applies to a member when providing professional services that involve *tax planning*. A member may still recommend a nonfrivolous position provided that the member recommends appropriate disclosure (see SSTS No. 1, paragraph 2c [section 100.02c]).

**.46** For purposes of this Interpretation, *tax planning* includes, both with respect to prospective and completed transactions, recommending or expressing an opinion (whether written or oral) on (a) a tax return position or (b) a specific tax plan developed by the member, the taxpayer, or a third party.

**.47** When issuing an opinion to reflect the results of the tax planning service, a member should do all of the following:

- Establish the relevant background facts.
- Consider the reasonableness of the assumptions and representations.
- Apply the pertinent authorities to the relevant facts.
- Consider the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction.
- Arrive at a conclusion supported by the authorities.

**.48** In assisting a taxpayer in a tax planning transaction in which the taxpayer has obtained an opinion from a third party, and the taxpayer is looking to the member for an evaluation of the opinion, the member should be satisfied as to the source, relevance, and persuasiveness of the opinion, which would include considering whether the opinion indicates the third party did all of the following:

- Established the relevant background facts
- Considered the reasonableness of the assumptions and representations
- Applied the pertinent authorities to the relevant facts
- Considered the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction
- Arrived at a conclusion supported by the authorities

**.49** In conducting the due diligence necessary to establish the relevant background facts, the member should consider whether it is appropriate to rely on an assumption concerning facts in lieu of either other procedures to support the advice or a representation from the taxpayer or another person. A member should also consider whether the member's tax advice will be communicated to third parties, particularly if those third parties may not be knowledgeable or may not be receiving independent tax advice with respect to a transaction.

**.50** In tax planning, members often rely on assumptions and representations. Although such reliance is often necessary, the member must take care to assess whether such assumptions and representations are reasonable. In deciding whether an assumption or representation is reasonable, the member should consider its source and consistency with other information known to the member. For example, depending on the circumstances, it may be reasonable for a member to rely on a representation made by the taxpayer, but not on a representation made by a person who is selling or otherwise promoting the transaction to the taxpayer.

**.51** When engaged in tax planning, the member should understand the business purpose and economic substance of the transaction when relevant to the tax consequences. If a transaction has been proposed by a party other than the taxpayer, the member should consider whether the assumptions made by the third party are consistent with the facts of the taxpayer's situation. If written advice is to be rendered concerning a transaction, the business purpose for the transaction generally should be described. If the business reasons are relevant to the tax consequences, it is insufficient to merely assume that a transaction is entered into for valid business reasons without specifying what those reasons are.

**.52** The scope of the engagement should be appropriately determined. A member should be diligent in applying such procedures as are appropriate under the circumstances to understand and evaluate the entire transaction. The specific procedures to be performed in this regard will vary with the circumstances and the scope of the engagement.

### ***Specific Illustrations***

**.53** The following illustrations address general fact patterns. Accordingly, the application of the guidance discussed in the "General Interpretation" section to variations in such general facts or to particular facts or circumstances may lead to different conclusions. In each illustration, there is no authority other than that indicated.

**.54 *Illustration 1***—The relevant tax code imposes penalties on substantial underpayments that are not associated with tax shelters as defined in such code unless the associated positions are supported by substantial authority.

**.55 *Conclusion***—In assisting the taxpayer in tax planning in which any associated underpayment would be substantial, the member should inform the taxpayer of the penalty risks associated with the tax return position recommended with respect to any plan under consideration that satisfies the realistic possibility of success standard, but does not possess sufficient authority to satisfy the substantial authority standard.

**.56 *Illustration 2***—The relevant tax code imposes penalties on tax shelters, as defined in such code, unless the taxpayer concludes that a position taken on a tax return associated with such a tax shelter is, more likely than not, the correct position.

**.57 *Conclusion***—In assisting the taxpayer in tax planning, the member should inform the taxpayer of the penalty risks associated with the tax return position recommended with respect to any plan under consideration that satisfies the realistic possibility of success standard, but does not possess sufficient authority to satisfy the more likely than not standard.

**.58 *Illustration 3***—The relevant tax regulation provides that the details of (or certain information regarding) a specific transaction are required to be attached to the tax return, regardless of the support for the associated tax return position (for example, even if there is substantial authority or a higher level of comfort for the position). While preparing the taxpayer's return for the year, the member is aware that an attachment is required.

**.59 *Conclusion***—In general, if the taxpayer agrees to include the attachment required by the regulation, the member may sign the return if the member concludes the associated tax return position satisfies the realistic possibility standard. However, if the taxpayer refuses to include the attachment, the member should not sign the return, unless the member concludes the

associated tax return position satisfies the realistic possibility standard and there are reasonable grounds for the taxpayer's position with respect to the attachment. In this regard, the member should consider SSTS No. 2, *Answers to Questions on Returns*, paragraphs 1 and 5, [section 200.01 and .05], which provides that the term *questions*, as used in the standard, "includes requests for information on the return, in the instructions, or in the regulations, whether or not stated in the form of a question," and that a "member should not omit an answer merely because it might prove disadvantageous to a taxpayer."

**.60 Illustration 4**—The relevant tax regulations provide that the details of certain potentially abusive transactions that are designated as "listed transactions" are required to be disclosed in attachments to tax returns, regardless of the support for the associated tax return position (for example, even if there is substantial authority or a higher level of support for the position). Under the regulations, if a listed transaction is not disclosed as required, the taxpayer will have additional penalty risks. While researching the tax consequences of a proposed transaction, a member concludes that the transaction is a listed transaction.

**.61 Conclusion**—Notwithstanding the member's conclusion that the transaction is a listed transaction, the member may still recommend a tax return position with respect to the transaction if he or she concludes that the proposed tax return position satisfies the realistic possibility standard. However, the member should inform the taxpayer of the enhanced disclosure requirements of listed transactions and the additional penalty risks for nondisclosure.

**.62 Illustration 5**—The same regulations apply as in Illustration 4. The member first becomes aware that a taxpayer entered into a transaction while preparing the taxpayer's return for the year of the transaction. While researching the tax consequences of the transaction, the member concludes that the taxpayer's transaction is a listed transaction.

**.63 Conclusion**—The member should inform the taxpayer of the enhanced disclosure requirement and the additional penalty risks for nondisclosure. If the taxpayer agrees to make the disclosure required by the regulation, the member may sign the return if the member concludes the associated tax return position satisfies the realistic possibility standard. Reasonable grounds for nondisclosure (see the conclusion to Illustration 3) generally are not present for a listed transaction. The member should not sign the return if the transaction is not disclosed. If the member is a nonsigning preparer of the return, the member should recommend that the taxpayer disclose the transaction.

**.64 Illustration 6**—The same regulations apply as in Illustration 4. The member first becomes aware that a taxpayer entered into a transaction while preparing the taxpayer's return for the year of the transaction. While researching the tax consequences of the transaction, the member concludes that there is uncertainty about whether the taxpayer's transaction is a listed transaction.

**.65 Conclusion**—The member should inform the taxpayer of the enhanced disclosure requirement and the additional penalty risks for nondisclosure. If the taxpayer agrees to make the disclosure required by the relevant regulation, the member may sign the return if the member concludes the associated tax return position satisfies the realistic possibility standard. If the taxpayer does not want to disclose the transaction because of the uncertainty about whether it is a listed transaction, the member may sign the return if the

member concludes the associated tax return position satisfies the realistic possibility standard and there are reasonable grounds for the taxpayer's position with regard to nondisclosure. In this regard, the member should consider SSTS No. 2, paragraph 4 [section 200.04], which indicates that the degree of uncertainty regarding the meaning of a question on a return may affect whether there are reasonable grounds for not responding to the question.

**.66 Illustration 7**—A member advises a taxpayer concerning the tax consequences of a transaction involving a loan from a U.S. bank. In the process of reviewing documents associated with the proposed transaction, the member uncovers a reference to a deposit that a wholly owned foreign subsidiary of the taxpayer will make with an overseas branch of the U.S. bank. The transaction documents appear to indicate that this deposit is linked to the U.S. bank's issuance of the loan.

**.67 Conclusion**—The member should consider the effect, if any, of the deposit in advising the taxpayer about the tax consequences of the proposed transaction.

**.68 Illustration 8**—Under the relevant tax law, the tax consequences of a leasing transaction depend on whether the property to be leased is reasonably expected to have a residual value of 15 percent of its value at the beginning of the lease. The member has relied on a taxpayer's instruction to use a particular assumption concerning the residual value.

**.69 Conclusion**—Such reliance on the taxpayer's instructions may be appropriate if the assumption is supported by the expertise of the taxpayer, by the member's review of information provided by the taxpayer or a third party, or through the member's own knowledge or analysis.

**.70 Illustration 9**—A member is assisting a taxpayer with evaluating a proposed equipment leasing transaction in which the estimated residual value of the equipment at the end of the lease term is critical to the tax consequences of the lease. The broker arranging the leasing transaction has prepared an analysis that sets out an explicit assumption concerning the equipment's estimated residual value.

**.71 Conclusion**—The member should consider whether it is appropriate to rely on the broker's assumption concerning the estimated residual value of the equipment instead of obtaining a representation from the broker concerning estimated residual value or performing other procedures to validate the amount to be used as an estimate of residual value in connection with the member's advice. In considering the appropriateness of the broker's assumption, the member should consider, for example, factors such as the broker's experience in the area, the broker's methodology, and whether alternative sources of information are reasonably available.

**.72 Illustration 10**—The tax consequences of a particular reorganization depend, in part, on the majority shareholder of a corporation not disposing of any stock received in the reorganization pursuant to a prearranged agreement to dispose of the stock.

**.73 Conclusion**—The member should consider whether it is appropriate in rendering tax advice to assume that such a disposition will not occur or whether, under the circumstances, it is appropriate to request a written representation of the shareholder's intent concerning disposition as a condition to issuing an opinion on the reorganization.

**.74 Illustration 11**—A taxpayer is considering a proposed transaction. The taxpayer and the taxpayer's attorney advise the member that the member is responsible for advising the taxpayer on the tax consequences of the transaction.

**.75 Conclusion**—In addition to complying with the requirements of paragraph .47, the member generally should review all relevant draft transaction documents in formulating the member's tax advice relating to the transaction.

**.76 Illustration 12**—A member is responsible for advising a taxpayer on the tax consequences of the taxpayer's estate plan.

**.77 Conclusion**—Under the circumstances, the member should review the will and all other relevant documents to assess whether there appear to be any tax issues raised by the formulation or implementation of the estate plan.

**.78 Illustration 13**—A member is assisting a taxpayer in connection with a proposed transaction that has been recommended by an investment bank. To support its recommendation, the investment bank offers a law firm's opinion on the tax consequences. The member reads the opinion, and notes that it is based on a hypothetical statement of facts rather than the taxpayer's facts.

**.79 Conclusion**—The member may rely on the law firm's opinion when determining whether the realistic possibility standard has been satisfied with respect to the tax consequences of the hypothetical transaction if the member is satisfied about the source, relevance, and persuasiveness of the opinion. However, the member should be diligent in taking such steps as are appropriate under the circumstances to understand and evaluate the transaction as it applies to the taxpayer's specific situation by:

- Establishing the relevant background facts
- Considering the reasonableness of the assumptions and representations
- Applying the pertinent authorities to the relevant facts
- Considering the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction (Mere reliance on a representation that there is business purpose or economic substance is generally insufficient.)
- Arriving at a conclusion supported by the authorities

**.80 Illustration 14**—The facts are the same as in Illustration 13 except the member also notes that the law firm that prepared the opinion is one that has a reputation as being knowledgeable about the tax issues associated with the proposed transaction.

**.81 Conclusion**—The conclusion is the same as the conclusion to Illustration 13, notwithstanding the expertise of the law firm.

**.82 Illustration 15**—A member is assisting a taxpayer in connection with a proposed transaction that has been recommended by an investment bank. To support that recommendation, the investment bank offers a law firm's opinion about the tax consequences. The member reads the opinion, and notes that (unlike the opinions described in Illustrations 13 and 14), it is carefully tailored to the taxpayer's facts.

**.83 Conclusion**—The member may rely on the opinion when determining whether the realistic possibility standard has been met with respect to the taxpayer's participation in the transaction if the member is satisfied about the source, relevance, and persuasiveness of the opinion. In making that determination, the member should consider whether the opinion indicates the law firm did all of the following:

- Established the relevant background facts
- Considered the reasonableness of the assumptions and representations

- Applied the pertinent authorities to the relevant facts
- Considered the business purpose and economic substance of the transaction, if relevant to the tax consequences of the transaction (Mere reliance on a representation that there is business purpose or economic substance is generally insufficient.)
- Arrived at a conclusion supported by the authorities

**.84 Illustration 16**—The facts are the same as in Illustration 15, except the member also notes that the law firm that prepared the opinion is one that has a reputation of being knowledgeable about the tax issues associated with the proposed transaction.

**.85 Conclusion**—The conclusion is the same as the conclusion to Illustration 15, notwithstanding the expertise of the law firm.

**.86 Illustration 17**—A member is assisting a taxpayer with year-end planning in connection with the taxpayer's proposed contribution of stock in a closely held corporation to a charitable organization. The taxpayer instructs the member to calculate the anticipated tax liability assuming a contribution of 10,000 shares to a tax-exempt organization assuming the stock has a fair market value of \$100 per share. The member is aware that on the taxpayer's gift tax returns for the prior year, the taxpayer indicated that her stock in the corporation was worth \$50 per share.

**.87 Conclusion**—The member's calculation of the anticipated tax liability is subject to the general interpretations described in paragraphs .49 and .50. Accordingly, even though this potentially may be a case in which the value of the stock substantially appreciated during the year, the member should consider the reasonableness of the assumption and consistency with other information known to the member in connection with preparing the projection. The member should consider whether to document discussions concerning the increase in value of the stock with the taxpayer.

**.88 Illustration 18**—The tax consequences to Target Corporation's shareholders of an acquisition turn in part on Acquiring Corporation's continuance of the trade or business of Target Corporation for some time after the acquisition. The member is preparing a tax opinion addressed to Target's shareholders. A colleague has drafted a tax opinion for the member's review. That opinion makes an explicit assumption that Acquiring will continue Target's business for two years following the acquisition.

**.89 Conclusion**—In conducting the due diligence necessary to establish the relevant background facts, the member should consider whether it is appropriate to rely on an assumption concerning facts in lieu of a representation from another person. In this case, the member should make reasonable efforts to obtain a representation from Acquiring Corporation concerning its plan to continue Target's business and further consider whether to request a written representation to that effect.

**.90 Illustration 19**—The member receives a telephone call from a taxpayer who is the sole shareholder of a corporation. The taxpayer indicates that he is thinking about exchanging his stock in the corporation for stock in a publicly traded business. During the call, the member explains how the transaction should be structured so it will qualify as a tax-free acquisition.

**.91 Conclusion**—Although oral advice may serve a taxpayer's needs appropriately in routine matters or in well-defined areas, written communications are recommended in important, unusual, or complicated transactions. The member should use professional judgment about the need to document oral advice.



**.92** *Illustration 20*—The member receives a telephone call from a taxpayer who wants to know whether he or she should lease or purchase a car. During the call, the member explains how the arrangement should be structured so as to help achieve the taxpayer's objectives.

**.93** *Conclusion*—In this situation, the member's response is in conformity with this Interpretation in view of the routine nature of the inquiry and the well-defined tax issues. However, the member should evaluate whether other considerations, such as avoiding misunderstanding with the taxpayer, suggest that the conversation should be documented.

[Issue Date: December, 2003.]

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## TS Section 200

# Answers to Questions on Returns

Issue date, unless  
otherwise indicated:  
August, 2000

### Introduction

**.01** This Statement sets forth the applicable standards for members when signing the preparer's declaration on a tax return if one or more questions on the return have not been answered. The term *questions* includes requests for information on the return, in the instructions, or in the regulations, whether or not stated in the form of a question.

### Statement

**.02** A member should make a reasonable effort to obtain from the taxpayer the information necessary to provide appropriate answers to all questions on a tax return before signing as preparer.

### Explanation

**.03** It is recognized that the questions on tax returns are not of uniform importance, and often they are not applicable to the particular taxpayer. Nevertheless, there are at least two reasons why a member should be satisfied that a reasonable effort has been made to obtain information to provide appropriate answers to the questions on the return that are applicable to a taxpayer.

- a.* A question may be of importance in determining taxable income or loss, or the tax liability shown on the return, in which circumstance an omission may detract from the quality of the return.
- b.* A member often must sign a preparer's declaration stating that the return is true, correct, and complete.

**.04** Reasonable grounds may exist for omitting an answer to a question applicable to a taxpayer. For example, reasonable grounds may include the following:

- a.* The information is not readily available and the answer is not significant in terms of taxable income or loss, or the tax liability shown on the return.
- b.* Genuine uncertainty exists regarding the meaning of the question in relation to the particular return.
- c.* The answer to the question is voluminous; in such cases, a statement should be made on the return that the data will be supplied upon examination.

**.05** A member should not omit an answer merely because it might prove disadvantageous to a taxpayer.

**.06** If reasonable grounds exist for omission of an answer to an applicable question, a taxpayer is not required to provide on the return an explanation of the reason for the omission. In this connection, a member should consider whether the omission of an answer to a question may cause the return to be deemed incomplete.

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**TS Section 300*****Certain Procedural Aspects of  
Preparing Returns***

**Issue date, unless  
otherwise indicated:  
August, 2000**

**Introduction**

**.01** This Statement sets forth the applicable standards for members concerning the obligation to examine or verify certain supporting data or to consider information related to another taxpayer when preparing a taxpayer's tax return.

**Statement**

**.02** In preparing or signing a return, a member may in good faith rely, without verification, on information furnished by the taxpayer or by third parties. However, a member should not ignore the implications of information furnished and should make reasonable inquiries if the information furnished appears to be incorrect, incomplete, or inconsistent either on its face or on the basis of other facts known to a member. Further, a member should refer to the taxpayer's returns for one or more prior years whenever feasible.

**.03** If the tax law or regulations impose a condition with respect to deductibility or other tax treatment of an item, such as taxpayer maintenance of books and records or substantiating documentation to support the reported deduction or tax treatment, a member should make appropriate inquiries to determine to the member's satisfaction whether such condition has been met.

**.04** When preparing a tax return, a member should consider information actually known to that member from the tax return of another taxpayer if the information is relevant to that tax return and its consideration is necessary to properly prepare that tax return. In using such information, a member should consider any limitations imposed by any law or rule relating to confidentiality.

**Explanation**

**.05** The preparer's declaration on a tax return often states that the information contained therein is true, correct, and complete to the best of the preparer's knowledge and belief based on all information known by the preparer. This type of reference should be understood to include information furnished by the taxpayer or by third parties to a member in connection with the preparation of the return.

**.06** The preparer's declaration does not require a member to examine or verify supporting data. However, a distinction should be made between (a) the need either to determine by inquiry that a specifically required condition, such

as maintaining books and records or substantiating documentation, has been satisfied or to obtain information when the material furnished appears to be incorrect or incomplete and (b) the need for a member to examine underlying information. In fulfilling his or her obligation to exercise due diligence in preparing a return, a member may rely on information furnished by the taxpayer unless it appears to be incorrect, incomplete, or inconsistent. Although a member has certain responsibilities in exercising due diligence in preparing a return, the taxpayer has the ultimate responsibility for the contents of the return. Thus, if the taxpayer presents unsupported data in the form of lists of tax information, such as dividends and interest received, charitable contributions, and medical expenses, such information may be used in the preparation of a tax return without verification unless it appears to be incorrect, incomplete, or inconsistent either on its face or on the basis of other facts known to a member.

**.07** Even though there is no requirement to examine underlying documentation, a member should encourage the taxpayer to provide supporting data where appropriate. For example, a member should encourage the taxpayer to submit underlying documents for use in tax return preparation to permit full consideration of income and deductions arising from security transactions and from pass-through entities, such as estates, trusts, partnerships, and S corporations.

**.08** The source of information provided to a member by a taxpayer for use in preparing the return is often a pass-through entity, such as a limited partnership, in which the taxpayer has an interest but is not involved in management. A member may accept the information provided by the pass-through entity without further inquiry, unless there is reason to believe it is incorrect, incomplete, or inconsistent, either on its face or on the basis of other facts known to the member. In some instances, it may be appropriate for a member to advise the taxpayer to ascertain the nature and amount of possible exposure to tax deficiencies, interest, and penalties, by contact with management of the pass-through entity.

**.09** A member should make use of a taxpayer's returns for one or more prior years in preparing the current return whenever feasible. Reference to prior returns and discussion of prior-year tax determinations with the taxpayer should provide information to determine the taxpayer's general tax status, avoid the omission or duplication of items, and afford a basis for the treatment of similar or related transactions. As with the examination of information supplied for the current year's return, the extent of comparison of the details of income and deduction between years depends on the particular circumstances.

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## TS Section 400

### *Use of Estimates*

Issue date, unless  
otherwise indicated:  
August, 2000

#### Introduction

**.01** This Statement sets forth the applicable standards for members when using the taxpayer's estimates in the preparation of a tax return. A member may advise on estimates used in the preparation of a tax return, but the taxpayer has the responsibility to provide the estimated data. Appraisals or valuations are not considered estimates for purposes of this Statement.

#### Statement

**.02** Unless prohibited by statute or by rule, a member may use the taxpayer's estimates in the preparation of a tax return if it is not practical to obtain exact data and if the member determines that the estimates are reasonable based on the facts and circumstances known to the member. If the taxpayer's estimates are used, they should be presented in a manner that does not imply greater accuracy than exists.

#### Explanation

**.03** Accounting requires the exercise of professional judgment and, in many instances, the use of approximations based on judgment. The application of such accounting judgments, as long as not in conflict with methods set forth by a taxing authority, is acceptable. These judgments are not estimates within the purview of this Statement. For example, a federal income tax regulation provides that if all other conditions for accrual are met, the exact amount of income or expense need not be known or ascertained at year end if the amount can be determined with reasonable accuracy.

**.04** When the taxpayer's records do not accurately reflect information related to small expenditures, accuracy in recording some data may be difficult to achieve. Therefore, the use of estimates by a taxpayer in determining the amount to be deducted for such items may be appropriate.

**.05** When records are missing or precise information about a transaction is not available at the time the return must be filed, a member may prepare a tax return using a taxpayer's estimates of the missing data.

**.06** Estimated amounts should not be presented in a manner that provides a misleading impression about the degree of factual accuracy.

**.07** Specific disclosure that an estimate is used for an item in the return is not generally required; however, such disclosure should be made in unusual

circumstances where nondisclosure might mislead the taxing authority regarding the degree of accuracy of the return as a whole. Some examples of unusual circumstances include the following:

- a.* A taxpayer has died or is ill at the time the return must be filed.
  - b.* A taxpayer has not received a Schedule K-1 for a pass-through entity at the time the tax return is to be filed.
  - c.* There is litigation pending (for example, a bankruptcy proceeding) that bears on the return.
  - d.* Fire or computer failure has destroyed the relevant records.
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## TS Section 500

# ***Departure From a Position Previously Concluded in an Administrative Proceeding or Court Decision***

Issue date, unless  
otherwise indicated:  
August, 2000

### **Introduction**

**.01** This Statement sets forth the applicable standards for members in recommending a tax return position that departs from the position determined in an administrative proceeding or in a court decision with respect to the taxpayer's prior return.

**.02** For purposes of this Statement, *administrative proceeding* also includes an examination by a taxing authority or an appeals conference relating to a return or a claim for refund.

**.03** For purposes of this Statement, *court decision* means a decision by any court having jurisdiction over tax matters.

### **Statement**

**.04** The tax return position with respect to an item as determined in an administrative proceeding or court decision does not restrict a member from recommending a different tax position in a later year's return, unless the taxpayer is bound to a specified treatment in the later year, such as by a formal closing agreement. Therefore, as provided in Statement on Standards for Tax Services (SSTS) No. 1, *Tax Return Positions* [section 100], the member may recommend a tax return position or prepare or sign a tax return that departs from the treatment of an item as concluded in an administrative proceeding or court decision with respect to a prior return of the taxpayer.

### **Explanation**

**.05** If an administrative proceeding or court decision has resulted in a determination concerning a specific tax treatment of an item in a prior year's return, a member will usually recommend this same tax treatment in subsequent years. However, departures from consistent treatment may be justified under such circumstances as the following:

- a.* Taxing authorities tend to act consistently in the disposition of an item that was the subject of a prior administrative proceeding but generally are not bound to do so. Similarly, a taxpayer is not bound to follow the tax treatment of an item as consented to in an earlier administrative proceeding.



- b.* The determination in the administrative proceeding or the court's decision may have been caused by a lack of documentation. Supporting data for the later year may be appropriate.
- c.* A taxpayer may have yielded in the administrative proceeding for settlement purposes or not appealed the court decision, even though the position met the standards in SSTS No. 1 [section 100].
- d.* Court decisions, rulings, or other authorities that are more favorable to a taxpayer's current position may have developed since the prior administrative proceeding was concluded or the prior court decision was rendered.

**.06** The consent in an earlier administrative proceeding and the existence of an unfavorable court decision are factors that the member should consider in evaluating whether the standards in SSTS No. 1 [section 100] are met.

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## TS Section 600

# Knowledge of Error: Return Preparation

Issue date, unless  
otherwise indicated:  
August, 2000

### Introduction

**.01** This Statement sets forth the applicable standards for a member who becomes aware of an error in a taxpayer's previously filed tax return or of a taxpayer's failure to file a required tax return. As used herein, the term error includes any position, omission, or method of accounting that, at the time the return is filed, fails to meet the standards set out in Statement on Standards for Tax Services (SSTS) No. 1, *Tax Return Positions* [section 100]. The term *error* also includes a position taken on a prior year's return that no longer meets these standards due to legislation, judicial decisions, or administrative pronouncements having retroactive effect. However, an error does not include an item that has an insignificant effect on the taxpayer's tax liability.

**.02** This Statement applies whether or not the member prepared or signed the return that contains the error.

### Statement

**.03** A member should inform the taxpayer promptly upon becoming aware of an error in a previously filed return or upon becoming aware of a taxpayer's failure to file a required return. A member should recommend the corrective measures to be taken. Such recommendation may be given orally. The member is not obligated to inform the taxing authority, and a member may not do so without the taxpayer's permission, except when required by law.

**.04** If a member is requested to prepare the current year's return and the taxpayer has not taken appropriate action to correct an error in a prior year's return, the member should consider whether to withdraw from preparing the return and whether to continue a professional or employment relationship with the taxpayer. If the member does prepare such current year's return, the member should take reasonable steps to ensure that the error is not repeated.

### Explanation

**.05** While performing services for a taxpayer, a member may become aware of an error in a previously filed return or may become aware that the taxpayer failed to file a required return. The member should advise the taxpayer of the error and the measures to be taken. Such recommendation may be given orally. If the member believes that the taxpayer could be charged with fraud or other criminal misconduct, the taxpayer should be advised to consult legal counsel before taking any action.

**.06** It is the taxpayer's responsibility to decide whether to correct the error. If the taxpayer does not correct an error, a member should consider whether to continue a professional or employment relationship with the taxpayer. While recognizing that the taxpayer may not be required by statute to correct an error by filing an amended return, a member should consider whether a taxpayer's decision not to file an amended return may predict future behavior that might require termination of the relationship. The potential for violating Code of Professional Conduct rule 301 [ET section 301.01] (relating to the member's confidential client relationship), the tax law and regulations, or laws on privileged communications, and other considerations may create a conflict between the member's interests and those of the taxpayer. Therefore, a member should consider consulting with his or her own legal counsel before deciding upon recommendations to the taxpayer and whether to continue a professional or employment relationship with the taxpayer.

**.07** If a member decides to continue a professional or employment relationship with the taxpayer and is requested to prepare a tax return for a year subsequent to that in which the error occurred, the member should take reasonable steps to ensure that the error is not repeated. If the subsequent year's tax return cannot be prepared without perpetuating the error, the member should consider withdrawal from the return preparation. If a member learns that the taxpayer is using an erroneous method of accounting and it is past the due date to request permission to change to a method meeting the standards of SSTS No. 1 [section 100], the member may sign a tax return for the current year, providing the tax return includes appropriate disclosure of the use of the erroneous method.

**.08** Whether an error has no more than an insignificant effect on the taxpayer's tax liability is left to the professional judgment of the member based on all the facts and circumstances known to the member. In judging whether an erroneous method of accounting has more than an insignificant effect, a member should consider the method's cumulative effect and its effect on the current year's tax return.

**.09** If a member becomes aware of the error while performing services for a taxpayer that do not involve tax return preparation, the member's responsibility is to advise the taxpayer of the existence of the error and to recommend that the error be discussed with the taxpayer's tax return preparer. Such recommendation may be given orally.

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## TS Section 700

# Knowledge of Error: Administrative Proceedings

Issue date, unless  
otherwise indicated:  
August, 2000

### Introduction

**.01** This Statement sets forth the applicable standards for a member who becomes aware of an error in a return that is the subject of an administrative proceeding, such as an examination by a taxing authority or an appeals conference. The term *administrative proceeding* does not include a criminal proceeding. As used herein, the term *error* includes any position, omission, or method of accounting that, at the time the return is filed, fails to meet the standards set out in Statement on Standards for Tax Services (SSTS) No. 1, *Tax Return Positions* [section 100]. The term *error* also includes a position taken on a prior year's return that no longer meets these standards due to legislation, judicial decisions, or administrative pronouncements having retroactive effect. However, an error does not include an item that has an insignificant effect on the taxpayer's tax liability.

**.02** This Statement applies whether or not the member prepared or signed the return that contains the error. Special considerations may apply when a member has been engaged by legal counsel to provide assistance in a matter relating to the counsel's client.

### Statement

**.03** If a member is representing a taxpayer in an administrative proceeding with respect to a return that contains an error of which the member is aware, the member should inform the taxpayer promptly upon becoming aware of the error. The member should recommend the corrective measures to be taken. Such recommendation may be given orally. A member is neither obligated to inform the taxing authority nor allowed to do so without the taxpayer's permission, except where required by law.

**.04** A member should request the taxpayer's agreement to disclose the error to the taxing authority. Lacking such agreement, the member should consider whether to withdraw from representing the taxpayer in the administrative proceeding and whether to continue a professional or employment relationship with the taxpayer.

### Explanation

**.05** When the member is engaged to represent the taxpayer before a taxing authority in an administrative proceeding with respect to a return containing an error of which the member is aware, the member should advise

the taxpayer to disclose the error to the taxing authority. Such recommendation may be given orally. If the member believes that the taxpayer could be charged with fraud or other criminal misconduct, the taxpayer should be advised to consult legal counsel before taking any action.

**.06** It is the taxpayer's responsibility to decide whether to correct the error. If the taxpayer does not correct an error, a member should consider whether to withdraw from representing the taxpayer in the administrative proceeding and whether to continue a professional or employment relationship with the taxpayer. While recognizing that the taxpayer may not be required by statute to correct an error by filing an amended return, a member should consider whether a taxpayer's decision not to file an amended return may predict future behavior that might require termination of the relationship. Moreover, a member should consider consulting with his or her own legal counsel before deciding on recommendations to the taxpayer and whether to continue a professional or employment relationship with the taxpayer. The potential for violating Code of Professional Conduct rule 301 [ET section 301.01] (relating to the member's confidential client relationship), the tax law and regulations, laws on privileged communications, potential adverse impact on a taxpayer of a member's withdrawal, and other considerations may create a conflict between the member's interests and those of the taxpayer.

**.07** Once disclosure is agreed on, it should not be delayed to such a degree that the taxpayer or member might be considered to have failed to act in good faith or to have, in effect, provided misleading information. In any event, disclosure should be made before the conclusion of the administrative proceeding.

**.08** Whether an error has an insignificant effect on the taxpayer's tax liability is left to the professional judgment of the member based on all the facts and circumstances known to the member. In judging whether an erroneous method of accounting has more than an insignificant effect, a member should consider the method's cumulative effect and its effect on the return that is the subject of the administrative proceeding.

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## TS Section 800

# *Form and Content of Advice to Taxpayers*

Issue date, unless  
otherwise indicated:  
August, 2000

### Introduction

**.01** This Statement sets forth the applicable standards for members concerning certain aspects of providing advice to a taxpayer and considers the circumstances in which a member has a responsibility to communicate with a taxpayer when subsequent developments affect advice previously provided. The Statement does not, however, cover a member's responsibilities when the expectation is that the advice rendered is likely to be relied on by parties other than the taxpayer.

### Statement

**.02** A member should use judgment to ensure that tax advice provided to a taxpayer reflects professional competence and appropriately serves the taxpayer's needs. A member is not required to follow a standard format or guidelines in communicating written or oral advice to a taxpayer.

**.03** A member should assume that tax advice provided to a taxpayer will affect the manner in which the matters or transactions considered would be reported on the taxpayer's tax returns. Thus, for all tax advice given to a taxpayer, a member should follow the standards in Statement on Standards for Tax Services (SSTS) No. 1, *Tax Return Positions* [section 100].

**.04** A member has no obligation to communicate with a taxpayer when subsequent developments affect advice previously provided with respect to significant matters, except while assisting a taxpayer in implementing procedures or plans associated with the advice provided or when a member undertakes this obligation by specific agreement.

### Explanation

**.05** Tax advice is recognized as a valuable service provided by members. The form of advice may be oral or written and the subject matter may range from routine to complex. Because the range of advice is so extensive and because advice should meet the specific needs of a taxpayer, neither a standard format nor guidelines for communicating or documenting advice to the taxpayer can be established to cover all situations.

**.06** Although oral advice may serve a taxpayer's needs appropriately in routine matters or in well-defined areas, written communications are recommended in important, unusual, or complicated transactions. The member may use professional judgment about whether, subsequently, to document oral advice in writing.

**.07** In deciding on the form of advice provided to a taxpayer, a member should exercise professional judgment and should consider such factors as the following:

- a.* The importance of the transaction and amounts involved
- b.* The specific or general nature of the taxpayer's inquiry
- c.* The time available for development and submission of the advice
- d.* The technical complications presented
- e.* The existence of authorities and precedents
- f.* The tax sophistication of the taxpayer
- g.* The need to seek other professional advice

**.08** A member may assist a taxpayer in implementing procedures or plans associated with the advice offered. When providing such assistance, the member should review and revise such advice as warranted by new developments and factors affecting the transaction.

**.09** Sometimes a member is requested to provide tax advice but does not assist in implementing the plans adopted. Although such developments as legislative or administrative changes or future judicial interpretations may affect the advice previously provided, a member cannot be expected to communicate subsequent developments that affect such advice unless the member undertakes this obligation by specific agreement with the taxpayer.

**.10** Taxpayers should be informed that advice reflects professional judgment based on an existing situation and that subsequent developments could affect previous professional advice. Members may use precautionary language to the effect that their advice is based on facts as stated and authorities that are subject to change.

**.11** In providing tax advice, a member should be cognizant of applicable confidentiality privileges.

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## TS Section 900

## Appendix: Cross-Reference of Previous and Revised Statements

<i>Previous Statement No.</i>	<i>Previous Section</i>	<i>Changes</i>	<i>1988 Revised Section</i>	<i>2000 Revised Section</i>
1	111	Withdrawn 1982	—	
2	121	Withdrawn 1982	—	
3	131	Superseded by Statement No. 2, August 1988	122	
3	131	Superseded by Statement No. 2, August 2000		200
4	141	Superseded by Statement No. 5, August 1988	152	
4	141	Superseded by Statement No. 5, August 2000		500
5	151	Superseded by Statement No. 4, August 1988	142	
5	151	Superseded by Statement No. 4, August 2000		400
6	161	Superseded by Statement No. 6, August 1988; Revised May 1991	162	
6	161	Superseded by Statement No. 6, August 2000		600
7	171	Superseded by Statement No. 7, August 1988; Revised May 1991	172	
7	171	Superseded by Statement No. 7, August 2000		700
8	181	Superseded by Statement No. 8, August 1988	182	
8	181	Superseded by Statement No. 8, August 2000		800
9	191	Superseded by Statement No. 3, August 1988	132	
9	191	Superseded by Statement No. 3, August 2000		300



<i>Previous Statement No.</i>	<i>Previous Section</i>	<i>Changes</i>	<i>1988 Revised Section</i>	<i>2000 Revised Section</i>
10	201	Superseded by Statement No. 1, August 1988	112	
10	201	Superseded by Statement No. 1, August 2000		100

---

# TS TOPICAL INDEX

References are to TS section and paragraph numbers.

## A

### ADMINISTRATIVE PROCEEDINGS

- Contrary Tax Return Positions ..... 500.01-06
- Definition ..... 500.02; 700.01
- Disclosure of an Error ..... 700.04-06
- Errors ..... 700.01-08
- Realistic Possibility Standard ..... 9100.01-41

### ADVICE TO CLIENTS

- Alternative Acceptable Positions ..... 100.08
- Communication of Significant Developments ..... 800.09
- Corrections on Return ..... 600.03-05; 700.03-05
- Discovery of Error in Non-Tax Engagements ..... 600.08
- Errors Subject to Administrative Proceedings ..... 700.03-05
- Factors to Consider ..... 800.07
- Follow-Up on Advice ..... 800.08
- Form and Content ..... 800.01-11
- Judgment ..... 800.02; 800.06-07; 800.10
- Legal Consultation ..... 600.05; 700.05
- Oral Communications ..... 800.04-07
- Precautionary Statements ..... 800.10
- Subsequent Developments ..... 800.01-11
- Tax Planning ..... 9100.42-93
- Tax Return Positions ..... 100.08; 100.10-11; 9100.01-41
- Written Communications ..... 800.04-07

### ANSWERS TO QUESTIONS—See Questions on Returns

## C

### CLIENTS

- Advice—See Advice to Clients
- Disclosure of Error to IRS ..... 700.04-06
- Errors on Tax Returns ..... 600.01-09
- Errors Subject to Administrative Proceedings ..... 700.01-08
- Estimates on Tax Returns ..... 400.01-07
- Failure to File Return ..... 600.01-09
- Information Furnished to Member ..... 300.02; 300.07
- Position Contrary to Member's Advice ..... 100.09
- Prior Year's Returns ..... 300.02; 300.09
- Responsibility for Return ..... 100.05-06; 100.11; 300.06; 400.01; 600.06; 700.06

### CLIENTS—continued

- Tax Return Position Contrary to Administrative Proceedings ..... 500.01-05
- Tax Return Position Recommendations ..... 100.02-04

### COMMUNICATION

- Privileged—See Confidential Client Information

### CONFIDENTIAL CLIENT INFORMATION

- Information Related to Another Client ..... 300.04

### COURT DECISIONS

- Contrary Tax Return Positions ..... 500.01-05
- Definition ..... 500.03

## D

### DATA

- Examination of Supporting Data ..... 300.01-02; 300.05-07

### DECISIONS

- Court—See Court Decisions

### DECLARATIONS

- Reliance on Client's Information ..... 300.05-06

### DEFINITIONS—See Terminology

### DISCLOSURE

- Errors on Tax Returns ..... 700.04-06
- Estimates ..... 400.07
- Tax Planning ..... 9100.42-93
- Tax Return Positions ..... 100.02; 100.09-11; 9100.01-41

### DUE PROFESSIONAL CARE

- Information Supplied by Client to Member ..... 300.06

## E

### ERRORS

- Advice to Clients ..... 600.03; 600.05; 700.03-05
- Applicability of Statement of Member's Responsibility ..... 600.02; 700.02
- Communication to IRS ..... 600.03; 700.03
- Definition ..... 600.01; 700.01
- Disclosure ..... 700.04-06
- Effect on Tax Liability ..... 600.08; 700.08
- Knowledge of Error ..... 600.01-09; 700.01-08
- Subject of Administrative Proceedings ..... 700.01-08

References are to TS section and paragraph numbers.

**ESTIMATION**

- Disclosure ..... 400.07
- Judgment ..... 400.03
- Tax Returns ..... 400.01-.07
- Transactions Involving Small Expenditures ..... 400.04
- Unavailable Data ..... 400.05

**EVENTS**

- Subsequent—See Subsequent Events

**EXPENSES**

- Estimates on Returns ..... 400.04

**F****FRIVOLOUS POSITION**

- Realistic Possibility Standard ..... 9100.01-.41

**I****ILLUSTRATIONS**

- Realistic Possibility Standard ..... 9100.01-.41
- Tax Planning ..... 9100.53-.93

**INCOME TAX RETURNS—See Tax Returns****INTERNAL REVENUE CODE**

- Member's Treatment of Conditions Imposed by Tax Regulations ..... 300.03

**INTERNAL REVENUE SERVICE**

- Administrative Proceeding ..... 500.02; 700.05
- Communication of Errors ..... 600.03; 700.03

**J****JUDGMENT**

- Advice to Clients ..... 800.02; 800.06-.07; 800.10
- Effect of Error on Tax Liability ..... 600.08; 700.08
- Legal Opinion ..... 9100.01-.41
- Realistic Possibility Standard ..... 9100.01-.41
- Use of Estimates ..... 400.03

**JUDICIAL PROCEEDINGS**

- Realistic Possibility Standard ..... 9100.01-.41

**M****MEMBERS**

- Applicability of Statement on Responsibility ..... 600.02; 700.02
- Client's Failure to File Tax Return ..... 600.01-.09
- Client's Information Provided by a Pass-Through Entity ..... 300.08
- Communication of Errors ..... 600.03; 700.03
- Communication of Significant Developments Affecting Previous Advice ..... 800.09

**MEMBERS—continued**

- Conditions Imposed by Tax Regulations ..... 300.03
- Contrary Tax Return Positions ..... 100.02; 100.09
- Discovery of Error in Non-Tax Engagement ..... 600.08
- Error on Client's Tax Return ..... 600.01-.09
- Errors Subject to Administrative Proceedings ..... 700.01-.08
- Estimates on Tax Returns ..... 400.01-.07
- Examination of Supporting Data ..... 300.01-.02; 300.05-.07
- Follow-Up on Advice to Clients ..... 800.08
- Information Related to Another Client ..... 300.01; 300.04
- Litigation Support Services ..... 700.02
- Procedural Aspects of Preparing Returns ..... 300.01-.09
- Reliance on Client's Information ..... 300.02; 300.05-.06
- Responsibilities ..... 100.04; 100.06; 300.06; 600.09
- Signatures—See Signatures
- Subsequent Developments Affecting Advice ..... 800.01-.11
- Support for Tax Return Positions ..... 100.07
- Tax Planning ..... 9100.42-.93
- Tax Return Positions ..... 100.01-.12; 9100.01-.41
- Tax Return Positions Contrary to Administrative Proceedings ..... 500.01-.05
- Unanswered Questions on Returns ..... 200.01-.06
- Use of Prior Year Return ..... 300.02; 300.09
- Withdrawal From Engagement ..... 600.04-.06; 700.04

**MISREPRESENTATION**

- Estimates on Return ..... 400.06-.07

**O****OPINIONS, MEMBER**

- Tax Planning ..... 9100.42-.93

**P****PENALTIES**

- Tax Return Positions ..... 100.02; 100.11; 9100.01-.41

**PREPARER'S DECLARATION—See Declarations**

References are to TS section and paragraph numbers.

**PRIOR YEAR RETURNS**

- Errors on Return ..... 600.01-09
- Tax Return Positions Contrary to Administrative Proceedings ..... 500.01-05
- Use in Preparing Tax Returns ..... 300.02; 300.09

**PRIVILEGED COMMUNICATION—See Confidential Client Information**

**Q**

**QUESTIONS ON RETURNS**

- Definition ..... 200.01
- Reasonable Grounds for Omission of Answers ..... 200.04-06
- Signature of Preparer ..... 200.01-03
- Unanswered Questions ..... 200.01-06

**R**

**REALISTIC POSSIBILITY STANDARD**

- Background ..... 9100.01-03
- Definition ..... 9100.01
- Frivolous Position ..... 9100.02
- General Interpretation ..... 9100.04-10
- Good-Faith Belief and Argument ..... 9100.01-41
- Illustrations ..... 9100.11-41
- Judgment ..... 9100.01-41
- Reliance on Authority ..... 9100.01-41
- Versus Reasonable Basis Standard ..... 9100.01-41
- Versus Substantial Authority Standard ..... 9100.01-41

**REASONABLE BASIS STANDARD**

- Versus Realistic Possibility Standard ..... 9100.01-41

**REGULATORY AGENCIES**

- Realistic Possibility Standard ..... 9100.01-41

**REPRESENTATIONS**

- Tax Planning ..... 9100.42-93

**S**

**SCOPE OF ENGAGEMENT**

- Tax Planning ..... 9100.42-93

**SIGNATURES**

- Evaluation of Tax Positions ..... 500.04
- Tax Returns ..... 100.02-04; 9100.01-41
- Unanswered Questions on Returns ..... 200.01-03

**SUBSEQUENT EVENTS**

- Advice to Clients ..... 800.01-11

**SUBSTANTIAL AUTHORITY STANDARD**

- Versus Realistic Possibility Standard . 9100.01-.41

**T**

**TAX PLANNING**

- Advice to Clients ..... 9100.42-93
- Assumptions ..... 9100.42-93
- Background ..... 9100.42-44
- Definition ..... 9100.46
- General Interpretation ..... 9100.45-52
- Illustrations ..... 9100.53-93
- Issuance of Opinion ..... 9100.42-93
- Representations ..... 9100.42-93
- Scope of Engagements ..... 9100.42-93
- Third Parties ..... 9100.42-93

**TAX RETURN POSITIONS**

- Advice to Clients ..... 100.08; 100.10-11; 9100.01-41
- Alternative Acceptable Positions ..... 100.08
- Client Asserts Position Against Member's Advice ..... 100.09
- Contrary Positions ..... 100.02; 100.09
- Contrary to Prior Administrative Proceeding ..... 500.01-05
- Contrary to Prior Year's Return ..... 500.04
- Definition ..... 100.01
- Disclosure ..... 100.02; 100.09-11; 9100.01-41
- Frivolous ..... 100.09; 9100.01-41
- Materiality ..... 100.01
- Penalties ..... 100.02; 100.11; 9100.01-41
- Realistic Possibility Standard ..... 100.02; 9100.01-41
- Recommendations to Client ..... 100.02-04; 9100.01-41
- Rights and Responsibilities ..... 100.04-05
- Settlement Negotiation ..... 100.03
- Support for Positions ..... 100.07
- Tax Planning ..... 9100.42-93

**TAX RETURNS**

- Conditions Imposed by Tax Regulations ..... 300.03
- Cumulative Effect of Error ... 600.08; 700.08
- Declaration of Preparer ..... 300.05-06
- Errors on Returns ..... 600.01-09
- Errors Subject to Administrative Proceedings ..... 700.01-08
- Estimates on Returns ..... 400.01-07
- Failure to File ..... 600.01-09
- Incomplete ..... 200.06
- Information Related to Another Client ..... 300.01; 300.04
- Preparation ..... 100.02-04; 100.12; 9100.01-41
- Prior Year—See Prior Year Returns
- Procedural Aspects of Preparing Returns ..... 300.01-09
- Responsibility of Client ..... 100.05; 100.11
- Signatures—See Signatures
- Supporting Data ..... 300.01-02; 300.05-08

References are to TS section and paragraph numbers.

**TAX RETURNS**—continued

- Tax Return Positions—See Tax Return Positions
- Unanswered Questions on Returns ..... 200.01-.06

**TAX SERVICES**

- Advice—See Advice to Clients
- Error on Client’s Return ..... 600.01-.09
- Estimates on Returns ..... 400.01-.07
- Misrepresentation—See Misrepresentation
- Tax Return Positions—See Tax Return Positions
- Unanswered Questions on Returns ..... 200.01-.06

**TERMINOLOGY**

- Administrative Proceedings ..... 500.02; 700.01
- Court Decision ..... 500.03
- Error ..... 600.01; 700.01
- Frivolous Position ..... 100.09; 9100.02
- Preparation of a Tax Return ..... 100.12
- Questions ..... 200.01
- Realistic Possibility Standard ..... 9100.01
- Tax Planning ..... 9100.46
- Tax Return Positions ..... 100.01
- Taxpayer ..... 100.01

**THIRD PARTIES**

- Tax Planning ..... 9100.42-93



## PFP Section

# PERSONAL FINANCIAL PLANNING

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## STATEMENTS ON RESPONSIBILITIES IN PERSONAL FINANCIAL PLANNING PRACTICE

Statements on Responsibilities in Personal Financial Planning Practice (SRFPs) are published for the guidance of members of the Institute and do not constitute enforceable standards under *Rule 202* of the AICPA Code of Professional Conduct. The Statements have been approved by at least two-thirds of the members of the Personal Financial Planning Executive Committee.

### TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
100	Basic Personal Financial Planning Engagement Functions and Responsibilities	.01-.23
	Definition and Scope of Personal Financial Planning .....	.01-.05
	Guidance Applicable to Personal Financial Planning Engagements .....	.06-.10
	Personal Financial Planning Engagements .....	.11-.19
	Defining the Engagement Objectives .....	.11-.13
	Planning the Specific Procedures Appropriate to the Engagement .....	.14
	Developing a Basis for Recommendations .....	.15-.16
	Communicating Recommendations .....	.17-.18
	Identifying the Tasks for Taking Action on Planning Decisions .....	.19
	Other Personal Financial Planning Services .....	.20-.23
	Assisting the Client to Take Action on Planning Decisions	.21
	Monitoring the Client's Progress in Achieving Goals ....	.22
	Updating Recommendations and Helping the Client Revise Planning Decisions .....	.23
200	Working With Other Advisers	.01-.15
	Introduction .....	.01-.03
	Working With Other Advisers in Personal Financial Planning Engagements .....	.04-.15

Section	Paragraph
200	Working With Other Advisers—continued
	Guidance Applicable to Working With Other Advisers ..... .04
	Engagement Scope Limitations ..... .05-09
	Recommending Other Advisers ..... .10-12
	Using Advice Provided by Other Advisers ..... .13-15
300	Implementation Engagement Functions and Responsibilities ..... .01-16
	Definition and Scope of Implementation ..... .01-04
	Implementation Engagements ..... .05-13
	Guidance Applicable to Implementation Engagements .. .05
	Planning the Engagement ..... .06-07
	Communicating With the Client ..... .08-09
	Establishing Selection Criteria ..... .10
	Participating in the Selection Process ..... .11
	Implementing Planning Decisions Developed by Others ..... .12-13
	Illustrations ..... .14
	Appendix A—Illustration: Implementation Involving Risk Management ..... .15
	Appendix B—Illustration: Implementation Involving Investment Planning ..... .16
400	Monitoring and Updating Engagements—Functions and Responsibilities ..... .01-20
	Definition and Scope of Monitoring and Updating ..... .01-05
	Guidance Applicable to Monitoring and Updating Engagements ..... .06-07
	Monitoring Engagements ..... .08-15
	Updating Engagements ..... .16-20
500	Developing a Basis for Recommendations ..... .01-21
	Definition and Scope ..... .01-04
	Guidance Applicable to Developing a Basis for Recommendations ..... .05-06
	Collecting Information ..... .07-11
	Analyzing Information ..... .12-16
	Formulating Strategies and Recommendations ..... .17-20
	Appendix—Excerpt From <i>Guide for Prospective Financial     Information</i> ..... .21

## PFP Section 100

# ***Basic Personal Financial Planning Engagement Functions and Responsibilities***

Issued October 1992  
unless otherwise  
indicated

## **Definition and Scope of Personal Financial Planning**

**.01** Personal financial planning engagements are only those that involve developing strategies and making recommendations to assist a client in defining and achieving personal financial goals.

**.02** Personal financial planning engagements involve all of the following:

- a. Defining the engagement objectives
- b. Planning the specific procedures appropriate to the engagement
- c. Developing a basis for recommendations
- d. Communicating recommendations to the client
- e. Identifying the tasks for taking action on planning decisions

**.03** Personal financial planning engagements may also include—

- a. Assisting the client to take action on planning decisions.
- b. Monitoring the client's progress in achieving goals.
- c. Updating recommendations and helping the client revise planning decisions.

**.04** Personal financial planning does not include services that are limited to, for example—

- a. Compiling personal financial statements.
- b. Projecting future taxes.
- c. Tax compliance, including, but not limited to, preparation of tax returns.
- d. Tax advice or consultations.

**.05** Personal financial planning engagements may address all of a client's personal financial goals or may focus on a limited number of goals. When an engagement addresses a limited number of specific personal financial goals, the CPA should consider the client's overall financial circumstances in developing recommendations.

## **Guidance Applicable to Personal Financial Planning Engagements**

**.06** The following is a summary of existing professional standards and published guidance applicable to personal financial planning engagements.



Other standards and guidance may apply depending on the scope of the services provided.

**.07** The CPA should act in conformity with the AICPA Code of Professional Conduct in all matters related to a personal financial planning engagement. The following is a partial list of the rules of the AICPA Code of Professional Conduct:

- a. Rule 102, *Integrity and Objectivity* [ET section 102.01]. A member shall maintain objectivity and integrity, be free of conflicts of interest, and not knowingly misrepresent facts or subordinate his or her judgment to others.
- b. Rule 201, *General Standards* [ET section 201.01]. A member shall undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence, shall exercise due professional care in the performance of professional services, shall adequately plan and supervise the performance of professional services, and shall obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations relating to any professional services performed.
- c. Rule 301, *Confidential Client Information* [ET section 301.01]. A member in public practice shall not disclose any confidential client information without the specific consent of the client.
- d. Rule 302, *Contingent Fees* [ET section 302.01]; Rule 503, *Commissions and Referral Fees* [ET section 503.01]. A member in public practice shall follow these rules in making fee arrangements.

**.08** Personal financial planning often involves providing tax advice. The Tax Division of the AICPA has published guidance on tax advice in Statement on Responsibilities in Tax Practice (SRTP) No. 8, *Form and Content of Advice to Clients*. In addition to the Statements on Responsibilities in Personal Financial Planning Practice, CPAs should consider the guidance in SRTP No. 8 when personal financial planning activities involve tax advice. Other tax-related matters may also come to the CPA's attention in the course of providing personal financial planning services. Additional guidance on these matters may be found in other SRTPs.

**.09** When a personal financial planning engagement includes providing assistance in the preparation of personal financial statements or financial projections, the CPA should consider the applicable provisions of AICPA pronouncements, including—

- a. Statements on Standards for Accounting and Review Services [AR sections 100–600].
- b. Statement on Standards for Attestation Engagements No. 10, *Attestation Standards: Revision and Recodification*, chapter 3, *Financial Forecasts and Projections* [AT section 301].
- c. *Guide for Prospective Financial Information*.
- d. *Personal Financial Statements Guide*.

[Revised, January 2001, to reflect conforming changes necessary due to the issuance of Statement on Standards for Attestation Engagements No. 10. Revised, June 2009.]

.10 CPAs providing business valuation services as part of a personal financial planning engagement should consider the Statement on Standards for Consulting Services (SSCS), *Consulting Services: Definitions and Standards* [CS section 100].

## Personal Financial Planning Engagements

### Defining the Engagement Objectives

.11 The personal financial planning engagement includes defining the objectives of the engagement so that the CPA can determine the services needed. The CPA should—

- a. Obtain an understanding of the client's goals and resources in order to determine the appropriate scope of service that will meet the client's needs.
- b. Reach an understanding with the client concerning the engagement objectives. When the CPA identifies issues not originally considered by the client that may require special attention, those issues should be brought to the client's attention.
- c. Evaluate the appropriateness of the original engagement objectives as the engagement proceeds.

.12 The CPA should obtain an understanding of matters such as the client's family situation, commitment to the planning process, current cash flow and assets available, personal preferences, and relationships with other professionals. This understanding can be obtained through knowledge gained during a long-term relationship with the client, inquiry, and information gathering.

.13 The CPA should document his or her understanding of the scope and nature of the services to be provided. Such documentation could be in the form of an engagement letter or in the form of file memos that document oral understandings. This documentation may include a description of (a) engagement objectives; (b) the scope of services to be provided; (c) the roles and responsibilities of the CPA, the client, and other advisers in the personal financial planning process; (d) the fee arrangements; and (e) scope limitations and other constraints.

### Planning the Specific Procedures Appropriate to the Engagement

.14 The personal financial planning engagement should be adequately planned. The engagement's objectives form the basis for planning the engagement. The procedures should produce information that is useful in making planning recommendations. Procedures should be selected that are appropriate in the circumstances and reflect materiality and cost-benefit considerations. The CPA should document personal financial planning engagements in a manner that—

- a. Shows that a systematic approach to the engagement was taken.
- b. Shows that the analysis and other procedures performed provide an adequate basis for the recommendations made.

## Developing a Basis for Recommendations

**.15** Personal financial planning engagements involve collecting, analyzing, and integrating sufficient relevant information to develop a basis for recommendations. Relevant information may include, but is not limited to, an understanding of the client's goals, existing financial situation, the available resources for achieving the goals, nonfinancial factors, and external factors. Relevant information may also include reasonable estimates, projections, and assumptions furnished by the client, provided by the client's advisers, or developed by the CPA.

**.16** In personal financial planning, some information deals with the future, which is uncertain. Planning may also involve a broad range of goals, which may change as events occur. Consequently, the CPA may develop recommendations based on several selected hypothetical events.

## Communicating Recommendations

**.17** The CPA should communicate recommendations to the client in a manner that assists the client in evaluating strategies and implementing financial planning decisions. Such communications should ordinarily be in writing and include a summary of the client's goals and significant assumptions, a description of any limitations on the work performed, the recommendations made, and a statement that projected results may not be achieved.

**.18** The following is an illustration of a communication when recommendations are made only on selected goals and the CPA communicates the parameters of the limited engagement.

We have considered ways to achieve your goal of providing for the education of your children. However, you have instructed us not to consider other planning areas that might have an impact on that goal. If we had done so, it is possible that different conclusions or recommendations might have resulted.

## Identifying the Tasks for Taking Action on Planning Decisions

**.19** The CPA should assist clients to identify tasks that are essential in order to act on planning decisions. The CPA may also assist the client to set target dates for the completion of tasks and identify parties responsible for completing them.

## Other Personal Financial Planning Services

**.20** Unless undertaken by specific agreement with the client, the CPA is not responsible for additional services. Such services include—

- Assisting the client to take action on planning decisions.
- Monitoring progress in achieving goals.
- Updating recommendations and revising planning decisions.

## Assisting the Client to Take Action on Planning Decisions

**.21** The CPA should have an understanding with the client, preferably in writing, regarding the degree of responsibility he or she will assume for helping the client to act upon planning decisions.

### **Monitoring the Client's Progress in Achieving Goals**

**.22** A CPA is not responsible for monitoring the client's progress in achieving goals unless the CPA undertakes this obligation by specific agreement with the client.

### **Updating Recommendations and Helping the Client Revise Planning Decisions**

**.23** A CPA is not responsible for updating recommendations unless the CPA undertakes this obligation by specific agreement with the client. The agreement should identify the scope of the CPA's responsibility for updating the plan and proposing new actions.

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## PFP Section 200

# Working With Other Advisers

First Issued October  
1993; Revised  
January 1996

### Introduction

**.01** This section is intended to provide guidance to the CPA who uses the work of other advisers in performing a personal financial planning engagement.

**.02** Personal financial planning engagements may require the CPA to interact with other advisers. Such interaction includes, but is not limited to, the following:

- a. The CPA may use advice provided by others in developing recommendations for a client. Some advice will suggest that action be taken, other advice will provide information.
- b. The CPA may refer a client to other advisers who assist the client in securing products or services that have been identified in the personal financial planning engagement.
- c. The CPA may refer a client to advisers who provide services in areas in which the CPA either does not practice, or chooses not to practice, in a specific engagement.

**.03** Circumstances in which the CPA may use the advice of other advisers or refer a client to other advisers include those in which there is a need for specialized expertise outside the scope of the CPA's practice and for services or products for which the CPA is not a licensed provider.

## Working With Other Advisers in Personal Financial Planning Engagements

### Guidance Applicable to Working With Other Advisers

**.04** The CPA should apply existing applicable professional standards and should consider the guidance included in other published Statements on Responsibilities in Personal Financial Planning Practice (SRFPs).<sup>1</sup>

### Engagement Scope Limitations

**.05** If the CPA does not provide a service needed to complete an engagement, he or she should restrict the scope of the engagement and recommend that the client engage another adviser who provides the needed service.

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<sup>1</sup> Refer to paragraphs 6 through 10 of SRFP No. 1, *Basic Personal Financial Planning Engagement Functions and Responsibilities* [section 100.06–.10], for a discussion of applicable standards and guidance.

**.06** If the client declines to engage another adviser, the CPA and the client may still agree to proceed with the engagement.

**.07** In such situations, the CPA should communicate to the client any limitation on the scope of the engagement, as well as the fact that this limitation could affect the conclusions and recommendations developed in the engagement. Such communication should ordinarily be in writing. The CPA should refer to SRPFP No. 1, *Basic Personal Financial Planning Engagement Functions and Responsibilities*, paragraphs 5 and 18 [section 100.05 and .18], for further guidance when the engagement is limited in scope.

**.08** For example, in the CPA's judgment, a valuation of a client's business may be appropriate to complete a personal financial planning engagement; however, undertaking such a valuation may be beyond the CPA's expertise and the client may be unwilling to incur the additional cost of an outside appraiser. The CPA and the client may therefore agree that the CPA will complete the personal financial planning engagement and develop planning recommendations using the client's estimate of the value of the business.

**.09** The following is an illustration of a communication in the event that limitations are placed on the scope of information considered in the personal financial planning engagement.

At your request, an independent valuation of your business has not been obtained. Such a valuation may have affected the conclusions reached in your financial plan.

## Recommending Other Advisers

**.10** The CPA should become satisfied concerning the professional qualifications and reputation of another adviser before referring the client to that adviser. The CPA should consider information such as the following:

- a. The CPA's previous experience in working with the adviser
- b. The professional certification or license or other recognition of the competence of the adviser in his or her field
- c. The reputation and standing of the adviser in the views of the adviser's peers and others who have worked with the adviser
- d. The adviser's relationship, if any, with the client

**.11** When recommending another adviser to a client, the CPA should communicate to the client the nature of the work to be performed by the other adviser and the extent to which the CPA will evaluate that work. Such communication should ordinarily be in writing.

**.12** The following is an illustration of a communication in the event that the CPA recommends that the client engage an attorney to take action on recommendations developed in the personal financial planning engagement.

As we discussed, you should consult an attorney to prepare updated will provisions. We have provided you with the names of several attorneys whose professional credentials and reputations are familiar to us. The selection of an attorney is your decision. Our referral does not constitute an endorsement of these attorneys or of any advice they may render.

## Using Advice Provided by Other Advisers

**.13** When the CPA uses the opinions of another adviser in completing the personal financial planning engagement, the CPA should understand and evaluate the adviser's opinions and the procedures used to develop them. If the CPA concurs with the other adviser's opinions, he or she need not communicate this concurrence to the client.

**.14** If the CPA uses the other adviser's opinions in the engagement without evaluating these opinions, he or she should communicate that fact to the client. Such communication should ordinarily be in writing.

**.15** The following are illustrations of communications for instances in which the CPA uses the advice or opinion of another adviser in a personal financial planning engagement.

- a.* An appraisal provided by an outside appraiser is incorporated into a client's personal financial plan and the CPA has not evaluated the appraiser's opinion.

We have used the ABC Company's estimate of the value of your real estate in developing your financial plan. We have not evaluated their estimate and do not accept responsibility for it. If a different value were used, different recommendations may have resulted.

- b.* An insurance agent has recommended that the client purchase a specific life insurance policy and the CPA, by agreement with the client, has not evaluated the agent's recommendation.

Bob Jones, CLU, has recommended that you purchase a specific life insurance policy. As agreed, we have not evaluated this recommendation and do not accept responsibility for it.

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## PFP Section 300

# Implementation Engagement Functions and Responsibilities

First Issued October  
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### Definition and Scope of Implementation

**.01** Implementation engagements are those that involve assisting the client to take action on planning decisions developed during the personal financial planning engagement described in Statement on Responsibilities in Personal Financial Planning Practice (SRPFP) No. 1, *Basic Personal Financial Planning Engagement Functions and Responsibilities* [section 100]. Implementation includes activities such as selecting investment advisers, restructuring debt, creating estate documents, establishing cash reserves, preparing budgets, and selecting and acquiring specific investments and insurance products.

**.02** This section is intended to address only those situations in which the CPA is engaged by a client to assist in implementation activities. This section does not extend to those situations in which the CPA is functioning in a fiduciary or an agency relationship.<sup>1</sup>

**.03** The CPA may be engaged at one or more of the following levels to assist the client to take action on planning decisions:

- a. The CPA may refer the client to other advisers (see SRPFP No. 2, *Working With Other Advisers* [section 200]).
- b. The CPA may coordinate and/or review the delivery of services and/or products by other advisers (see SRPFP No. 2 [section 200]).
- c. The CPA may participate in implementation by establishing selection criteria.
- d. The CPA may participate in implementation by participating in the selection of service providers and/or the selection and acquisition of products.<sup>2</sup>

**.04** Implementation is typically completed when products are acquired or services are rendered in accordance with the recommendations developed during the personal financial planning engagement.

### Implementation Engagements

#### Guidance Applicable to Implementation Engagements

**.05** The CPA may be engaged to assist the client to take action on planning decisions. When undertaking an implementation engagement, the CPA

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<sup>1</sup> Agency and fiduciary relationships are defined by state law.

<sup>2</sup> CPAs advising clients on the selection or acquisition of products (such as investments or insurance policies) should determine whether they meet the qualifications and licensing requirements established by applicable federal and state laws.

should apply existing applicable professional standards and should consider the guidance included in other published SRPFPs.<sup>3</sup>

## Planning the Engagement

**.06** Implementation engagements vary in complexity and scope, as well as in the level of assistance to be provided by the CPA. The CPA and the client should identify and agree on the level of the CPA's assistance in implementation. Regardless of the level of assistance, implementation decisions are made by the client, not by the CPA.

**.07** The CPA should document his or her understanding of the nature and scope of the implementation services to be provided and the roles and responsibilities of the CPA, the client, and other advisers. The CPA should refer to SRPFP No. 1, paragraphs 13 and 14 [section 100.13-.14], for additional guidance.

## Communicating With the Client

**.08** The CPA should communicate information and recommendations to the client in a manner that assists the client in understanding the nature and scope of services performed by the CPA in an implementation engagement. Such communication ordinarily should be in writing and include a summary of the planning decisions being implemented, recommended actions to be taken, and a description of limitations on the work performed in the engagement and the results of the engagement.

**.09** The following is an illustration of a communication in the event that a client instructs the CPA not to consider certain investment options (for example, limited partnerships) in developing implementation recommendations for funding a retirement plan.

We have evaluated investment alternatives available to fund your retirement plan. However, you have instructed us not to consider limited partnerships as an investment alternative. If we had done so, it is possible that we would have recommended a different investment strategy.

## Establishing Selection Criteria

**.10** The CPA who is engaged to establish selection criteria should identify those attributes or other specifications that are required to accomplish the client's objectives, subject to any constraints that result from the client's circumstances. Selection criteria may be expressed in ranges if the CPA and the client agree that such practice is useful. Since it is not always possible to secure products or services that exactly match the established selection criteria, the CPA should assist the client in prioritizing attributes so that available alternatives can be compared.

## Participating in the Selection Process

**.11** When the CPA is engaged to participate in selecting and acquiring products, the CPA should gather data that provides a reasonable basis for

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<sup>3</sup> Refer to paragraphs 6 through 10 of SRPFP No. 1, *Basic Personal Financial Planning Engagement Functions and Responsibilities* [section 100.06-.10], for a discussion of applicable standards and guidance.

determining whether the alternatives meet the selection criteria. Upon analyzing this information, the CPA may communicate to the client his or her evaluation of all alternatives that the CPA recommends for action.

## Implementing Planning Decisions Developed by Others

**.12** The CPA may be engaged to assist the client in taking action on planning decisions developed in a personal financial planning engagement in which the CPA did not participate. For example, the planning decisions may have been developed by another adviser or by the client acting alone. The CPA might also be asked to assist the client in developing more specific selection criteria or exploring issues related to each planning decision, other than those established in the personal financial planning engagement.

**.13** In situations such as these, the CPA should obtain a sufficient understanding of the planning decisions to effectively assist in implementation. To obtain such an understanding, the CPA should consider factors such as the client's goals, existing financial situation, the available resources for achieving the goals, nonfinancial factors, and external factors. Relevant information may also include estimates, projections, and assumptions.

## Illustrations

**.14** Appendixes A and B [paragraphs .15 and .16] contain illustrations of possible procedures to be followed by the CPA who is engaged by a client to assist in implementing a personal financial planning decision. In each example, the initial personal financial planning engagement is presumed to have been completed before implementation, either by the CPA in the illustration or another adviser.

.15

## Appendix A

### Illustration: Implementation Involving Risk Management

#### Background

1. The CPA is engaged to assist a client in taking action on a planning decision that disability insurance be purchased. The CPA has the expertise to advise the client regarding the selection of disability insurance.

#### Communication

2. To assist the client in understanding the implementation decision-making process, the CPA should review with the client the disability coverage identified in the personal financial planning engagement, including options such as loss of earnings coverage, definition of occupation, coverage amounts, and exclusion periods.

#### Strategy Development and Product Selection

##### *Planning the Engagement*

3. The CPA and the client should agree on whether the CPA, the client, or another adviser is responsible for identifying available insurance products and carriers and clearly define who is responsible for reviewing the proposals provided by the solicited insurance carriers. A schedule of required actions should be developed that includes how and when the actions will take place.

- a. When selecting insurance professionals, reference should be made to SRPFP No. 2 [section 200].
- b. The rest of this illustration assumes that the CPA is responsible for identifying the appropriate insurance products and carriers and reviewing the proposals provided.

##### *Establishing Selection Criteria*

4. The CPA should identify the characteristics of disability insurance products that meet the criteria identified in the personal financial planning engagement. These characteristics generally include the following:

- a. Appropriate protection levels, considering factors such as the amount of coverage needed, how disability is defined, the waiting period to receive benefits, partial disability coverage, and duration of benefits
- b. Optional coverage conditions, such as cost-of-living adjustments, guaranteed insurability riders, and waiver of premium riders
- c. Minimum quality standards for disability coverage, generally based on the insurer's financial stability

##### *Participating in the Selection Process*

5. The CPA should identify and solicit proposals from insurance carriers whose disability products meet the established criteria.

6. When selecting a specific disability insurance product, the CPA should review and discuss with the client the financial stability of the company providing coverage and determine that the policy meets the following criteria:

- a. The client's goals, as identified in the personal financial planning engagement, are satisfied.
- b. The policy is cost effective when compared to other insurance company proposals received.
- c. The insurance carrier has demonstrated a commitment to servicing the disability market.

## Documentation

7. The CPA should document meetings, discussions, or other contacts with the client and indicate the decisions regarding responsibilities for actions and product selections and the results of reviewing proposals from various insurance carriers. The CPA may supplement such documentation by indicating when the application was filled out, insurance coverage bound, and the policy issued. The CPA may also document any insurability issues and the ultimate resolution of those issues.

## Appendix B

### Illustration: Implementation Involving Investment Planning

#### Background

1. The CPA is engaged to assist a client in structuring an investment portfolio to take action on a planning decision that funds be invested to provide for the client's postretirement needs. The CPA has the expertise to advise the client regarding investment planning.

#### Communication

2. To assist the client in understanding the implementation decision-making process, the CPA should review with the client financial strategies, investment constraints, asset allocations, and rate of return goals identified in the personal financial plan or the investment policy statement.

#### Strategy Development and Product Selection

##### *Planning the Engagement*

3. The CPA and the client should agree on whether the CPA, the client, or another adviser is responsible for identifying available investment alternatives and clearly define who is responsible for reviewing prospectuses, partnership agreements, offering documents, and other such reports. A schedule of required actions, including how, when, and where these actions will take place, should be developed.

- a. Other advisers may include money managers (private and public, such as mutual fund managers), general partners of partnerships, investment bankers, and stockbrokers. When selecting other advisers, reference should be made to SRPFP No. 2 [section 200].
- b. The rest of this illustration assumes that the CPA is responsible for identifying the appropriate investment alternatives and reviewing the related documents.

##### *Establishing Selection Criteria*

4. The CPA should develop the appropriate investment strategy based on the specific investment criteria, rate of return requirements, and risk tolerance of the client, as identified in the personal financial planning engagement. This generally includes the following:

- a. Developing an appropriate investment class allocation, including the amount of investment resources to be invested in financial assets, such as cash equivalents, stocks, or bonds, and the amount of investment resources to be invested in nonfinancial assets, such as real estate or oil and gas interests.
- b. Developing an appropriate allocation within each investment class.

***Participating in the Selection Process***

5. When selecting specific investment assets, the CPA should review and discuss with the client the available investment alternatives and identify those investments that meet the following criteria:

- a. The client's goals, as identified in the personal financial planning engagement, are satisfied.
- b. The client's investment constraints, such as risk tolerance, capacity to assume financial risk, cash flow and asset availability, and personal preferences, as identified in the personal financial planning engagement, are honored.
- c. The diversification plans established in the client's investment strategy are achieved.

**Documentation**

6. The CPA should document meetings, discussions, or other contacts with the client and indicate the decisions regarding responsibilities for actions and product selections. The CPA may supplement such documentation by providing the client with an inventory of investment assets in the client's portfolio along with a description of values, yields, portfolio percentages, and so forth.

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## PFP Section 400

# ***Monitoring and Updating Engagements—Functions and Responsibilities***

First Issued October  
1994; Revised  
January 1996

### **Definition and Scope of Monitoring and Updating**

**.01** This section is intended to address only those situations in which the certified public accountant (CPA) is specifically engaged by a client to provide monitoring services, updating services, or both.<sup>1</sup>

**.02** Monitoring engagements are those that involve determining the client's progress in achieving established personal financial planning goals.

**.03** Updating engagements are those that involve revising the client's existing financial plan and financial planning recommendations, as appropriate, in light of the client's goals, current circumstances, and current external factors.

**.04** Monitoring and updating activities are typically undertaken after implementation of actions and recommendations developed during a personal financial planning engagement (see Statement on Responsibilities in Personal Financial Practice [SRPFP] No. 3, *Implementation Engagement Functions and Responsibilities* [section 300]). Monitoring and updating services may be either separate or combined engagements.

**.05** Updating generally occurs as a result of a monitoring engagement, but may also occur as a result of changed goals or circumstances or a lapse of time, independent of a monitoring engagement.

### **Guidance Applicable to Monitoring and Updating Engagements**

**.06** The CPA should apply existing applicable professional standards and should consider the guidance included in other published SRPFPS.<sup>2</sup>

**.07** The CPA should document his or her understanding of the nature and extent of the monitoring and/or updating services to be provided and the roles

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<sup>1</sup> Although the CPA would typically have informed the client during a personal financial planning engagement in which planning recommendations are developed that monitoring and updating are important elements of the financial planning process, the CPA is not responsible for undertaking these services except by specific agreement with the client.

<sup>2</sup> Refer to paragraphs 6 through 10 of SRFPF No. 1, *Basic Personal Financial Planning Engagement Functions and Responsibilities* [section 100.06-.10], for a discussion of applicable standards and guidance.

and responsibilities of the CPA, the client, and other advisers. The CPA should refer to paragraphs 13 and 14 of SRPFP No. 1 [section 100.13-.14] for additional documentation guidance.

## Monitoring Engagements

**.08** Monitoring engagements vary in complexity and scope, as well as in the nature and extent of assistance to be provided by the CPA. For example, the CPA may—

- a. Undertake some, or all, of the monitoring services.
- b. Coordinate and/or review monitoring services performed by other advisers (see SRPFP No. 2, *Working With Other Advisers* [section 200]).
- c. Monitor the progress toward goals in a financial plan developed by other advisers (see SRPFP No. 2 [section 200]).

The CPA and client should agree on the nature and extent of the CPA's services in a monitoring engagement.

**.09** In determining the client's progress toward achieving established financial planning goals, the CPA should—

- a. Ascertain whether all recommended actions to achieve the goals were undertaken.
- b. Measure and evaluate the actual progress toward achievement of the goals.
- c. Identify developments in the client's circumstances and in external factors that affect the financial plan.

**.10** The CPA and client should agree on how frequently the progress toward the client's financial planning goals should be monitored. The CPA should use monitoring criteria that are appropriate and consistent with the criteria used to establish the financial planning goals being monitored.

**.11** The CPA should focus on criteria and other factors that are important to the ultimate attainment of the financial planning goals being monitored. For example, realizing a targeted investment rate of return may be important for the ultimate achievement of the client's retirement planning goals; however, at a particular time, monitoring the client's level of spending may be more important.

**.12** The CPA should communicate to the client the CPA's evaluation of progress toward achieving the client's financial planning goals. Such communication should ordinarily be in writing.

**.13** As a result of a monitoring engagement, the CPA may identify differences from the expected progress toward the client's financial planning goals or other circumstances that might warrant a review or update of the existing financial plan. In this case, the CPA should evaluate whether the differences or circumstances necessitate an update of the client's existing financial plan and financial planning recommendations and advise the client accordingly.

**.14** The following is an illustration of a communication in the event that the CPA, during the course of a monitoring engagement, has determined that the progress in achieving the client's financial planning goals differs from the expected progress.

Your children's college education funds have not earned the targeted rate of return assumed in your existing financial plan. If this trend continues, you will not have saved enough to meet anticipated costs. We, therefore, recommend that your education savings plan be updated.

**.15** The following is an illustration of a communication in the event that the CPA, during the course of a monitoring engagement, has identified changes in the client's circumstances that warrant an update of the client's financial plan.

During the course of our monitoring engagement, we learned that you have inherited a large interest in a closely held business. This change in your business circumstances may impact several of the recommendations contained in your financial plan. Accordingly, we recommend that your financial plan now be updated.

## Updating Engagements

**.16** Updating engagements vary in complexity and scope, as well as in the nature and extent of assistance to be provided by the CPA. The CPA should communicate to the client the fact that updating a personal financial plan affects all aspects of the plan and that all existing financial planning recommendations should be reviewed as part of the updating process. The CPA and client should agree on the nature and extent of the CPA's services in updating financial planning recommendations.

**.17** An updating engagement generally involves the same functions and responsibilities outlined in SRPFP No. 1 [section 100] and expanded upon in other SRPFPs. Accordingly, the CPA should refer to other SRPFPs, as appropriate, when engaged to update a client's personal financial planning recommendations. For example, SRPFP No. 5 [section 500] and paragraphs 15 and 16 of SRPFP No. 1 [section 100.15-.16] provide guidance on developing a basis for recommendations; the CPA should, therefore, determine whether all criteria and assumptions used as a basis for existing financial planning recommendations are still valid before developing revised recommendations.

**.18** In updating a personal financial plan and financial planning recommendations, the CPA should consider the integrated nature of financial planning and the effect of revising recommendations to achieve one financial planning goal on the client's ability to achieve all other financial planning goals. For example, if, as part of updating a client's financial plan, the CPA revises the amount to be saved each month to fund retirement goals, the CPA should consider the effect of this recommendation on the client's ability to fund other goals, such as children's education, and on the client's cash flow.

**.19** The CPA should communicate to the client any revisions to financial planning recommendations that arise as a result of the engagement. Such communication should ordinarily be in writing.

**.20** The following is an illustration of a communication in the event that the client has engaged the CPA to update the client's estate plan, but not to revise recommendations on other financial planning issues.

Updating any portion of your personal financial plan may affect other aspects of the plan. All of your financial planning recommendations should be reviewed periodically as part of the updating process. You have asked us to update only those financial planning recommendations for achieving your estate planning goals. Had we addressed all aspects of your financial plan, different recommendations may have resulted.

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## PFP Section 500

# *Developing a Basis for Recommendations*

Issued January  
1996

### Definition and Scope

**.01** This section is intended to provide guidance to the certified public accountant (CPA) engaged by a client to develop personal financial planning recommendations.

**.02** Financial planning recommendations are suggested actions developed to assist the client in achieving financial goals.

**.03** Recommendations are based on analyses and other procedures that are conducted prior to and in preparation for developing suggested actions. The CPA's knowledge and experience also contribute to the basis for recommendations.

**.04** Developing a basis for the recommendations involves the following:

- a. Collecting relevant quantitative and qualitative information, which may include but is not limited to—
  1. The client's goals, existing financial situation, and available resources
  2. Nonfinancial factors such as client attitudes, risk tolerance, family considerations, age, health, and life expectancy
  3. External factors such as estimates of inflation, taxes, economic conditions, legislative activity, investment markets, and interest rates
  4. Reasonable estimates, projections, and assumptions furnished by the client, provided by the client's advisers, or developed by the CPA
- b. Analyzing the client's current situation as it relates to the client's goals and objectives and identifying strengths and weaknesses of the existing financial situation
- c. Formulating, evaluating, and recommending appropriate strategies and courses of action for achieving the client's goals

### Guidance Applicable to Developing a Basis for Recommendations

**.05** The CPA should apply existing applicable professional standards and should consider the guidance included in other published Statements on Responsibilities in Personal Financial Planning Practice (SRFPs).<sup>1</sup>

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<sup>1</sup> Refer to paragraphs 6 through 10 of SRFP No. 1, *Basic Personal Financial Planning Engagement Functions and Responsibilities* [section 100.06-.10], for a discussion of applicable standards and guidance.

**.06** The CPA should document the nature and extent of the procedures performed in developing financial planning recommendations.<sup>2</sup> The CPA should refer to paragraphs 13 and 14 of SRPFP No. 1, *Basic Personal Financial Planning Engagement Functions and Responsibilities* [section 100.13-14], for documentation guidance.

## Collecting Information

**.07** Since personal financial planning recommendations are developed to address specified goals, the CPA should obtain an understanding of the client's measurable goals.

**.08** The CPA should obtain sufficient relevant information to form a basis for recommendations to assist the client in achieving his or her financial goals. The nature and amount of information will depend on the scope and complexity of the engagement and the professional judgment of the CPA.

**.09** If the CPA is unable to collect sufficient relevant information to form a basis for recommendations, he or she may restrict the scope of the engagement to those matters for which sufficient information is available. The CPA should communicate to the client any limitation on the scope of the engagement, as well as the fact that this limitation could affect the conclusions and recommendations developed.

**.10** If there is not sufficient information to proceed, the CPA should consider terminating the engagement. The CPA should communicate notice of such termination to the client.

**.11** Communications involving limitations on the scope or terminations of engagements should ordinarily be in writing. The CPA should refer to SRPFP No. 1, paragraphs 5 and 18 [section 100.05 and .18], for further guidance when engagements are limited in scope.

## Analyzing Information

**.12** The nature and extent of analyses and other procedures performed in developing a basis for recommendations are affected by the scope and objectives of the engagement. However, even when an engagement addresses a limited number of specific personal financial goals, the CPA should consider the client's overall financial circumstances in developing recommendations. For example, in considering ways to achieve the goal of providing for the education of the client's children, other planning areas, such as providing for the client's retirement, may have an impact on that goal.

**.13** The CPA should evaluate the reasonableness of estimates and assumptions that are significant to the plan.

- a. The CPA should consider the appropriateness of the assumptions used.<sup>3</sup> For example, the use of a current rate of return on investments

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<sup>2</sup> If the CPA will be developing investment recommendations, he or she may need to obtain information on becoming a Registered Investment Adviser and may want to refer to the AICPA's *Guide to Registering as an Investment Adviser*.

<sup>3</sup> Regarding the use of appropriate assumptions, the CPA should consider the guidance provided in paragraphs 6.30 to 6.36 of the Audit and Accounting Guide *Guide for Prospective Financial Information* (see the appendix [paragraph .21] of this section).

to calculate the amount of capital needed to fund a short-term goal is appropriate if the recommendation is to fund the goal with short-term investments.

- b. The CPA should use assumptions that are consistent with each other. For example, an assumed low rate of inflation would be consistent with an assumed low rate of return for future investments in fixed-income securities.
- c. When performing analyses based on estimates, assumptions, and projections, the CPA should consider their sensitivity in relation to the overall plan.<sup>4</sup> For example, in a long-range retirement funding projection, a slight change in the assumed rate of return on investments may have a significant impact on the projected result.
- d. If, during the course of the engagement, the CPA determines that significant estimates, projections, or assumptions are no longer valid, the CPA should evaluate the appropriateness of the original engagement objectives. The CPA should also revise the collection of relevant information and the analysis of that information, as appropriate. The CPA should refer to "Defining the Engagement Objectives" (paragraphs 11 through 13) in SRPFP No. 1 [section 100.11-13].

**.14** The CPA should communicate to the client the assumptions and estimates that are significant to the plan and should identify those that have a high probability of variation that could materially affect the plan. Such communication should ordinarily be in writing and include a statement that projected results may not be achieved.

**.15** The CPA should integrate analyses in one financial planning area with analyses in other financial planning areas for which the CPA has been engaged. For example, analysis for college funding may affect or be affected by analysis in risk management, retirement funding, cash management, investment strategies, and income, estate, and gift taxation.

**.16** If the CPA determines that the client's goals cannot reasonably be achieved, the CPA should communicate to the client the need to reconsider the originally stated goals.

## Formulating Strategies and Recommendations

**.17** Recommendations are derived, in part, from analyses of relevant information and should be consistent with the client's goals.

**.18** The client may impose a constraint on the engagement that affects the CPA's recommendations. For example, the client may stipulate that he or she will not purchase health insurance. This stipulation may affect the personal financial planning recommendations developed.

**.19** In situations of a client-imposed constraint, the CPA should communicate to the client the fact that this constraint could affect the conclusions and recommendations developed. Communications involving client-imposed constraints on engagements should ordinarily be in writing. The CPA should refer

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<sup>4</sup> Regarding the sensitivity of appropriate assumptions, the CPA should consider the guidance provided in paragraphs 6.37 and 6.38 of the Audit and Accounting Guide *Guide for Prospective Financial Information* (see the appendix [paragraph .21] of this section).



to SRPFP No. 1, paragraphs 5 and 18 [section 100.05 and .18], for further guidance when the engagement is limited in scope.

**.20** The CPA should integrate recommendations developed to achieve one financial planning goal with the recommendations regarding other goals. For example, recommendations for college funding may affect or be affected by recommendations in risk management, retirement funding, cash management, investment strategies, and income, estate, and gift taxation.

.21

## Appendix

### Excerpt From *Guide for Prospective Financial Information*

The appendix is an excerpt from chapters 1 and 6 of the AICPA Audit and Accounting Guide *Guide for Prospective Financial Information*.

#### Chapter 1—Introduction

##### Structure of the Guide

1.07 The guidance on forecasted financial information contained in Chapters 6–23 generally also applies to projected financial information. Certain paragraphs in those chapters, however, do not apply—partially or fully—to projections. In those instances, readers interested in financial projections should refer to the corresponding *italicized* paragraphs (which bear the same paragraph numbers followed by the letter P) and consider the modifications discussed in those paragraphs in conjunction with the paragraphs that precede them.

#### Chapter 6—Preparation Guidelines

##### ***Assumptions used in preparing financial forecasts should be appropriate.***

6.30 Assumptions are the essence of developing financial forecasts and are the single most important determinant of such statements. The quality of the underlying assumptions largely determines the quality of financial forecasts.

6.31 The attention devoted to the appropriateness of a particular assumption should be commensurate with the likely relative impact of that assumption on the prospective results. Assumptions with greater impact should receive more attention than those with less impact.

6.32 The assumptions should be reasonable and suitably supported. The level of support should be persuasive, although there are times when a number of assumptions within a narrow range of possibilities may appear equally likely.

*6.32P Hypothetical assumptions need not be reasonable but should be appropriate in light of the purpose for which the financial projection is prepared. All other assumptions should be reasonable, given the hypothetical assumptions, and be consistent with the hypothetical assumptions and with each other. That is, the other assumptions should be developed to depict conditions based on the hypothetical assumptions. For example, if a financial projection is prepared to show the effect of the construction of a new production facility that is partially financed, the presentation should include the effect of the related debt service. Furthermore, hypothetical assumptions need not be supported, as they relate to the special purpose of the presentation. The other assumptions, however, should be suitably supported given the hypothetical assumptions.*

6.33 The nature of a business enterprise is such that many underlying assumptions are interrelated, and certain of their elements may have multiple effects. For example, a slowdown in economic activity typically will not only cause a slowdown in sales volume, but may also affect sales prices and the availability and cost of resources. The conditions assumed in arriving at the prospective sales or revenue data should be consistent with those assumed in developing the prospective financial data for the cost of operations. Care should be exercised to ensure that appropriate costs and revenues have been considered, that sufficient capacity and resources would be available to produce the

forecasted revenues, that capital expenditures have been recognized as appropriate, that provision has been made for applicable taxes, and that the need for financing has been considered.

6.34 Support for assumptions might include market surveys; general economic indicators; trends and patterns developed from the entity's operating history, such as historical sales trends; and internal data and analyses, such as obligations under union contracts for labor rates.

6.35 In analyzing alternative assumptions, care should be exercised to assess the situation objectively. Relating assumptions to past or present conditions often is a useful approach for checking reasonableness or appropriateness; however, trends are not necessarily reliable indicators of the future. Particular attention should be given to the possibility of changes in conditions, which must rest mainly on theory and on an understanding of the basic causal factors.

6.36 It is ordinarily not feasible to exhaustively document and support all the assumptions underlying financial forecasts. It is nevertheless necessary to seek out and to identify explicitly the information that forms a basis for the most significant assumptions; although, frequently, the most basic assumptions with enormous potential impact, such as those relating to war or peace conditions, are not addressed explicitly. Despite precautions, hindsight will often reveal assumptions that have been overlooked or that, in light of later circumstances, received inadequate treatment. Furthermore, the nature of developing financial forecasts is such that some assumptions may not materialize, and unanticipated events and circumstances may occur no matter what effort, analysis, or support may be applied.

***The process used to develop financial forecasts should provide the means to determine the relative effect of variations in the major underlying assumptions.***

6.37 Prospective financial results are relatively more sensitive to certain assumptions and less sensitive to others. Small changes in certain assumed conditions can result in relatively large variations in the prospective results, while relatively large changes in other assumptions cause only minor shifts in the prospective results.

6.38 In developing financial forecasts, an understanding of the relative sensitivity of the results to the assumed conditions permits the allocation of analysis and study, as well as review by persons of higher authority, to those areas with the most significant effects. Particular attention should be devoted to those assumptions (a) to which the attainment of forecasted results is particularly sensitive (that is, those in which a small variation in the assumptions would have a large effect on forecasted results) and (b) for which the probability of variation is high.

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# FPF TOPICAL INDEX

References are to PFP section and paragraph numbers.

## C

### CERTIFIED PUBLIC ACCOUNTANTS

- Additional Services ..... 100.20-23
- Analyzing Information ..... 500.12-16
- Assisting Client in Planning Decisions ..... 300.03
- Collecting Information ..... 500.07-11
- Communicating Recommendations ..... 100.17-18; 300.08-09; 400.14-15; 400.19-20
- Consideration of Client's Goals ..... 100.05; 400.09-15; 400.18
- Defining Engagement Objectives ..... 100.11-13
- Determining Level of Service ..... 400.08; 400.16
- Documentation ..... 100.13-14; 100.17-18; 100.21; 200.07; 200.09; 200.11-12; 200.14-15; 300.07-09; 300.15-16; 400.07; 400.12; 400.14-15; 400.19-20; 500.06; 500.11; 500.14; 500.19
- Engagement Scope Limitations ..... 200.05-09
- Establishing Selection Criteria in Implementation Engagements ..... 300.10
- Formulating Strategies ..... 500.17-20
- Identifying Tasks for Taking Action ..... 100.19
- Implementing Planning Decisions Developed by Others ..... 300.12-13
- Participating in Selection Criteria Process in Implementation Engagement ..... 300.11
- Planning ..... 100.11-19
- Planning Implementation Engagement ..... 300.06-07
- Recommendations—Developing a Basis ..... 100.15-16; 400.17; 500.01-20
- Recommendations—Implementation Engagement ..... 300.08-09
- Recommendations—Monitoring and Updating Engagements ..... 400.14-15; 400.19-20
- Recommending Other Advisers ..... 200.10-12
- Responsibilities ..... 100.01-23; 200.01-15; 300.01-16; 400.01-20; 500.01-21
- Using Other Advisers' Advice ..... 200.02-03; 200.13-15
- Working With Other Advisers ..... 200.01-15

### CLIENTS

- Additional Services of CPA ..... 100.20-22
- Communication by CPA ..... 100.17-18; 200.07-09; 200.11-15; 300.08-09; 400.12; 400.14-16; 400.19-20
- Definition of Personal Financial Planning Engagement ..... 100.01
- Goals ..... 100.05; 400.09-15; 400.18

### COMMUNICATION

- Implementation Engagement ..... 300.08-09; 300.11
- Monitoring and Updating Engagements ..... 400.12; 400.14-16; 400.19-20
- Recommendations ..... 100.17-18; 300.08-09; 400.14-15; 400.19-20
- Recommending Other Advisers ..... 200.11-12
- Scope Limitations ..... 200.07-09
- Using Other Advisers' Advice ..... 200.13-15

### CONDUCT, CODE OF PROFESSIONAL

- Personal Financial Planning Engagements ..... 100.07

## D

### DOCUMENTATION

- References ..... 100.13-14; 100.17-18; 100.21; 200.07; 200.09; 200.11-12; 200.14-15; 300.07-09; 300.15-16; 400.07; 400.12; 400.14-15; 400.19-20; 500.06; 500.11; 500.14; 500.19
- Understanding of Engagement Scope ..... 100.13; 300.07; 400.07

## I

### ILLUSTRATIONS

- Communication
- Implementation Engagement Recommendations ..... 300.09
- Monitoring and Updating Recommendations ..... 400.14-15; 400.19-20
- Recommendations ..... 100.18; 300.09; 400.14-15; 400.19-20
- Scope Limitation ..... 200.09
- Using Other Adviser's Advice ..... 200.15
- When Recommending Other Advisers ..... 200.12
- Implementation Engagement ..... 300.14-16

References are to PFP section and paragraph numbers.

**ILLUSTRATIONS—continued**

- Investment Planning in Implementation Engagement ..... 300.16
- Risk Management in Implementation Engagement ..... 300.15

**IMPLEMENTATION ENGAGEMENT**

- Communicating With Client ..... 300.08-09
- Completion ..... 300.04
- CPA Assisting Client in Planning Decisions ..... 300.03
- Definition ..... 300.01
- Establishing Selection Criteria ..... 300.10
- Implementing Planning Decisions Made by Others ..... 300.12-13
- Participating in Selection Process ..... 300.11
- Planning ..... 300.06-07

**L****LIMITATIONS**

- Additional Services ..... 100.20-23
- Scope—See Scope Limitations
- Types of Services That Are Not Included in Personal Financial Planning ..... 100.04

**M****MONITORING AND UPDATING ENGAGEMENTS**

- Applicable Standards and Guidance ..... 400.06-07
- Communicating With Client ..... 400.12; 400.14-16; 400.19-20
- CPA Responsibilities ..... 400.01; 400.08-20
- Definition and Scope ..... 400.01-05
- Determining Client's Progress Toward Goals ..... 400.09-15; 400.18
- Determining Level of Service ..... 400.08; 400.16
- Developing a Basis for Recommendations ..... 400.17; 500.01-20
- Functions and Responsibilities ..... 400.01-20

**P****PERSONAL FINANCIAL PLANNING**

- Additional Services by CPA ..... 100.20-23
- Analyzing Information ..... 500.12-16
- Applicable Guidance ..... 100.06-10; 200.04; 300.05; 400.06-07; 500.05-06
- Collecting Information ..... 500.07-11
- Communicating Recommendations ..... 100.17-18
- Considering Client's Goals in Engagements ..... 100.05; 400.09-15; 400.18
- CPA Using Work of Other Advisers ..... 200.01-15
- Defining Engagement Objectives ..... 100.11-13
- Definition ..... 100.01

**PERSONAL FINANCIAL PLANNING—continued**

- Documentation ..... 100.13-14; 100.17-18; 100.21; 200.07; 200.09; 200.11-12; 200.14-15; 300.07-09; 300.15-16; 400.07; 400.12; 400.14-15; 400.19-20; 500.06; 500.11; 500.14; 500.19
- Engagement Scope Limitations ..... 200.05-09
- Formulating Strategies ..... 500.17-20
- Hypothetical Events ..... 100.16
- Identifying Tasks for Taking Action ..... 100.19
- Illustrations—See Illustrations
- Implementation Engagement ..... 300.01-16
- Implementing Planning Decisions Made by Others ..... 300.12-13
- Monitoring and Updating Engagements ..... 400.01-20
- Other Services ..... 100.20-23
- Participation in & Selection Criteria Establishment in Implementation Engagement ..... 300.10-11
- Planning ..... 100.11-19
- Recommendations—Developing a Basis ..... 100.15-16; 400.17; 500.01-20
- Recommendations—Implementation Engagement ..... 300.08-09
- Recommendations—Monitoring and Updating Engagements ..... 400.14-15; 400.19-20
- Recommending Other Advisers ..... 200.10-12
- Services Included ..... 100.02-04
- Updating Engagements ..... 400.16-20
- Working With Other Advisers ..... 200.01-15

**PLANNING**

- Identifying Tasks ..... 100.19
- Implementation Engagement ..... 300.06-07
- Implementing Decisions Developed by Others ..... 300.12-13
- Specific Procedures ..... 100.14

**R****RECOMMENDATIONS**

- Analyzing Information ..... 500.12-16
- Applicable Guidance ..... 500.05-06
- Collecting Information ..... 500.07-11
- Communicating ..... 100.17-18; 400.14-15; 400.19-20
- Definition and Scope ..... 500.01-04
- Developing a Basis ..... 100.15-16; 400.17; 500.01-20
- Formulating Strategies and Recommendations ..... 500.17-20
- Implementation Engagement ..... 300.08-09
- Monitoring and Updating Engagements ..... 400.14-15; 400.19-20

References are to PFP section and paragraph numbers.

**RECOMMENDATIONS**—continued

- Other Advisers.....200.10-12

**S**

**SCOPE LIMITATIONS**

- Communication to Client ..... 200.07-09; 300.08
- Responsibility of CPA.....200.05-09

**SPECIALISTS**

- Working With Other Advisers.....200.01-15

**T**

**TAX PRACTICE**

- Applicable Guidance for Personal Financial Planning Engagements ..... 100.08

**TERMINOLOGY**

- Implementation Engagement ..... 300.01
- Monitoring Engagement.....400.02
- Personal Financial Planning Engagement..... 100.01
- Updating Engagement ..... 400.03





# CPE Section

## CONTINUING PROFESSIONAL EDUCATION

Since they were first issued jointly in 1996, the AICPA and the National Association of State Board of Accountancy (NASBA) have worked collaboratively to create continuing professional education (CPE) standards. The latest revision of those standards, dated December 31, 2001, is presented here. While individual state boards of accountancy are encouraged to adopt these standards as presented, the state boards have the final authority on the acceptance of individual courses for CPE credit for their licensees. For AICPA members that are not currently licensed to practice as a CPA, these standards are effective as of January 1, 2002 for purposes of complying with the Institute's membership requirement.

In revising these standards, the AICPA and NASBA recognized advances in the delivery of CPE. The Joint AICPA/NASBA CPE Committee believes the new standards will promote having the professional create a plan to identify and close gaps in his or her needed skill set.

These standards have been approved by the AICPA/NASBA Joint Committee on CPE Standards, and the Boards of Directors of both the AICPA and NASBA. Effective implementation dates are as follows:

- January 1, 2002 for CPAs, group programs and independent study;
- Upon publication for self-study courses initially released after December 31, 2002; and
- January 1, 2004 for self-study courses already on the market as of December 31, 2002.

### TABLE OF CONTENTS

<i>Section</i>	<i>Paragraph</i>
10	Policies for the CPE Membership Requirement
...	CPE Form—Form for CPE Information
100	Preamble <span style="float: right;">.01-.04</span>
200	Standards for CPAs <span style="float: right;">.01-.15</span>
300	Standards for CPE Program Sponsors <span style="float: right;">.01-.48</span>
	General Standards <span style="float: right;">.01-02</span>
	Standards for CPE Program Development <span style="float: right;">.03-.16</span>
	Standards for CPE Program Presentation <span style="float: right;">.17-.28</span>
	Standards for CPE Program Measurement <span style="float: right;">.29-.43</span>
	Standards for CPE Program Reporting <span style="float: right;">.44-.48</span>
400	Glossary <span style="float: right;">.01-.24</span>
	Effective Dates <span style="float: right;">.24</span>





## CPE Section 10

# *Policies for the CPE Membership Requirement*

Revised December 2001

### I. GENERAL

- A. **Purpose**—The purpose of the continuing professional education (CPE) requirement is to increase the professional competence of each member. Members are expected to maintain the high standards of the profession by selecting quality education programs to fulfill their continuing education requirements. Members will have wide latitude in selecting continuing education programs suitable to their professional activities. This policy contains the following sections:

General	I.
Basic Requirements	II.
Qualifying Programs	III.
Exceptions	IV.
Audits of CPE	V.

- B. **AICPA vs. State Requirements**—Members of the American Institute of Certified Public Accountants (AICPA) who are Certified Public Accountants licensed in specific states and/or who are members of their respective state CPA societies are cautioned that the AICPA's CPE policy, while similar in many respects to the state boards of accountancy and state CPA society policies, is not identical. For example, the AICPA's continuing education requirement covers a three-year period in contrast to the states' one-, two- or three-year periods, and some states may not award CPE credit for some subjects. Thus, complying with the AICPA's policy may not necessarily maintain membership in state CPA societies or provide for continued state licensing or certification. Individuals should carefully consult the relevant state boards of accountancy and/or state CPA society guidance to ensure compliance.
- C. **Effective Date**—These policies apply to all members and became effective as of January 1, 1990.
- D. **Failure to Meet CPE Requirements**—Failure to meet the CPE requirements will, unless the requirement is waived under section IV, result in a loss of membership in the AICPA.

### II. BASIC REQUIREMENTS

- A. **Members**—From January 1, 2001, forward and for each three-year reporting period thereafter, all AICPA members shall complete 120 hours, or its equivalent, of continuing professional education. Compliance can be achieved either by a formal program of education or by any other means, however measured, that would be reasonably expected to maintain professional competencies in the member's area

of practice or employment. Members shall report compliance with such requirement to the AICPA each year and shall keep appropriate records and submit copies of such on request of the Institute.

- B. **New Members**—For those individuals joining the AICPA on January 1, 1990, and thereafter ("new members"), the three-year reporting period and the CPE requirements begin in the calendar year following the year membership commences. For example, a new member in calendar year 1993 begins a three-year reporting period on January 1, 1994, which ends December 31, 1996, and is required, beginning for the calendar year 1994, to comply with the CPE requirements set forth above.
- C. **Reinstatement**—Individuals applying for reinstatement who have voluntarily or involuntarily lost their membership or come out of retirement or inactive status shall be treated as "new members." Their new three-year reporting period for CPE requirements begins in the calendar year following their reinstatement.
- D. **Changing Status**—Members changing from or to public practice do not begin a new three-year reporting period. However, the CPE requirement shall be adjusted to the following three-year totals:

	<i>Year of Change</i>		
	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>
To Public Practice	120	110	100
From Public Practice	100	110	120

- E. **Grace Period**—Any member who has not completed the required number of hours during a reporting period will be allowed the two months immediately following the period to make up the deficiency. Hours credited toward a deficiency during this two-month period may not be counted toward the annual minimum requirement of the educational year in which they are taken. Furthermore, any continuing professional education hours claimed during the two-month period to make up any deficiency for the preceding three-year period may not be counted toward the requirement for the three-year reporting period in which they are taken.
- F. **Reporting**—No separate reporting is required. By paying their dues each year, members affirm they are in compliance with the CPE membership requirements. Members should keep detailed records of the CPE they complete in the event they are selected to verify their compliance. See the next section for information that should be retained.
- G. **Documentation and Records Retention**—Members of the AICPA bear the primary responsibility of documenting that they have complied with the CPE requirements. They should retain evidence of satisfactory completion for a period of five years after the completion of the educational programs. For each CPE program completed, members should be able to document the following:
1. Sponsor
  2. Title and description of content
  3. Date(s)
  4. Location
  5. Number of CPE contact hours.

### III. QUALIFYING PROGRAMS

Members have wide latitude in selecting continuing professional education suitable to their professional activities. The underlying principle is that all programs should contribute to a member's professional competence. Acceptable subjects include the fields of study set forth in the AICPA National CPE Curriculum: accounting and auditing, consulting services, specialized knowledge and applications, management, personal development, and taxation. Other subjects may also be acceptable if they maintain and/or increase the accounting professional's competence. Members have the option of selecting programs that relate to their specific jobs. For example, a member in industry who is engaged in marketing activities may fulfill the requirement by completing continuing education in marketing and a member who owns or operates a small business may complete CPE that relates to running that business.

Members may participate in CPE programs sponsored by a wide variety of organizations including, but not limited to, the AICPA, state societies of CPAs, other professional associations, colleges and universities, and their own firms. Service as an instructor at a CPE program may qualify when it increases the instructor's professional competence. Writing published articles, books or CPE programs may also qualify.

CPE credit should be measured in whole hours and claimed only for the time a group study program is actually attended. (CPE credit is measured in 50-minute "contact hours.") CPE credit for self-study programs is recommended by the sponsor and must be documented by a certificate or other evidence of completion.

Ultimately the CPE credit claimed is the responsibility of the individual member. Each member must only claim credit for the formal programs of learning he or she actually completed that contributed to his or her professional competence.

For more detailed information about qualifying programs, please refer to the *Statement on Standards for Continuing Professional Education (CPE) Programs* which is included here [sections 100–400] as part of these policies. Members must comply with those standards that apply to individual accounting professionals—namely, the standards in these sections: General Standards, Standards for CPE Program Measurement, and Standards for CPE Program Reporting. The other two sections contain standards that apply to program developers and program sponsors. To the extent a member is in the role of a program developer or sponsor, he or she must also comply with the developer and sponsor standards. Members are not responsible to see that the program developers and sponsors of programs they attend are in compliance with the CPE standards.

### IV. EXCEPTIONS

- A. **General**—Members may request a waiver if they are prohibited from fulfilling the CPE requirements for the reasons set forth below. Such requests must be submitted in writing to the CPE Division of the AICPA. When the status changes from the one for which the exception applies, the CPE requirement begins in the calendar year following the change.

1. **Foreign Residency**—The request should include the country of residence, the name of the employer, the principal duties and responsibilities performed, and the reasons foreign residency prohibits fulfilling the requirement.
  2. **Health**—The request should include the nature of the illness, the name and address of the attending physician, and the reason the illness prohibits fulfilling the requirement.
  3. **Military Service**—The request should include the principal duties performed, where stationed, the name and address of member's commanding officer, and the reason why military service prohibits fulfilling the requirement.
  4. **Other Similar Reasons**—The request should include the nature of the hardship and the reason why it prohibits fulfilling the CPE requirement.
- B. **Retired and Inactive Members**—For purposes of the CPE requirement, "retired" and "inactive" mean a member is in one of those categories for paying AICPA dues. Retired members and inactive members who are unemployed or have left the workforce to raise a family are exempt from the CPE requirement. Members who are retired or exempt for any part of the year are exempt for the full year.

## V. AUDITS OF CPE

The AICPA will verify compliance on a test basis. The extent and scope of such examination will be determined and administered by the AICPA.

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## CPE Section 100

### *Preamble*

**.01** The right to use the title "Certified Public Accountant" (CPA) is regulated in the public interest and imposes a duty to maintain public confidence and current knowledge, skills, and abilities in all areas in which they provide services. CPAs must accept and fulfill their ethical responsibilities to the public and the profession regardless of their fields of employment.<sup>1</sup>

**.02** The profession of accountancy is characterized by an explosion of relevant knowledge, ongoing changes and expansion, and increasing complexity. Advancing technology, globalization of commerce, increasing specialization, proliferating regulations, and the complex nature of business transactions have created a dynamic environment that requires CPAs to continuously maintain and enhance their knowledge, skills, and abilities.

**.03** The continuing development of professional competence involves a program of lifelong educational activities. Continuing Professional Education (CPE) is the term used in these standards to describe the educational activities that assist CPAs in achieving and maintaining quality in professional services.

**.04** The following standards have been broadly stated in recognition of the diversity of practice and experience among CPAs. They establish a framework for the development, presentation, measurement, and reporting of CPE programs and thereby help to ensure that CPAs receive the quality CPE necessary to satisfy their obligations to serve the public interest.

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<sup>1</sup> The term "CPAs" is used in these standards to identify all persons who are licensed and/or regulated by boards of accountancy.





## CPE Section 200

# Standards for CPAs

### General Standards

**.01 Standard No. 1. All CPAs should participate in learning activities that maintain and/or improve their professional competence.<sup>1</sup>**

**.02 Commentary.** Selection of learning activities should be a thoughtful, reflective process addressing the individual CPA's current and future professional plans, current knowledge and skills level, and desired or needed additional competence to meet future opportunities and/or professional responsibilities.

**.03** CPA's fields of employment do not limit the need for CPE. CPAs performing professional services need to have a broad range of knowledge, skills, and abilities. Thus, the concept of professional competence should be interpreted broadly. Accordingly, acceptable continuing education encompasses programs contributing to the development and maintenance of both technical and non-technical professional skills.

**.04** Acceptable subjects include accounting, assurance/auditing, consulting services, specialized knowledge and applications, management, taxation, and ethics. Other subjects, including personal development, may also be acceptable if they maintain and/or improve the CPA's professional competence.

**.05** To help guide their professional development, CPAs may find it useful to develop a learning plan (see definition in Glossary [section 400.15]). The learning plan can be used to evaluate learning and professional competence development. It should be reviewed periodically and modified as professional competence needs change.

**.06 Standard No. 2. CPAs should comply with all applicable CPE requirements and should claim CPE credit only for CPE programs when the CPE program sponsors have complied with the Standards for CPE Program Presentation (Nos. 8–11) and Standard for CPE Program Reporting No. 17.**

**.07 Commentary.** CPAs are responsible for compliance with all applicable CPE requirements, rules, and regulations of state licensing bodies, other governmental entities, membership associations, and other professional organizations or bodies. CPAs should contact each appropriate entity to which they report to determine its specific requirements or any exceptions it may have to the standards presented herein.

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<sup>1</sup> The terms "should" and "must" are intended to convey specific meanings within the context of this *Joint AICPA/NASBA Statement on Standards for Continuing Professional Education Programs* [sections 100–400]. The term "must" is used only in the standards applying to CPE program sponsors to convey that CPE program sponsors are not permitted any departure from those specific standards. The term "should" is used in the standards applying to both CPAs and CPE program sponsors and is intended to convey that CPAs and CPE program sponsors are expected to follow such standards as written and are required to justify any departures from such standards when unusual circumstances warrant such departures.

.08 Periodically, CPAs participate in learning activities which do not comply with all applicable CPE requirements, for example specialized industry programs offered through industry sponsors. If CPAs propose to claim credit for such learning activities, they should retain all relevant information regarding the program to provide documentation to state licensing bodies and/or all other professional organizations or bodies that the learning activity is equivalent to one which meets all these Standards.

**.09 Standard No. 3. CPAs are responsible for accurate reporting of the appropriate number of CPE credits earned and should retain appropriate documentation of their participation in learning activities, including: (1) name and contact information of CPE program sponsor, (2) title and description of content, (3) date(s) of program, (4) location (if applicable), and (5) number of CPE credits, all of which should be included in documentation provided by the CPE program sponsor.**

**.10 Commentary.** To protect the public interest, regulators require CPAs to document maintenance and enhancement of professional competence through periodic reporting of CPE. For convenience, measurement is expressed in CPE credits. However, the objective of CPE must always be maintenance/enhancement of professional competence, not attainment of credits. Compliance with regulatory and other requirements mandates that CPAs keep documentation of their participation in activities designed to maintain and/or improve professional competence. In the absence of legal or other requirements, a reasonable policy is to retain documentation for a minimum of five years from the end of the year in which the learning activities were completed.

.11 Participants must document their claims of CPE credit. Examples of acceptable evidence of completion include:

- For group and independent study programs, a certificate or other verification supplied by the CPE program sponsor.
- For self-study programs, a certificate supplied by the CPE program sponsor after satisfactory completion of an examination.
- For instruction credit, a certificate or other verification supplied by the CPE program sponsor
- For a university or college course that is successfully completed for credit, a record or transcript of the grade the participant received.
- For university or college non-credit courses, a certificate of attendance issued by a representative of the university or college.
- For published articles, books, or CPE programs, (1) a copy of the publication (or in the case of a CPE program, course development documentation) that names the writer as author or contributor, (2) a statement from the writer supporting the number of CPE hours claimed, and (3) the name and contact information of the independent reviewer(s) or publisher.

**.12 Standard No. 4. CPAs who complete sponsored learning activities that maintain or improve their professional competence should claim the CPE credits recommended by CPE program sponsors.**

**.13 Commentary.** CPAs may participate in a variety of sponsored learning activities, such as workshops, seminars and conferences, self-study

courses, Internet-based programs, and independent study. While CPE program sponsors determine credits, CPAs should claim credit only for activities through which they maintained or improved their professional competence. CPAs who participate in only part of a program should claim CPE credit only for the portion they attended or completed.

**.14 Standard No. 5. CPAs may engage in independent study under the direction of a CPE program sponsor who has met the applicable standards for CPE program sponsors when the subject matter and level of study maintain or improve their professional competence.**

**.15 Commentary.** Independent study is an educational process designed to permit a participant to learn a given subject under the guidance of a CPE program sponsor one-on-one. Participants in an independent study program should:

- Enter into a written learning contract with a CPE program sponsor who must comply with the applicable standards for CPE program sponsors.
- Accept the written recommendation of the CPE program sponsor as to the number of credits to be earned upon successful completion of the proposed learning activities. CPE credits will be awarded only if:
  1. All the requirements of the independent study as outlined in the learning contract are met,
  2. The CPE program sponsor reviews and signs the participant's report,
  3. The CPE program sponsor reports to the participant the actual credits earned, and
  4. The CPE program sponsor provides the participant with contact information.

The credits to be recommended by an independent study CPE program sponsor should be agreed upon in advance and should be equated to the effort expended to improve professional competence. The credits cannot exceed the time devoted to the learning activities and may be less than the actual time involved.

- Retain the necessary documentation to satisfy regulatory requirements as to the content, inputs, and outcomes of the independent study.
  - Complete the program of independent study in 15 weeks or less.
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## CPE Section 300

# *Standards for CPE Program Sponsors*

### General Standards

**.01 Standard No. 1. CPE program sponsors are responsible for compliance with all applicable standards and other CPE requirements.**

**.02 Commentary.** CPE program sponsors may have to meet specific CPE requirements of state licensing bodies, other governmental entities, membership associations, and/or other professional organizations or bodies. Professional guidance for CPE program sponsors is available from the AICPA and NASBA; state-specific guidance is available from the state boards of accountancy. CPE program sponsors should contact the appropriate entity to determine requirements.

### Standards for CPE Program Development

**.03 Standard No. 2. Sponsored learning activities must be based on relevant learning objectives and outcomes that clearly articulate the knowledge, skills, and abilities that can be achieved by participants in the learning activities.**

**.04 Commentary.** Learning activities provided by CPE program sponsors for the benefit of CPAs should specify the level, content, and learning objectives so that potential participants can determine if the learning activities are appropriate to their professional competence development needs. Levels include, for example, basic, intermediate, advanced, update, and overview (see definitions in Glossary [section 400]).

**.05 Standard No. 3. CPE program sponsors should develop and execute learning activities in a manner consistent with the prerequisite education, experience, and/or advance preparation of participants.**

**.06 Commentary.** To the extent it is possible to do so, CPE program sponsors should make every attempt to equate program content and level with the backgrounds of intended participants. All programs must clearly identify prerequisite education, experience, and/or advance preparation, if any, in precise language so that potential participants can readily ascertain whether they qualify for the program.

**.07 Standard No. 4. CPE program sponsors must use activities, materials, and delivery systems that are current, technically accurate, and effectively designed. CPE program sponsors must be qualified in the subject matter.**

**.08 Commentary.** To best facilitate the learning process, sponsored programs and materials must be prepared, presented and updated timely. Learning activities must be developed by individuals or teams having expertise in the subject matter. Expertise may be demonstrated through practical experience or education.

**.09** CPE program sponsors must review the course materials periodically to assure that they are accurate and consistent with currently accepted standards relating to the program's subject matter.

**.10 Standard No. 5. CPE program sponsors of group and self-study programs must ensure learning activities are reviewed by qualified persons other than those who developed them to assure that the program is technically accurate and current and addresses the stated learning objectives. These reviews must occur before the first presentation of these materials and again after each significant revision of the CPE programs.**

**.11 Commentary.** Individuals or teams qualified in the subject matter must review programs. When it is impractical to review certain programs in advance, such as lectures given only once, greater reliance should be placed on the recognized professional competence of the instructors or presenters. Using independent reviewing organizations familiar with these standards may enhance quality assurance.

**.12 Standard No. 6. CPE program sponsors of independent study learning activities must be qualified in the subject matter.**

**.13 Commentary.** A CPE program sponsor of independent study learning activities must have expertise in the specific subject area related to the independent study. The CPE program sponsor must also:

- Review, evaluate, approve and sign the proposed independent study learning contract, including agreeing in advance on the number of credits to be recommended upon successful completion.
- Review and sign the written report developed by the participant in independent study.
- Retain the necessary documentation to satisfy regulatory requirements as to the content, inputs, and outcomes of the independent study.

**.14 Standard No. 7. Self-study programs must employ learning methodologies that clearly define learning objectives, guide the participant through the learning process, and provide evidence of a participant's satisfactory completion of the program.**

**.15 Commentary.** To guide participants through a learning process, CPE program sponsors of self-study programs must elicit participant responses to test for understanding of the material, offer evaluative feedback to incorrect responses, and provide reinforcement feedback to correct responses. To provide evidence of satisfactory completion of the course, CPE program sponsors of self-study programs must require participants to successfully complete a final examination with a minimum-passing grade of at least 70 percent before issuing CPE credit for the course. Examinations may contain questions of varying format, (for example, multiple-choice, essay and simulations.) If objective type questions are used, at least five questions per CPE credit must be included on the final examination. For example, the final examination for a five-credit course must include at least 25 questions.

**.16** Self-study programs must be based on materials specifically developed for instructional use. Self-study programs requiring only the reading of general professional literature, IRS publications, or reference manuals followed by a test will not be acceptable. However, the use of the publications and

reference materials in self-study programs as supplements to the instructional materials could qualify if the self-study program complies with each of the CPE standards.

## Standards for CPE Program Presentation

**.17 Standard No. 8. CPE program sponsors must provide descriptive materials that enable CPAs to assess the appropriateness of learning activities. To accomplish this, CPE program sponsors must inform participants in advance of:**

- **Learning objectives.**
- **Prerequisites.**
- **Program level.**
- **Program content.**
- **Advance preparation.**
- **Instructional delivery methods.**
- **Recommended CPE credit.**
- **Course registration requirements.**

**.18 Commentary.** For potential participants to effectively plan their CPE, the program sponsor should disclose the significant features of the program in advance (e.g., through the use of brochures, Internet notices, invitations, direct mail, or other announcements). When CPE programs are offered in conjunction with noneducational activities, or when several CPE programs are offered concurrently, participants should receive an appropriate schedule of events indicating those components that are recommended for CPE credit. The CPE program sponsor's registration policies and procedures should be formalized, published, and made available to participants.

**.19** CPE program sponsors should distribute program materials timely and encourage participants to complete any advance preparation requirements. All programs should clearly identify prerequisite education, experience, and/or advance preparation requirements, if any, in the descriptive materials. Prerequisites should be written in precise language so that potential participants can readily ascertain whether they qualify for the program.

**.20 Standard No. 9. CPE program sponsors must ensure instructors are qualified with respect to both program content and instructional methods used.**

**.21 Commentary.** Instructors are key ingredients in the learning process for any group program. Therefore, it is imperative that CPE program sponsors exercise great care in selecting qualified instructors for all group programs. Qualified instructors are those who are capable, through training, education, or experience of communicating effectively and providing an environment conducive to learning. They should be competent and current in the subject matter, skilled in the use of the appropriate instructional methods and technology, and prepared in advance.

**.22** CPE program sponsors should evaluate the instructor's performance at the conclusion of each program to determine the instructor's suitability to serve in the future.



**.23 Standard No. 10. CPE program sponsors must employ an effective means for evaluating learning activity quality with respect to content and presentation, as well as provide a mechanism for participants to assess whether learning objectives were met.**

**.24 Commentary.** The objectives of evaluation are to assess participant satisfaction with specific programs and to increase subsequent program effectiveness. Evaluations, whether written or electronic, should be solicited from participants and instructors for each program session, including self-study, to determine, among other things, whether:

- Stated learning objectives were met.
- If applicable, prerequisite requirements were appropriate.
- Program materials were accurate.
- Program materials were relevant and contributed to the achievement of the learning objectives.
- Time allotted to the learning activity was appropriate.
- If applicable, individual instructors were effective.
- Facilities and/or technological equipment was appropriate.
- Handout or advance preparation materials were satisfactory.
- Audio and video materials were effective.

**.25** CPE program sponsors should periodically review evaluation results to assess program effectiveness and should inform developers and instructors of evaluation results.

**.26 Standard No. 11. CPE program sponsors must ensure instructional methods employed are appropriate for the learning activities. Learning activities should be presented in a manner consistent with the descriptive and technical materials provided.**

**.27 Commentary.** CPE program sponsors should evaluate the instructional methods employed for the learning activities to determine if the delivery is appropriate and effective. Integral aspects in the learning environment that should be carefully monitored include the number of participants and the facilities and technologies employed in the delivery of the learning activity.

**.28** CPE program sponsors are expected to present learning activities that comply with course descriptions and objectives. Appropriate supplemental materials may also be used.

## **Standards for CPE Program Measurement**

**.29 Standard No. 12. Sponsored learning activities are measured by program length, with one 50-minute period equal to one CPE credit. One-half CPE credit increments (equal to 25 minutes) are permitted after the first credit has been earned in a given learning activity.**

**.30 Commentary.** For learning activities in which individual segments are less than 50 minutes, the sum of the segments should be considered one total program. For example, five 30-minute presentations would equal 150 minutes and should be counted as three CPE credits. When the total minutes

of a sponsored learning activity are greater than 50, but not equally divisible by 50, the CPE credits granted should be rounded down to the nearest one-half credit. Thus, learning activities with segments totaling 140 minutes should be granted two and one-half CPE credits.

**.31** While it is the participant's responsibility to report the appropriate number of credits earned, CPE program sponsors must monitor group learning activities to assign the correct number of CPE credits.

**.32** For university or college credit courses that meet these CPE Standards, each unit of college credit shall equal the following CPE credits:

- Semester System      15 credits
- Quarter System        10 credits

**.33** For university or college non-credit courses that meet these CPE standards, CPE credits shall be awarded only for the actual classroom time spent in the non-credit course.

**.34** Credit is not granted to participants for preparation time.

**.35** Only the portions of committee or staff meetings that are designed as programs of learning and comply with these standards qualify for CPE credit.

**.36 Standard No. 13. CPE credit for self-study learning activities must be based on a pilot test of the average completion time.**

**.37 Commentary.** A sample of intended professional participants should be selected to test program materials in an environment and manner similar to that in which the program is to be presented. The sample group of at least three individuals must be independent of the program development group and possess the appropriate level of knowledge before taking the program. The sample does not have to ensure statistical validity. CPE credits should be recommended based on the average completion time for the sample. If substantive changes are subsequently made to program materials further pilot tests of the revised program materials should be conducted to affirm or amend, as appropriate, the average completion time.

**.38 Standard No. 14. Instructors or discussion leaders of learning activities should receive CPE credit for both their preparation and presentation time to the extent the activities maintain or improve their professional competence and meet the requirements of these CPE standards.**

**.39 Commentary.** Instructors, discussion leaders, or speakers who present a learning activity for the first time should receive CPE credit for actual preparation time up to two times the number of CPE credits to which participants would be entitled, in addition to the time for presentation. For example, for learning activities in which participants could receive 8 CPE credits, instructors may receive up to 24 CPE credits (16 for preparation plus 8 for presentation). For repeat presentations, CPE credit can be claimed only if it can be demonstrated that the learning activity content was substantially changed and such change required significant additional study or research.

**.40 Standard No. 15. Writers of published articles, books, or CPE programs should receive CPE credit for their research and writing time to the extent it maintains or improves their professional competence.**

**.41 Commentary.** Writing articles, books, or CPE programs for publication is a structured activity that involves a process of learning. For the writer to receive CPE credit, the article, book, or CPE program must be formally reviewed by an independent party. CPE credits should be claimed only upon publication.

**.42 Standard No. 16. CPE credits recommended by a CPE program sponsor of independent study must not exceed the time the participant devoted to complete the learning activities specified in the learning contract.**

**.43 Commentary.** The credits to be recommended by an independent study CPE program sponsor should be agreed upon in advance and should be equated to the effort expended to improve professional competence. The credits cannot exceed the time devoted to the learning activities and may be less than the actual time involved.

## Standards for CPE Program Reporting

**.44 Standard No. 17. CPE program sponsors must provide program participants with documentation of their participation, which includes the following:**

- **CPE program sponsor name and contact information.**
- **Participant's name.**
- **Course title.**
- **Course field of study.**
- **Date offered or completed.**
- **If applicable, location.**
- **Type of instructional/delivery method used.**
- **Amount of CPE credit recommended.**
- **Verification by CPE program sponsor representative.**

**.45 Commentary.** CPE program sponsors should provide participants with documentation to support their claims of CPE credit. Acceptable evidence of completion includes:

- For group and independent study programs, a certificate or other verification supplied by the CPE program sponsor.
- For self-study programs, a certificate supplied by the CPE program sponsor after satisfactory completion of an examination.
- For instruction credit, a certificate or other verification supplied by the CPE program sponsor
- For a university or college course that is successfully completed for credit, a record or transcript of the grade the participant received.
- For university or college non-credit courses, a certificate of attendance issued by a representative of the university or college.
- For published articles, books, or CPE programs, (1) a copy of the publication (or in the case of a CPE program, course development documentation) that names the writer as author or contributor, (2) a statement

from the writer supporting the number of CPE hours claimed, and (3) the name and contact information of the independent reviewer(s) or publisher.

**.46 Standard No. 18. CPE program sponsors must retain adequate documentation for five years to support their compliance with these standards and the reports that may be required of participants.**

**.47 Commentary.** Evidence of compliance with responsibilities set forth under these Standards which is to be retained by CPE program sponsors includes, but is not limited to:

- Records of participation.
- Dates and locations.
- Instructor names and credentials.
- Number of CPE credits earned by participants.
- Results of program evaluations.

Information to be retained by developers includes copies of program materials, evidence that the program materials were developed and reviewed by qualified parties, and a record of how CPE credits were determined.

**.48** For CPE program sponsors offering self-study programs, appropriate pilot test records must be retained regarding the following:

- When the pilot test was conducted.
  - The intended participant population.
  - How the sample was determined.
  - Names and profiles of sample participants.
  - A summary of participants' actual completion time.
-



## CPE Section 400

### *Glossary*

**.01 Advanced.** Learning activity level most useful for individuals with mastery of the particular topic. This level focuses on the development of in-depth knowledge, a variety of skills, or a broader range of applications. Advanced level programs are often appropriate for seasoned professionals within organizations; however, they may also be beneficial for other professionals with specialized knowledge in a subject area.

**.02 Basic.** Learning activity level most beneficial to CPAs new to a skill or an attribute. These individuals are often at the staff or entry level in organizations, although such programs may also benefit a seasoned professional with limited exposure to the area.

**.03 Continuing Professional Education (CPE).** An integral part of the lifelong learning required to provide competent service to the public. The set of activities that enables CPAs to maintain and improve their professional competence.

**.04 CPE credit.** Fifty minutes of participation in a group, independent study or self-study program. One-half CPE credit increments (equal to 25 minutes) are permitted after the first credit has been earned in a given learning activity.

**.05 CPE program sponsor.** The individual or organization responsible for setting learning objectives, developing the program materials to achieve such objectives, offering a program to participants, and maintaining the documentation required by these standards. The term CPE program sponsor may include associations of CPAs, whether formal or informal, as well as employers who offer in-house programs.

**.06 Evaluative feedback.** Specific response to incorrect answers to questions in self-study programs. Unique feedback must be provided for each incorrect response, as each one is likely to be wrong for differing reasons.

**.07 Group program.** An educational process designed to permit a participant to learn a given subject through interaction with an instructor and other participants either in a classroom or conference setting or by using the Internet.

**.08 Independent study.** An educational process designed to permit a participant to learn a given subject under a learning contract with a CPE program sponsor.

**.09 Instructional methods.** Delivery strategies such as case studies, computer-assisted learning, lectures, group participation, programmed instruction, teleconferencing, use of audiovisual aids, or work groups employed in group, self-study, or independent study programs.

**.10 Intermediate.** Learning activity level that builds on a basic program, most appropriate for CPAs with detailed knowledge in an area. Such persons are often at a mid-level within the organization, with operational and/or supervisory responsibilities.

**.11 Internet-based programs.** A learning activity, through a group program (paragraph .07 above) or a self-study program (paragraph .22 following), that is designed to permit a participant to learn the given subject matter via the Internet. To qualify as either a group or self-study program, the Internet learning activity must meet the respective standards.

**.12 Learning activity.** An educational endeavor that maintains or improves professional competence.

**.13 Learning contract.** A written contract signed by an independent study participant and a qualified CPE program sponsor prior to the commencement of the independent study that:

1. Specifies the nature of the independent study program and the time frame over which it is to be completed, not to exceed 15 weeks.
2. Specifies that the output must be in the form of a written report that will be reviewed by the CPE program sponsor or a qualified person selected by the CPE program sponsor.
3. Outlines the maximum CPE credit that will be awarded for the independent study program, but limits credit to actual time spent.

**.14 Learning objectives.** Specifications on what participants should accomplish in a learning activity. Learning objectives are useful to program developers in deciding appropriate instructional methods and allocating time to various subjects.

**.15 Learning plans.** Structured processes that help CPAs guide their professional development. They are dynamic instruments used to evaluate and document learning and professional competence development. This may be reviewed regularly and modified, as CPAs' professional competence needs change. Plans include:

- A self-assessment of the gap between current and needed knowledge, skills, and abilities;
- A set of learning objectives arising from this assessment; and
- Learning activities to be undertaken to fulfill the learning plan.

**.16 Overview.** Learning activity level that provides a general review of a subject area from a broad perspective. These programs may be appropriate for professionals at all organizational levels.

**.17 Personal development.** A field of study that covers such skills as communications, managing the group process, dealing effectively with others, interviewing, counseling, and career planning.

**.18 Pilot test.** Sampling of at least three independent individuals representative of the intended participants to measure the average completion time to determine the recommended CPE credit for self-study programs.

**.19 Professional competence.** Having requisite knowledge, skills, and abilities to provide quality services as defined by the technical and ethical standards of the profession. The expertise needed to undertake professional responsibilities and to serve the public interest.

**.20 Program of learning.** A collection of learning activities that are designed and intended as continuing education and that comply with these standards.

**.21 Reinforcement feedback.** Specific responses to correct answers to questions in self-study programs. Such feedback restates why the answer selected was correct.

**.22 Self-study program.** An educational process designed to permit a participant to learn a given subject without major involvement of an instructor. Self-study programs use a pilot test to measure the average completion time from which the recommended CPE credit is determined.

**.23 Update.** Learning activity level that provides a general review of new developments. This level is for participants with a background in the subject area who desire to keep current.

## Effective Dates

**.24** Unless otherwise established by state licensing bodies and/or other professional organizations, these Standards are to be effective as follows:

- For CPAs, group programs and independent study—January 1, 2002.
  - For self-study courses being published for the first time after December 31, 2002—upon publication.
  - For self-study courses already in existence as of December 31, 2002—January 1, 2004.
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# CPE TOPICAL INDEX

References are to CPE section and paragraph numbers.

## A

### ACCEPTABLE SUBJECTS

- Learning Activities ..... 200.04

### AMERICAN INSTITUTE OF CPAs

- Membership Maintenance and CPE Requirement ..... 10
- Policies for the CPE Membership Requirement ..... 10
- Sponsor of CPE Program ..... 10
- Versus State CPE Requirements ..... 10

## C

### COMPETENCE

- Continuing Development ..... 100.03
- CPE Membership ..... 10
- Glossary of Terms ..... 400.03; 400.12; 400.15; 400.19
- Standards for CPAs ..... 200.01–.05; 200.10; 200.12–.15
- Standards for CPE Program Sponsors ..... 300.04; 300.11; 300.38; 300.40; 300.43

### CONTINUING PROFESSIONAL EDUCATION

- Acceptable Subjects ..... 10; 200.04
- Advanced Learning Activity Level ..... 300.04; 400.01
- AICPA vs. State Requirements ..... 10
- Audits of Compliance ..... 10
- Basic Learning Activity Level ..... 300.04; 400.02
- Basic Requirements ..... 10
- Change in Membership Status ..... 10
- Credit Limitations ..... 200.06; 200.11; 200.15; 400.13
- Credit Measurement ..... 10; 200.10
- Documentation and Records Retention ..... 10; 200.08–.11; 300.13; 300.44–.46; 400.05
- Evaluation of Programs ..... 10; 300.23–.25
- Exceptions to Requirements ..... 10; 200.07
- Failure to Meet Requirements ..... 10
- Glossary of Terms ..... 400.01–.23
- Grace Period ..... 10
- Inactive Members ..... 10
- Independent Study ..... 200.14–.15

### CONTINUING PROFESSIONAL

#### EDUCATION—continued

- Instructors of Programs ..... 10; 300.11; 300.24–.25; 300.38–.39; 300.47
- Intermediate Learning Activity Level ..... 300.04; 400.10
- Learning Objectives ..... 300.03–.04; 300.10; 300.14; 300.17; 300.23–.24; 400.05; 400.14–.15
- Members in Public Practice ..... 10
- Members Not in Public Practice ..... 10
- New Members ..... 10
- Overview Learning Activity Level ..... 300.04; 400.16
- Policies for Membership Requirement ..... 10
- Prerequisites of Programs ..... 300.05–.06; 300.17; 300.19; 300.24
- Program Developers ..... 10; 400.14
- Program Materials ..... 300.19; 300.24; 300.37; 300.47; 400.05
- Program Sponsors ..... 10; 200.01; 200.06; 200.09; 200.11–.15; 300.01–.02; 300.04–.07; 300.09–.10; 300.12–.13
- Purpose of CPE Requirement ..... 10
- Qualifying Programs ..... 10; 200.08–.09
- Reinstated Individuals ..... 10
- Reporting ..... 10; 100.04; 200.06; 200.09–.10; 300.44
- Responsibilities of Members ..... 10; 100.01–.04; 200.02
- Retired Members ..... 10
- Self-Study Programs ..... 10; 200.11; 200.13; 300.10; 300.14–.16; 300.24; 300.36; 300.45; 300.48
- Standards for CPAs ..... 200.01–.15
- Standards for CPE Program Sponsors ..... 300.01–.48
- Standards for Program Development ..... 300.03–.16
- Standards for Program Measurement ..... 300.29–.43
- Standards for Program Presentation ..... 300.17–.28
- Standards for Program Reporting ..... 300.44–.48
- Standards, General ..... 200.01–.15
- Standards, Preamble ..... 100.01–.04
- Writing for Publication ..... 10; 300.40–.41

**CREDIT, CPE**

- Acceptable Evidence of Completion ..... 200.11; 300.45
- Basic Requirements ..... 10
- CPE vs. College Credit ..... 300.32–.33
- Instructors ..... 300.38–.39
- Limitations ..... 200.06–.07; 200.11; 200.13; ..... 300.35; 300.41–.45
- Measurement ..... 10; 300.29–.48
- Self-Study Programs ..... 10; 300.10–.16
- Writing for Publication ..... 300.40–.41

**D**

**DISCLOSURE**

- CPE Program Information ..... 300.17–.19

**DOCUMENTATION**

- CPA Responsibilities ..... 10; 200.09–.11
- CPE Program Sponsors ..... 10; 300.46–.48
- CPE Records ..... 10; 200.11; 300.44
- Self-Study Programs ..... 300.48

**M**

**MEMBERSHIP**

- Changing Status ..... 10
- Loss ..... 10
- Member ..... 10
- New ..... 10
- Policies for CPE Requirement ..... 10
- Reinstatement ..... 10

**P**

**PROGRAM DEVELOPERS, CPE**

- Information to Be Retained ..... 300.47
- Learning Objectives ..... 400.14
- Participant Satisfaction, Evaluation Results ..... 300.25
- Responsibilities ..... 300.03–.16
- Standards for CPE Program Development ..... 300.03–.16

**PROGRAM INSTRUCTORS, CPE**

- Earning Credit ..... 300.38–.40
- Evaluation of ..... 300.20–.22; 300.24–.25
- Qualifications ..... 300.10–.11; 300.20–.21

**PROGRAM SPONSORS, CPE**

- Descriptive Program Materials ..... 300.17–.19
- Evaluation of Instructors ..... 300.20–.22; ..... 300.24–.25
- Evaluation of Instructional Methods and Objectives ..... 300.23–.28
- General Standards ..... 300.01–.02
- Responsibilities ..... 10; 300.01–.48
- Sponsored Learning Activities, Requirements of ..... 300.03–.09

- Sponsored Learning Activities— Program Level, Content, and Objectives to Be Specified ..... 300.03–.04
- Standards for CPE Program Development ..... 300.17–.28
- Standards for CPE Program Measurement ..... 300.29–.43
- Standards for CPE Program Presentation ..... 300.03–.16
- Standards for CPE Program Reporting ..... 300.44–.48

**S**

**SELF-STUDY PROGRAMS**

- CPE Credit ..... 10; 200.13; 300.15; ..... 300.36–.37
- Documentation ..... 10; 300.45
- Miscellaneous ..... 10; 200.11; 200.13; ..... 300.10; 300.14–.16; 300.24; 300.36; ..... 300.45; 300.48

**STATE BOARDS OF ACCOUNTANCY**

- Versus AICPA CPE Requirements ..... 10

**STATE SOCIETIES, CPA**

- Sponsor of CPE Program ..... 10
- Versus AICPA CPE Requirements ..... 10

**T**

**TERMINOLOGY**

- Advanced Learning Activity Level ..... 400.01
- Basic Learning Activity Level ..... 400.02
- Continuing Professional Education ..... 400.03
- CPE Credit ..... 400.04
- CPE Program Sponsor ..... 400.05
- Evaluative Feedback ..... 400.06
- Group Program ..... 400.07
- Independent Study ..... 400.08
- Instructional Methods ..... 400.09
- Intermediate Learning Activity Level ..... 400.10
- Internet-based Programs ..... 400.11
- Learning Activity ..... 400.12
- Learning Contract ..... 400.13
- Learning Objectives ..... 400.14
- Learning Plans ..... 400.15
- New Members ..... 10
- Overview Learning Activity Level ..... 400.16
- Personal Development ..... 400.17
- Pilot Test ..... 400.18
- Professional Competence ..... 400.19
- Program of Learning ..... 400.20; 300.35
- Program Sponsor ..... 300.01–.02
- Reinforcement Feedback ..... 400.21
- Self-Study Program ..... 400.22
- Update Learning Activity Level ..... 400.23



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