

# AICPA Plain English Guide to Independence

## January 1, 2008

---

---

### TABLE OF CONTENTS

#### *NOTICE TO READERS*

#### *PREFACE*

*Purpose of this guide*

*Conventions and key terms used*

#### *INTRODUCTION*

*What is independence?*

*What should I do if no specific guidance exists on my particular independence issue?*

*When is independence required, and who sets the rules?*

*In addition to the AICPA, who else sets independence rules?*

#### *APPLYING THE RULES—COVERED MEMBERS AND OTHER FIRM PROFESSIONALS*

*How do the independence rules apply to me?*

*Do any of the rules apply to me if I am not a covered member?*

*What if I was formerly employed by a client or I was a member of the client's board of directors?*

*What rules apply if I am considering employment with an attest client?*

*What if I accept employment or a board position with an attest client?*

#### *APPLYING THE RULES—FAMILY MEMBERS*

*When is my family subject to the rules?*

*What about my other close relatives?*

## *FINANCIAL RELATIONSHIPS*

*When do my (or my family's) financial interests impair independence?*

*What are the rules that apply to my mutual fund investments (and those of my family) if my firm audits those mutual funds?*

*Which rules pertain to my mutual fund investments (and those of my family) if my firm audits companies held in those mutual funds?*

*May I have a joint closely held investment with a client?*

*May my family or I borrow money from or lend money to a client?*

*May I have a brokerage account with a client?*

*May I have a bank account with a client?*

*May I have an insurance policy with a client?*

*May I give gifts or entertainment to or accept gifts or entertainment from a client?*

## *BUSINESS RELATIONSHIPS*

*Which business relationships with a client impair independence?*

## *NONATTEST SERVICES*

*Which rules describe the nonattest services that my firm and I may or may not provide to attest clients?*

*What are the rules concerning performing bookkeeping services for a client?*

*May my firm provide internal audit assistance to a client?*

*May my firm provide valuation, appraisal, or actuarial services to a client?*

*May my firm provide investment advisory services to a client?*

*May my firm design or implement an information system for a client?*

### *FEE ISSUES*

*What types of fee arrangements between my firm and a client are prohibited?*

*When are referral fees permitted?*

*Is independence affected when a client owes the firm fees for professional services the firm has already provided?*

*Does being compensated for selling certain services to clients affect my independence?*

*Does it matter if a significant proportion of my firm's fees come from a particular client?*

### *FURTHER ASSISTANCE*

*Where can I find further assistance with my independence questions?*

## Notice to Readers

---

This publication is designed to provide illustrative information with respect to the subject matter covered. It does not establish standards or preferred practices. The material was prepared by AICPA staff and has not been considered or acted upon by senior technical committees or the AICPA Board of Directors and does not represent an official opinion or position of the AICPA. It is provided with the understanding that the author and publisher are not engaged in rendering legal, accounting, or other professional service. If legal advice or other expert assistance is required, the services of a competent professional person should be sought. The author and publisher make no representations, warranties, or guarantees as to and assume no responsibility for the content or application of the material contained herein, and expressly disclaim all liability for any damages arising out of the use of, reference to, or reliance on such material.

Copyright © 2008 by  
American Institute of Certified Public Accountants, Inc.  
New York, NY 10036-8775

Permission is granted to make copies of this work provided that such copies are for personal, intraorganizational, or educational use only and are not sold or disseminated and provided further that each copy bears the following credit line: "Copyright © 2008 by the American Institute of Certified Public Accountants, Inc. Used with permission."

---

## Preface

---

### *Purpose of this guide*

The purpose of the *AICPA Plain English Guide to Independence* is to help you understand your independence requirements under the *AICPA Code of Professional Conduct* (the code) and, if applicable, other rule-making and standard-setting bodies. Independence generally implies one's ability to act with integrity and exercise objectivity and professional skepticism. The AICPA and other rule-making bodies have developed rules that establish and interpret independence requirements for the accounting profession. We broadly use the term *rules* to also mean standards, interpretations, rulings, laws, regulations, opinions, policies, or positions. This guide discusses in plain English the independence requirements of the principal rule-making bodies in the United States so you can understand and apply the requirements with greater confidence and ease.

This guide is intentionally concise, so it does not cover all the rules (some of which are complex), nor does it cover every aspect of them. Nonetheless, this guide should help you to identify independence issues that may require further consideration. Therefore, you should always refer to the rules directly, in addition to your firm's policies on independence, for complete information.

### *Conventions and key terms used*

This guide contains answers to frequently asked questions (FAQs) on independence. Some of the conventions used are described in the following list:

- The word *Note* in boldface italics introduces text that emphasizes important points, highlights applicable government regulations, or indicates that a rule change may soon occur.
- AICPA interpretations and rulings to the *AICPA Code of Professional Conduct* are linked.
- Web addresses (universal resource locators or URLs) and hyperlinks to other sources of information are provided.
- Information on additional resources appears at the end of this guide to help you resolve your independence issues (see the question "Where can I find further assistance with my independence questions?").

We describe the rules of the U.S. Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB)—that is, those that apply to audits of public companies—in boxed text (like this one) and provide citations to specific rules. Generally, we provide these descriptions where SEC and PCAOB rules impose additional requirements, or where the SEC and PCAOB rules otherwise differ from the AICPA rules.

This guide uses the following key terms:

- *Client* (or *attest client*). An entity with respect to which independence is required.
  - *Firm*. A form of organization permitted by law or regulation (whose characteristics conform to resolutions of AICPA Council) that is engaged in the practice of public accounting.
-

---

## Introduction

---

### ***What is independence?***

*Independence* is defined in ET section 100.01, *Conceptual Framework for AICPA Independence Standards* (AICPA, *Professional Standards*, vol. 2), referred to herein as *the conceptual framework*, as follows:

- *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.
- *Independence in appearance.* The avoidance of circumstances that would cause a reasonable and informed third party, having knowledge of all relevant information, including safeguards 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.

These definitions reflect the longstanding professional requirement that members who provide services to entities for which independence is required be independent both “in fact” (that is, “of mind”) and in appearance.

### ***What should I do if no specific guidance exists on my particular independence issue?***

The “Other Considerations” section of Ethics Interpretation No. 101-1, “Interpretation of Rule 101” under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.02), recognizes that it is impossible for the code to identify all circumstances in which the appearance of independence might be questioned. The conceptual framework is referred to in Ethics Interpretation No. 101-1 of the code.

Specifically, Ethics Interpretation No. 101-1 requires that members use the risk-based approach described in the conceptual framework when making independence decisions involving matters that are not specifically addressed in the independence interpretations and rulings in the code. Where threats to independence are not at an acceptable level, safeguards must 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 must be documented.

The conceptual framework provides a valuable tool to help you comply with the requirement in the “Other Considerations” section to evaluate whether a specific

circumstance that is not addressed in the code would pose an unacceptable threat to your independence. These new provisions became effective for all independence decisions made after April 30, 2007.

***When is independence required, and who sets the rules?***

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

- financial statement audits,
- financial statement reviews, and
- other attest services as defined in the Statements on Standards for Attestation Engagements.

Performing a compilation of a client's financial statements does not require independence. However, if a nonindependent firm issues such a compilation report, the report must state, "I am (we are) not independent with respect to XYZ Company."<sup>1</sup>

You and your firm are not required to be independent to perform services that are not attest services (for example, tax preparation or advice or consulting services, such as personal financial planning) if they are the only services your firm provides to a particular client.

**Note:** You should familiarize yourself with your firm's independence policies, quality control systems, and list or database of attest clients.

***In addition to the AICPA, who else sets independence rules?***

Many clients are subject to oversight and regulation by governmental agencies. For example, The Government Accountability Office (GAO) sets independence rules that apply to entities audited under Governmental Auditing Standards. For these clients (and others, such as those subject to regulation by the SEC or Department of Labor [DOL]), you and your firm also must comply with the independence rules established by those agencies.

The SEC regulates public companies<sup>2</sup> and establishes the qualifications of independent auditors. This guide refers to these independence rules as *SEC rules*.

The PCAOB, a private standards-setting body whose activities are overseen by the SEC, is authorized to set, among other things, auditing, attestation, quality control, ethics, and

---

<sup>1</sup> See AICPA, *Professional Standards*, vol. 2, AR sec. 100.19.

<sup>2</sup> This includes companies that are registered with or are otherwise regulated by the U.S. Securities and Exchange Commission (SEC) or companies that file audited financial statements with the SEC, including foreign filers.

independence standards for accounting firms that audit public companies. The PCAOB adopted interim ethics standards based on the provisions of the code; Ethics Rule 102, *Integrity and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 102); Ethics Rule 101; and interpretations and rulings under those rules as of April 16, 2003. It also adopted Independence Standards Board standards. To the extent that the SEC's rules are more or less restrictive than the PCAOB's interim independence standards, registered public accounting firms must comply with the more restrictive requirements.

In addition to its detailed rules, the SEC looks to its general standard of independence and four basic principles to determine whether independence is impaired. The general standard is an appearance standard that considers whether a reasonable investor with knowledge of all relevant facts and circumstances would conclude that an accountant is independent.

Under the four basic principles, an auditor cannot (1) function in the role of management, (2) audit his or her own work, (3) serve in an advocacy role for the client, or (4) have a mutual or conflicting role with the client.

**Note:** The SEC has recently voted to approve PCAOB Interim Professional Auditing Standards Rule 3525, *Audit Committee Preapproval of Non-audit Services Related to Internal Control Over Financial Reporting* (AICPA, *PCAOB Standards and Related Rules*), which addresses the manner in which auditors must obtain preapproval of internal control-related services from audit committees.

Other organizations that establish independence requirements that may be applicable to you and your firm include the following. You should contact these organizations directly for further information:

- State boards of accountancy
- State CPA societies
- Federal and state agencies

**Note:** Generally, the AICPA independence rules will apply to you in all situations involving an attest client. If an additional set of rules governing an engagement also applies, you should comply with the most restrictive rule or the most restrictive portions of each rule.

Once you determine that your firm provides attest services to a client and which rules apply, the next step is to determine how the rules apply to you.

---

## Applying the Rules—Covered Members and Other Firm Professionals

---

### *How do the independence rules apply to me?*

Whenever you are a covered member, you become subject to the full range of independence rules with regard to a specific client. You are a [covered member](#) if you are

- an individual on the client’s [attest engagement team](#),
- an [individual in a position to influence the client’s attest engagement](#),
- a partner or manager who provides more than 10 hours of nonattest services to the attest client,
- a [partner](#) in the office in which the lead attest engagement partner primarily practices in connection with the client’s attest engagement,
- the [firm](#), including the firm’s employee benefit plans, or
- an entity whose operating, financial, or accounting policies can be controlled<sup>3</sup> by any of the individuals or entities described in items 1 through 5 or by 2 or more such individuals or entities if they act together.

The SEC uses the term *covered person*<sup>4</sup> to describe the individuals in a firm who are subject to SEC independence rules. This term is largely consistent with the AICPA’s term *covered member*. The only difference between the two definitions is that of classification. The AICPA considers consultants to be in a position to influence the engagement (SEC uses the term *chain of command*), whereas the SEC considers these persons to be on the attest engagement team. Overall, the definitions are the same.

**Note:** This guide uses the term *covered member* (and *covered person* with respect to SEC rules) extensively in explaining the “personal” independence rules (for example, rules that apply to you and your family’s loans, investments, and employment). Therefore, it is important that you understand these terms before proceeding. Also, remember to check your firm’s policies to determine whether they are more restrictive than the AICPA or SEC rules.

### *Do any of the rules apply to me if I am not a covered member?*

---

<sup>3</sup> As defined by generally accepted accounting principles for consolidation purposes.

<sup>4</sup> Rule 2-01(f)(11). Also see *Discussion of Rule 2-01, Covered persons in the firm*, in the [SEC’s Final Rule Release \[Section IV \(H\)\(9\)\]](#).

Yes, these rules apply in certain circumstances even if you are not a covered member. There are two categories of relationships with a client that, due to their magnitude, impair independence even if you are not a covered member. These relationships are defined as follows:

- Director, officer, or employee (or in any capacity equivalent to a member of management) of the client, promoter, underwriter, voting trustee, or trustee of any of the client's employee benefit plans
- Owner of more than [five percent](#) of an attest client's outstanding equity securities (or other ownership interests)

The independence rules prohibit these relationships if you are a partner or professional employee in a public accounting firm.

***What if I was formerly employed by a client or I was a member of the client's board of directors?***

There are a number of things you must be aware of, including the following:

1. You may not participate in the client's attest engagement, or be in a position to influence the engagement, for any periods covering the time that you were associated with the client. So, for example, if you worked for the client in 2007, you would be prohibited from serving on the client's audit engagement for the fiscal year 2007 financial statements. You also could not serve in a position that would allow you to influence the fiscal 2007 engagement. For example, you could not directly or indirectly supervise the audit engagement partner.
2. Before becoming a covered member, you must
  - terminate any relationships with the client as described in Ethics Interpretation No. 101-1, "Interpretation of Rule 101," under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.02),<sup>5</sup>
  - dispose of all financial interests in the client,<sup>6</sup>
  - collect and repay all loans to or from the client (except those specifically permitted or grandfathered),<sup>7</sup>
  - cease active participation in the client's employee benefits plans (except for benefits under the Consolidated Omnibus Budget Reconciliation Act of 1985), and
  - liquidate or transfer any vested benefits in the client's retirement plans.

---

<sup>5</sup> This includes the director, officer, employee in any capacity equivalent to that of a member of management, promoter underwriter, voting trustee, or trustee for the entity's pension and profit sharing trust.

<sup>6</sup> See "When do my (or my family's) financial interests impair independence?" in this guide.

<sup>7</sup> Also see AICPA Ethics Interpretation No. 101-5, "[Loans from financial institution clients and related terminology](#)" of Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.07).

***What rules apply if I am considering employment with an attest client?***

If an attest client offers you employment, or you seek employment with an attest client, you may need to take certain actions. If you are on that client's attest engagement team or can otherwise influence the engagement, you must promptly report any employment negotiations with the client to the appropriate person in your firm. You cannot participate in the engagement until your negotiations with the client end.

***What if I accept employment or a board position with an attest client?***

Being employed by a client or a member of the client's board of directors impairs independence. However, even if you leave your firm to take a position with a client, independence may still be affected. This would be the case if you accept a [key position](#) with the client, which means that you prepare financial statements or accounting records or are otherwise able to influence the client's statements or records. A few examples of key positions are controller, chief financial officer, or treasurer. Remember that the substance, and not only the position title, determines whether a position is considered "key" or not.

If you meet the following conditions, having a key position with a client will not impair your firm's independence:

- The amounts the firm owes you (capital balance or retirement benefits) are based on a fixed formula and are not material to the firm.
- You cannot influence the firm's operations or financial policies.
- You do not participate or appear to participate in the firm's business or professional activities.

Your firm must consider whether it should apply additional procedures to ensure that your transition to the client has not compromised the firm's independence and that independence will be maintained going forward. Some things the firm should consider are

- whether you served on the engagement team and for how long,
- positions you held with the firm and your status,
- your position and status with the client, and
- the amount of time that has passed since you left the firm.

Based on these factors, the firm may decide to

- adjust the audit plan to reduce the risk that your knowledge of the plan could lessen the audit's effectiveness,
- reconsider the successor engagement team to ensure it has sufficient stature and experience to deal effectively with you in your new position, or

- perform an internal technical review of the next attest engagement to determine whether engagement personnel exercised the appropriate level of professional skepticism in evaluating your work and representations.<sup>8</sup>

Under SEC rules, if a former partner will be in an accounting role or financial reporting oversight role with an SEC audit client, he or she may not have:

- a capital balance with the firm,
- a financial arrangement with the firm (for example, retirement benefits) that is not fully funded by the firm, or
- influence over the firm's operations or financial policies.

The SEC uses the terms *accounting role* and *financial reporting oversight role*<sup>9</sup> in its rules; taken together, these terms are consistent with the AICPA term *key position*. The SEC also requires a one-year cooling-off period for members of the audit engagement team who assume a *financial reporting oversight role* with that client. In other words, if an engagement team member who participated on the audit of the current (or immediately preceding) fiscal year goes to work for a client, the firm's independence would be impaired.

Only members who have provided fewer than 10 hours of services of audit, review, or other attest services to the client (and did not serve as either the lead or concurring partner for the client) are not considered to be members of the audit engagement team for purposes of this rule.

This rule applies to the audit client and its consolidated entities.

---

<sup>8</sup> An objective professional with the appropriate stature and expertise should perform this review, and the firm should take any recommendation(s) that result from the review.

<sup>9</sup> *Accounting role* or *financial reporting role* means a role in which a person is in a position to or does (1) exercise more than minimal influence over the contents of the accounting records or anyone who prepares them or (2) exercise influence over the contents of the financial statements or anyone who prepares them, such as when the person is a member of a board of directors or similar management or governing body, chief executive officer, president, chief financial officer, general counsel, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, vice president of marketing, or any equivalent position.

---

## Applying the Rules—Family Members

### *When is my family subject to the rules?*

If you are a covered member with respect to a client, members of your immediate family (your spouse, or equivalent, and your dependents) generally must follow the same rules that you do. For example, your spouse's investments must be investments that you could own under the rules. This rule applies even if your spouse keeps the investments in his or her own name or with a different broker.

There are two exceptions to this general rule:

1. Your immediate family member's employment with a client would not impair your firm's independence provided he or she is not in a [key position](#).
2. Immediate family members of certain covered members may invest in a client through an employee benefit plan (for example, retirement or savings account) provided the plan is normally offered to all similar employees. The covered members whose families may invest this way are
  - partners and managers who provide only nonattest services to the client, and
  - partners who are covered members only because they practice in the same office where the client's lead attest partner practices in connection with the engagement.

In other words, immediate family of individuals on the attest engagement team or of those who can influence the attest engagement team may not invest in a client under any circumstances.

Under SEC rules, the immediate family of certain covered persons may have financial interests in SEC audit clients only if such interests are an unavoidable consequence of their participation in an employee compensation or benefit plan. This means that if nonclient investments are available through the plan, the immediate family member must choose those investments.

### *What about my other close relatives?*

The close relatives (siblings, parents, and nondependent children) of most covered members are subject to some employment and financial restrictions. Your [close relative's employment](#) by a client in a key position impairs independence, except for covered members who provide only nonattest services to a client.

Rules pertaining to your close relatives' financial interests differ depending on why you are considered a covered member:

- If you are a covered member because you participate on the client's [attest engagement team](#), your independence would be considered to be impaired if you are aware that your close relative has a financial interest in the client that either
  - was material to your relative's net worth, or
  - enables the relative to exercise [significant influence](#) over the client.
  
- If you are a covered member because you are able to influence the client's attest engagement or are a partner in the office in which the lead attest engagement partner practices in connection with the engagement, your independence will be impaired if you are aware that your close relative has a financial interest in the client that
  - is material to your relative's net worth, and
  - enables your relative to exercise significant influence over the client.

Under SEC rules, your close family members include your spouse (or equivalent) and dependents and your parents, nondependent children, and siblings. If you are a covered person, your independence is affected if your close family member

- has an accounting role or financial reporting oversight role with the client (for example, the family member is a treasurer, chief financial officer, accounting supervisor, or controller), or
- owns more than five percent of a client's equity securities or controls the client.

In addition, independence is considered to be impaired if any partner's close family member controls a client.

---

## Financial Relationships

---

### *When do my (or my family's) financial interests impair independence?*

This section of the guide discusses various types of financial relationships and how they affect independence. Although this section focuses on how these rules apply to you and your family, keep in mind that your firm is also subject to the financial relationship rules (because firms are included in the AICPA definition of *covered member*).

As a covered member, you (and your spouse, or equivalent, and dependents) are not permitted to have

- a direct financial interest in that client, regardless of how immaterial it would be to your net worth, or
- a material indirect financial interest in that client.

**Note:** The code does not define or otherwise provide guidance on determining materiality. In determining materiality, you should apply professional judgment to all relevant facts and circumstances and refer to applicable guidance in the professional literature. Both qualitative and quantitative factors should be considered.

In addition, if you commit to acquire a direct or material indirect financial interest in a client, your independence would be impaired. For example, if you sign a stock subscription agreement with the client, your independence would be considered impaired as soon as you sign the agreement.

Examples of financial interests include shares of stock, mutual fund shares, debt security issued by an entity, partnership units, stock rights, options or warrants to acquire an interest in a client, or rights of participation such as puts, calls, or straddles.

Direct financial interests are financial interests that are

- owned by you directly,
- under your control, or
- beneficially owned<sup>10</sup> by you through an investment vehicle, estate, trust, or other intermediary if you can either
  - control the intermediary, or

---

<sup>10</sup> A financial interest is beneficially owned if an individual or entity is not the record owner of the interest but has a right to some or all of the underlying benefits of ownership. These benefits include the authority to direct the voting or the disposition of the interest or to receive the economic benefits of the ownership of the interest.

- have the authority to supervise or participate in the intermediary's investment decisions.

For example, if you invest in a participant-directed 401(k) plan, whereby you are able to select the investments held in your account or are able to select from investment alternatives offered by the plan, you would be considered to have a direct financial interest not only in the 401(k) plan but also in the investments held in your account.

You also have a direct financial interest in a client if you have a financial interest in a client through one of the following:

- A partnership, if you are a general partner
- A Section 529 savings plan, if you are the account owner
- An estate, if you serve as an [executor and meet certain other criteria](#)
- A trust, if you serve as the [trustee and meet certain other criteria](#)

For example, suppose you are a covered member with respect to ABC Co. and you are also a general partner of XYZ Partnership. XYZ Partnership owns shares in ABC Co. Under the independence rules, you would be deemed to have a direct financial interest in ABC Co., which would impair your independence, regardless of materiality.

An indirect financial interest arises if you have a financial interest that is beneficially owned through an investment vehicle, estate, trust, or other intermediary when you can neither control the intermediary nor have the authority to supervise or participate in the intermediary's investment decisions.

For example, if you invest in a defined contribution plan that is not participant-directed and you have no authority to supervise or participate in the plan's investment decisions, you would be considered to have an indirect financial interest in the underlying plan investments, in addition to a direct financial interest in the plan.

**Note:** Ethics Interpretation No. 101-15, [Financial Relationships](#), under Rule 101 *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.17), of the code (effective December 31, 2005) provides extensive examples of various types of financial interests and whether they should be considered to be direct or indirect financial interests, including investments in mutual funds, retirement and savings plans, Section 529 plans, trusts, partnerships, and insurance products.

The SEC classifies your investment in a client held through another entity (the intermediary) as *direct* if either of the following is true:

- You participate in the intermediary's investment decisions or have control over them.
- The investment in the client by the intermediary (which is not a

diversified mutual fund) represents 20 percent or more of the value of its total investments.

If neither of the above applies, your investment in a client through another entity would normally be considered to be an *indirect* financial interest in that client.

***What are the rules that apply to my mutual fund investments (and those of my family) if my firm audits those mutual funds?***

If you are a covered member with respect to a mutual fund attest client of your firm, and you or your immediate family own shares in the fund, you have a direct financial interest in the fund client.

The SEC rules also prohibit the firm and covered persons and their immediate family members from having any financial interest in an entity (even one that is not a client) that is part of an investment company complex that includes an audit client.

***Which rules pertain to my mutual fund investments (and those of my family) if my firm audits companies held in those mutual funds?***

Financial interests that you and your immediate family have in clients through a mutual fund are considered to be indirect financial interests in those clients unless the fund is a diversified mutual fund.

If a mutual fund is diversified, and you or your immediate family, or both, own five percent or less of its outstanding shares, the fund's holdings in clients for which you are a covered person will not be considered material indirect financial interests in those clients. Thus, you would be relieved of the burden of having to monitor whether, and to what degree, the fund invests in audit clients for which you are a covered person.

If the fund is not diversified, or if you or your family, or both, own more than five percent of the fund's equity, you should treat the fund's holdings as indirect financial interests. The following is an illustration.

Suppose ABC Mutual Fund, a diversified mutual fund, owns shares in a client, XYZ, and

- ABC Mutual Fund's net assets are \$10,000,000,
- your shares in ABC Mutual Fund are worth \$50,000,
- ABC Mutual Fund has 10 percent of its assets invested in XYZ, and
- your indirect financial interest in XYZ is \$5,000 ( $\$50,000 \times .10$ ).

If \$5,000 is material to your net worth, independence would be considered to be impaired.

***May I have a joint closely held investment with a client?***

As a covered member, if you or the client individually or collectively controls an investment, that investment is considered to be a [joint closely held investment](#). If this joint closely held investment is material to your net worth, independence would be considered to be impaired. In this rule, the term *client* includes certain persons associated with the client, such as officers, directors, or owners, who are able to exercise significant influence over the client.

The SEC rules prohibit you and your immediate family from having a joint business venture with a client or with persons associated with the client in a decision-making capacity (meaning officers, directors, or substantial shareholders) regardless of whether the venture is material to your net worth. The SEC believes that these joint ventures, whether material or not, cause the client and the audit firm to have mutuality of interests, which impairs independence.

***May my family or I borrow money from or lend money to a client?***

If you are a covered member with respect to an attest client, you and your immediate family may not have a loan to or from

- the client,
- an officer or director of the client, or
- an individual holding 10 percent or more of the client's outstanding equity securities (or other ownership interests).

There are certain exceptions to this rule. First, there are specific loans that covered members are permitted to have from financial institution attest clients. They are

- car loans and leases collateralized by the vehicle,
- credit card and overdraft reserve account balances that are kept current and do not exceed \$ 10,000 (by payment due date, including any grace period),
- passbook loans fully collateralized by cash deposits at the same financial institution, and
- loans fully collateralized by an insurance policy.

In addition, if you have a [loan from a client financial institution](#) (a bank, for example) that meets certain criteria, your loan may be *grandfathered* (that is, you may be allowed to keep it). For your loan to be grandfathered, you must have obtained it under normal lending procedures, terms, and requirements. The following loans may be grandfathered:

- Home mortgages
- Other secured loans

- Unsecured loans that are immaterial to your net worth

Generally speaking, a loan may be grandfathered if you obtained it before

- you became a covered member with respect to the client,
- the financial institution became a client, or
- the client acquired the loan.

To maintain your loan's grandfathered status, you must keep the loan current (make timely payments according to the loan agreement). Also, you cannot renew or renegotiate the terms of the loan (for example, the interest rate or formula) unless the change was part of the original agreement (for example, an adjustable rate mortgage).

The SEC rules differ from the AICPA rules in that secured loans (other than a mortgage on your primary residence) and immaterial unsecured loans may not be grandfathered.

***May I have a brokerage account with a client?***

The AICPA rules indicate that for independence to be maintained, a covered member whose assets are held by a broker-dealer client must not receive any preferential treatment or terms, and any assets that are subject to [risk of loss](#) must be immaterial to the covered member's net worth. In addition, margin accounts may be subject to the [loan rules](#).<sup>11</sup>

Under the SEC rules, you may have a brokerage account with a client if your account (1) only holds cash or securities and (2) is fully insured by the Securities Investor Protection Corporation.

***May I have a bank account with a client?***

As a covered member, you may have a [bank account with a client financial institution](#) (for example, checking, savings, money market accounts, and certificates of deposit) if your deposits are fully insured by state or federal deposit insurance agencies or if uninsured amounts are not material to your net worth.<sup>12</sup>

The SEC prohibits covered persons and their immediate families from having bank account balances in excess of Federal Deposit Insurance Corporation (FDIC) insurance limits. That is, deposits in excess of FDIC

<sup>11</sup> See the preceding question "May my family or I borrow money from or lend money to a client?" in the section titled "Applying the Rules—Family Members."

<sup>12</sup> Both AICPA and SEC rules permit a practical exception for firms that maintain deposits exceeding insured limits when the likelihood of the financial institution experiencing financial difficulties is considered remote.

limits are considered to impair independence even if the amounts are immaterial to you and your family.<sup>13</sup>

***May I have an insurance policy with a client?***

The AICPA rules indicate that to maintain independence, a covered member must not receive any preferential treatment or terms when purchasing an insurance policy from a client. If the policy has an investment option, the financial interest rules must be applied.

The SEC prohibits covered persons and their immediate family members from owning an individual insurance policy issued by a client unless both of the following criteria are met:

- He or she obtained the policy before the professional became a covered person.
- The likelihood of the insurer becoming insolvent is remote.

***May I give gifts or entertainment to or accept gifts or entertainment from a client?***

An ethics ruling<sup>14</sup> addresses the exchange of gifts and entertainment between covered members, the attest client, and certain persons associated with the client (for example, persons in key positions and 10 percent or more of the client's stockholders).

Independence is impaired if the firm, a member of the attest engagement team, or a person able to influence the engagement accepts a gift that is not *clearly insignificant*.

A covered member may give a gift to persons associated with the client and not impair independence if the gift is *reasonable in the circumstances*. In addition, covered members may give or receive entertainment provided it was reasonable in the circumstances.

Another ethics ruling<sup>15</sup> addresses the broader issue of integrity and objectivity when partners, professionals, or their firms exchange gifts or entertainment with clients or persons associated with clients. Generally, gifts are differentiated from entertainment by whether the client participates in the activity with the firm member (for example, giving tickets to a sporting event for the client to use would be considered a gift versus attending the event with the client, which would be considered entertainment).<sup>16</sup>

---

<sup>13</sup> The SEC treats money market funds (as opposed to money market accounts) as mutual funds for purposes of their rules. Also see [Rule 2-01\(c\) \(1\) \(B\)](#).

<sup>14</sup> Ethics Ruling No. 114, "Acceptance or Offering of Gifts or Entertainment to or From an Attest Client," of ET section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 191.228-.229).

<sup>15</sup> Ethics Ruling No. 113, "Acceptance or Offering of Gifts or Entertainment," of ET section 191, *Ethics Rulings on Independence, Integrity, and Objectivity* (AICPA, *Professional Standards*, vol. 2, ET sec. 191.226-.227).

<sup>16</sup> See [www.aicpa.org/download/ethics/Gifts\\_Basis\\_Document.pdf](http://www.aicpa.org/download/ethics/Gifts_Basis_Document.pdf).

Relevant factors in determining reasonableness include the event or occasion (if any) giving rise to the gift or entertainment, cost or value, frequency, whether business was conducted, and who participated.

---

## Business Relationships

### *Which business relationships with a client impair independence?*

As a partner or professional employee of your firm, independence would be considered to be impaired if you entered into certain [business relationships](#) with an attest client of the firm. Accordingly, you may not serve a client as

- employee, director, officer, or in any [management capacity](#),
- [promoter, underwriter, or voting trustee](#),
- stock transfer or escrow agent,
- general counsel (or equivalent), or
- trustee for a client's [pension or profit-sharing trust](#).

In essence, any time you are able to make management decisions on behalf of a client or exercise authority over a client's operations or business affairs, independence is impaired.

Your independence is considered impaired even if you were a volunteer board member because you would be part of the client's governing body and, therefore, would be able to participate in the client's management decisions.

There are two possible exceptions to this rule:

1. If you are an [honorary director or trustee](#) for a client that is a nonprofit charitable, civic, or religious organization, you may hold such position with a client if
  - a. your position is purely honorary,
  - b. you do not vote or participate in managing the organization, or
  - c. your position is clearly identified as honorary in any internal or external correspondence.
2. In addition, you may serve on a [client's advisory board](#) if all of the following criteria are met:
  - a. The board's function is purely advisory.<sup>17</sup>
  - b. The board does not appear to make decisions for the client.
  - c. The advisory board and any decision-making boards are separate and distinct bodies.
  - d. Common membership between the advisory board and any decision-making groups is minimal.

The SEC prohibits direct or material indirect business relationships with a client (or persons associated with client), except when the firm is acting as a

---

<sup>17</sup> When evaluating your independence under this rule, you should examine the applicable board or committee charter to determine whether it is consistent with this ethics ruling.

consumer in the ordinary course of business (for example, purchasing goods or services from a client at normal commercial terms and these goods or services will be consumed by the firm). Examples of prohibited business relationships include joint business ventures, limited partnership agreements, and certain leasing interests.

---

## Nonattest Services

***Which rules describe the nonattest services that my firm and I may or may not provide to attest clients?***

The term *nonattest services* includes accounting, tax, and consulting services that are not part of an attest engagement.<sup>18</sup> Nonattest services specifically addressed in the rules are

- bookkeeping services,
- nontax disbursement services,
- internal audit assistance,
- benefit plan administration,
- investment advisory or management services,
- tax compliance services,
- corporate finance consulting or advisory services,
- appraisal, valuation, or actuarial services,
- executive or employee search services,
- business risk consulting,
- information systems design, installation, or integration, and
- forensic accounting services.

In addition to considering the general standard and four guiding principals, the SEC and PCAOB rules generally prohibit a CPA from providing the following services to an issuer contemporaneously with an audit:

- Bookkeeping and other services related to the client's accounting records or financial statements
- Financial information systems design and implementation
- Appraisal or valuation services
- Actuarial services
- Internal audit outsourcing
- Management functions
- Human resources
- Broker-dealer, investment adviser, or investment banking
- Legal services
- Expert services unrelated to the audit
- Aggressive or confidential tax transactions (PCAOB)
- Personal tax services provided to persons in financial reporting oversight roles (PCAOB)

---

<sup>18</sup> Defined in the *Code of Professional Conduct*, an [\*attest engagement\*](#) is one that requires independence under AICPA professional standards, for example, audits and reviews of financial statements or agreed-upon procedures performed under the attestation standards.

If your firm performs nonattest services for an attest client, the independence rules impose limits on the nature and scope of the services your firm may provide. In other words, the extent to which your firm may perform certain tasks will be limited by the rules. Further, certain services will be prohibited in total (for example, serving as a client's general counsel).

This section does not discuss each of these services but rather focuses on a few for purposes of illustration. To see the full context of the rules, see Ethics [Interpretation No. 101-3](#), "Performance of Nonattest Services," under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.05), and [SEC Rule 2-01\(c\)\(4\)](#), "Non-audit services." You are also encouraged to review the [Nonattest Services Frequently Asked Questions](#) developed by the Professional Ethics Division.

The AICPA rules require a member to comply with more restrictive independence provisions, if applicable, of certain regulators such as state boards of accountancy, the SEC, GAO, and the DOL.

The SEC rules require independence of the client and various affiliated entities.<sup>19</sup>

**Note:** SEC rules also require a client's audit committee (or equivalent) to pre-approve all audit and nonaudit services provided by the firm to the audit client and the client's consolidated entities. Proposals to provide tax or internal control-related services are subject to more extensive audit committee preapproval requirements under PCAOB Interim Professional Auditing Standards Rules 3524, *Audit Committee Pre-approval of Certain Tax Services*, and 3525, *Audit Committee Pre-Approval of Non-Audit Services Related to Internal Control Over Financial Reporting* (AICPA, *PCAOB Standards and Related Rules*), respectively.

## **AICPA General Requirements**

### **GENERAL REQUIREMENT 1**

One of the key principles underlying the AICPA rules on nonattest services is that you may not serve—or even appear to serve—as a member of a client's management. For example, you may not

- make operational or financial decisions for the client,
- perform management functions for the client, or
- report to the board of directors on behalf of management.

---

<sup>19</sup> See [Rule 2-01\(f\) \(4\) and \(6\)](#).

In addition, the following are examples of the types of activities that impair independence:

- Authorizing or executing a transaction on behalf of a client
- Preparing the client's source documents (for example, purchase orders)
- Having custody of a client's assets
- Establishing or maintaining internal controls, including monitoring ongoing activities

## **GENERAL REQUIREMENT 2**

To help ensure compliance with the first general requirement, the second requirement states that the client must agree to assume certain responsibilities related to the nonattest services engagement. So, prior to agreeing to perform any nonattest services for the client, the firm must obtain the client's agreement to

- make all management decisions and perform all management functions,
- designate an individual who possesses suitable skill, knowledge, and experience, preferably within senior management, to oversee the services,
- evaluate the adequacy and results of the services performed, and
- accept responsibility for the results of the services.

With regard to item 2 in the preceding list, the firm should be satisfied that the client's designee understands the services to be performed sufficiently to oversee them. This does not mean that the individual must be able to perform or re-perform the services. It means that he or she should be able to understand and agree to the nature, objectives, and scope of the services, make all significant judgments, evaluate the adequacy and results of the service, accept responsibility for the service results, and ensure that the resulting work product meets the agreed-upon specifications. The client must also be willing to commit the time and resources needed for the designee to fulfill these duties.

## **GENERAL REQUIREMENT 3**

Before performing nonattest services, the firm should establish and document its understanding with the client regarding the following:

- Objectives of the engagement
- Services to be performed
- Client's acceptance of its responsibilities
- Member's responsibilities
- Any limitations of the engagement

The firm should document the understanding in the engagement letter, audit planning memo, or other internal firm file.

**Note:** Routine activities (for example, assisting clients with technical accounting questions, advising on internal controls, or providing periodic training on new pronouncements) that are part of the normal member-client relationship are exempt from the second and third general requirements.

***What are the rules concerning performing bookkeeping services for a client?***

The AICPA independence rules prohibit members from acting as client management in all circumstances. Accordingly, a member may provide bookkeeping services if the client oversees the services and, among other things, performs all management functions and makes all management decisions in connection with the services. For example, if a member is engaged to provide bookkeeping services that will result in a set of financial statements, the client must

- approve all account classifications,
- provide source documents to the member so that the member can prepare journal entries, and
- take responsibility for the results of the member's services (for example, financial statements).

**Note:** Proposing adjusting entries to a client's financial statements as part of the member's audit, review, or compilation services is considered a normal part of those engagements and would not be considered performance of a nonattest service subject to the general provisions of Ethics Interpretation 101-3 provided the client reviews these entries and understands the impact on its financial statements and records any adjustments identified by the member.

Because of self-audit concerns, performing any type of bookkeeping service for a client (or affiliate of a client) is considered to impair independence under SEC rules unless it is reasonable to expect that the results of the auditor's services will not be subject to the firm's audit procedures. The SEC considers there to be a rebuttable presumption that the results of these services would be subject to audit procedures and, therefore, the firm must overcome the presumption to perform the service.

This presumption of self-audit also applies to (1) financial information design and implementation; (2) appraisals, valuations, fairness opinions, or contribution-in-kind reports; (3) actuarial-related advisory services; and (4) internal audit outsourcing.

In August 2007, the SEC staff updated its FAQ document titled *Office of the Chief Accountant: Application of the Commission's Rules on Auditor Independence Frequently Asked Questions*. Question 7 under "Prohibited and Non-audit Services" addressed the question of whether a successor auditor who performed one of the above services during the audit period

(the period covered by the financial statements) would be independent of the client. The FAQ states that if the services (1) relate solely to the prior period audited by the predecessor auditor and (2) were performed before the successor auditor was engaged to audit the current audit period, independence would not be impaired.<sup>20</sup>

***May my firm provide internal audit assistance to a client?***

To perform [internal audit assistance](#) for a client and maintain independence, your firm may not act—or appear to act—as a member of the client's management. For example, you and your firm may not

- make decisions on the client's behalf, or
- report to the client's governing body.

To maintain independence, the client must

- designate an individual or individuals who possess suitable skill, knowledge, and experience to oversee the internal audit function,
- determine the scope, risk, and frequency of internal audit activities,
- evaluate the findings and results of internal audit activities, and
- evaluate the adequacy of the audit procedures performed and related findings.

Internal audit services impair independence under SEC rules unless it is reasonable to expect that the results of the auditor's services would not be subject to the firm's audit procedures.

**Note:** For entities regulated by the FDIC or other banking agencies, see [www.fdic.gov/news/news/financial/2003/fil0321.html](http://www.fdic.gov/news/news/financial/2003/fil0321.html).

***May my firm provide valuation, appraisal, or actuarial services to a client?***

Your firm may not provide valuation, appraisal, or actuarial services to a client if

- the results of the service would be material to the client's financial statements, and
- the service involves a significant amount of subjectivity.

For instance, your firm may not perform a valuation in connection with a business combination that would have a material effect on a client's financial statements because that service involves significant subjectivity (for example, setting the assumptions and selecting and applying the valuation methodology).

<sup>20</sup> In November 2007, the Professional Ethics Division issued similar guidance in the form of a frequently asked question (FAQ), which can be found at [www.aicpa.org/download/ethics/nonattest\\_q\\_a.pdf](http://www.aicpa.org/download/ethics/nonattest_q_a.pdf).

There are two limited exceptions to this rule. Valuation, appraisal, or actuarial services performed for nonfinancial statement purposes may be provided if they otherwise meet the rule's general requirements (for example, the client assigns an individual to oversee the service who is in a position to make an informed judgment on and accept responsibility for the results of the service). Also, your firm may provide an actuarial valuation of a client's pension or postretirement liabilities because the results of the valuation would be reasonably consistent regardless of who performs the valuation.

The SEC prohibits your firm from providing valuation, appraisal, or any service involving a fairness opinion or contribution-in-kind report<sup>21</sup> to clients unless it is reasonable to expect that your firm would not audit the results of those services.

***May my firm provide investment advisory services to a client?***

Here are examples of what you and your firm may do under the AICPA rules:

- Make recommendations to a client about the allocation of funds to various asset classes.
- Analyze investment performance.

However, the AICPA rules also indicate that you and your firm may not

- make investment decisions for the client,
- execute investment transactions, or
- take custody of a client's assets.

***May my firm design or implement an information system for a client?***

Your firm may not design or develop a client's financial information system or make more than insignificant modifications to the source code underlying such a system. In addition, operating a client's local area network is prohibited.

Your firm may install an accounting software package for a client, including helping the client set up a chart of accounts and financial statement format. Your firm may also provide training to the client's employees on how to use an information system. Your firm may not, however, supervise the client's employees in their day-to-day use of the system because that activity is a management function.

Your firm is not precluded from designing, implementing, integrating, or installing an information system that is unrelated to the client's financial reporting process.<sup>22</sup>

---

<sup>21</sup> Per the SEC, fairness opinions and contribution-in-kind reports are opinions and reports in which your firm provides its opinion on the adequacy of consideration in a transaction.

<sup>22</sup> FAQs to assist members in understanding and implementing the new information on technology services provisions may be obtained at [www.aicpa.org/download/ethics/QA\\_IT.pdf](http://www.aicpa.org/download/ethics/QA_IT.pdf).

SEC rules prohibit your firm from providing any service related to a client's financial information system design or implementation unless the results of your firm's services would not be subject to audit procedures during an audit of the client's financial statements. Your firm may either

- evaluate internal controls of a financial information system as it is being designed, implemented, or operated for the client by another service provider, or
- make recommendations on internal control matters to management in connection with a system design and implementation project being performed by another service provider.

**Note:** Effective for audits of fiscal years ending on or after November 15, 2007, your firm must obtain preapproval for these and other internal control-related services in accordance with PCAOB Rule 3525.

---

## Fee Issues

---

### *What types of fee arrangements between my firm and a client are prohibited?*

Two types of fee arrangements, contingent fees and commissions, are prohibited if the arrangement involves certain attest clients, even though the fee is not related to an attest service.

A [contingent fee](#) is an arrangement whereby (1) no fee is charged unless a specified result is attained or (2) the amount of the fee depends on the results of your firm's services.

Some examples of contingent fees are

- your firm receives a "finder's fee" for helping a client locate a buyer for one of your client's assets, and
- your firm performs a consulting engagement to decrease a client's operating costs. The fee is based on a percentage of the cost reduction that the client achieves as a result of your service.

Exceptions are

- fees fixed by a court or other public authority, and
- in tax matters, fees based on the results of judicial proceedings or the findings of governmental agencies.

A [commission](#) is any compensation paid to you or your firm for (1) recommending or referring a third party's product or service to a client or (2) recommending or referring a client's product or service to a third party.

Examples of commission are if you or your firm

- refers a client to a financial planning firm that pays you a commission for the referral,
- sells accounting software to a client and receives a percentage of the sales price (a commission) from a software company, or
- refers a nonclient to an insurance company client, which pays you a percentage of any premiums subsequently received (a commission) from the nonclient.

Commissions or contingent fee arrangements with a client are not allowed if your firm also provides one of the following services to a client:

- An audit of financial statements
- A review of financial statements
- A compilation of financial statements if a third party (for example, a bank or investor) will rely on the financial statements and the report does not disclose a lack of independence
- An examination of prospective financial statements

You may have commission and contingent fee arrangements with persons associated with a client—such as officers, directors, and principal shareholders—or with a benefit plan that is sponsored by a client (that is, the plan itself is not an attest client). For example, you may receive a commission from a nonclient insurer if you refer an officer of an attest client to the insurer and the officer purchases a policy. Even though this situation is permitted, you are still required to tell the officer that you received a commission for making the referral.

**Note:** [State boards of accountancy and state societies](#) may also have more restrictive regulations regarding fee arrangements, as well as specific disclosure requirements.

PCAOB Rule 3521, *Contingent Fees*, (AICPA, *PCAOB Standards and Related Rules*) prohibits you and your firm from providing any service or product to an audit client for a contingent fee or a commission or receiving from the audit client, directly or indirectly, a contingent fee or commission. Although the PCAOB's definition of contingent fees was adapted from the SEC's definition, the PCAOB rule eliminates the exception for fees in tax matters, if determined based on the results of judicial proceedings or the findings of governmental agencies. In addition, the PCAOB rule specifically indicates that the contingent fees cannot be received directly or indirectly from the audit client. PCAOB Rule 3521 does not apply to contingent fee arrangement that were paid in their entirety, converted to fixed fee arrangements, or otherwise unwound before June 18, 2006.

***When are referral fees permitted?***

The AICPA rule provides an exception for referral fees for recommending or referring a CPA's services to another person or entity. That is, you may (1) receive a fee for referring a CPA's services to any person or entity or (2) if you are a CPA, you may pay a fee to obtain a client. You must inform the client if you receive or pay a referral fee.

***Is independence affected when a client owes the firm fees for professional services the firm has already provided?***

If a client owes your firm fees for services rendered more than one year ago, your firm's independence is considered impaired. It does not matter if the fees are related to attest services; what matters is that the client has an outstanding debt with the firm. This is the case even if the client has given you a note receivable for these fees.

The SEC generally expects payment of past-due fees before an engagement has begun, although a short-term payment plan may be accepted if the client has committed to pay the balance in full before the

current year report is issued.<sup>23</sup>

***Does being compensated for selling certain services to clients affect my independence?***

The AICPA rules do not specifically address this issue.

The SEC prohibits audit partners from being directly compensated for selling nonattest services to audit clients. The SEC believes that such financial incentives could threaten an audit partner's objectivity and that the appearance of independence could be affected by such compensation arrangements.<sup>24</sup>

The rule does not prevent an audit partner from sharing in profits of the audit practice or the overall firm. Nor does it preclude the firm from evaluating a partner based on factors related to the sale of nonaudit services to clients, for example, the complexity of engagements or overall management of audit or nonaudit engagements.

***Does it matter if a significant proportion of my firm's fees come from a particular client?***

The conceptual framework states that a financial self-interest threat may exist due to "excessive reliance on revenue from a single attest client." In addition, Ethics Rule 102 and Article IV, *Objectivity and Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 55), of the Principles of Professional Conduct, discuss in broad terms that members should be alert for relationships that could diminish their objectivity and independence in performing attest services. The significance of a client to a member (or his or her firm)—measured in terms of fees, status, or other factors—may diminish a member's ability to be objective and maintain independence when performing attest services.

To address this issue, firms should consider implementing the following policies and procedures to identify and monitor significant clients to help mitigate possible threats to a member's objectivity and independence:

1. Policies and procedures for identifying and monitoring significant client relationships, including the following:
  - Considering client significance in the planning stage of the engagement.

---

<sup>23</sup> The exception has generally been applied only to engagements to audit a client's financial statements included in its annual report, not in a registration statement.

<sup>24</sup> Accounting firms with 10 or fewer partners and 5 or fewer audit clients that are issuers, as defined by the SEC, are exempt from this rule.

- Basing the consideration of client significance on firm-specific criteria or factors that are applied on a facts and circumstances basis (see the section “Factors to Consider in Identifying Significant Clients” in this guide).
  - Periodically monitoring the relationship. What constitutes *periodic* is a matter of judgment, but assessments of client significance that are performed at least annually can be effective in monitoring the relationship. During the course of such a review, a client previously deemed to be significant may cease to be significant. Likewise, clients not identified as significant could become significant whenever factors the firm considers relevant for identifying significant clients arise (for example, additional services are contemplated).
2. Policies and procedures to help mitigate possible threats to independence and objectivity by
- assigning a second (or concurring) review partner who is not otherwise associated with the engagement and practices in an office other than those that perform the attest engagement,
  - subjecting the assignment of engagement personnel to approval by another partner or manager,
  - periodically rotating engagement partners,
  - subjecting significant client attest engagements to internal firm monitoring procedures, and
  - subjecting significant client attest engagements to preissuance or postissuance reviews or to the firm’s external peer review process.

The most effective safeguards a firm can employ will vary significantly depending on the size of the firm, the way the firm is structured (for example, whether highly centralized or departmentalized), and other factors. For example, smaller firms (particularly those with one office) tend to be simpler and less departmentalized than larger firms. Generally, their processes will be less formal and involve fewer people than those of larger firms. Further, their firms’ managing partners may engage in frequent and direct communications with the firms’ partners and professional staff on client matters and be personally involved in staff assignments. Larger firms draw from a sizeable and diverse talent pool. In those firms, partners who are not affiliated with the engagement (or the client service office or business unit) can choose second (or concurring) review partners from outside the office performing the attest engagement. Mid-sized—or regional—firms may have aspects of both their smaller and larger counterparts, like combining the ability to choose second review partners from an office other than the client service office while maintaining a relatively close connection to specific client relationships.

### **Factors to Consider in Identifying Significant Clients**

Both qualitative and quantitative factors can reveal a significant client, including

- the size of the client in terms of the percentage of fees or the dollar amount of fees versus total revenue of the engagement partner, office, practice unit,<sup>25</sup> or the firm;
- the significance of the client to the engagement partner, office, or practice unit of the firm in light of the
  - amount of time the partner, office, or practice unit devotes to the engagement,
  - effect on the partner’s stature within the firm due to his or her relationships with the client,
  - manner in which the partner, office, or practice unit is compensated, and
  - effect that losing the client would have on the partner, office, or practice unit;
- the importance of the client to the firm’s growth strategies (for example, the firm is trying to gain entry into a particular industry);
- the stature of the client, which may enhance the firm’s stature (for example, the client is a company of distinction within its industry or in the local, regional, national, or international business community);
- whether the firm also provides services to related parties (for example, also provides professional services to affiliates or owners of the client); and
- whether the engagement is recurring or not.

Judgment is necessary to determine whether a client is significant to the firm, office, practice unit, or partner of the firm. Firms will vary considerably in terms of the degree to which they consider some factors to be more pertinent than others. Gauges that relate to each relevant level within a firm (for example, firm, geographic region, office, or practice unit) may be useful but will likely be different for various levels within the firm.

According to SEC guidance, in general, if a firm derives more than 15 percent of its total revenues from one client or group of related clients, independence may be impaired because this may cause the firm to be overly dependent on the client or group of related clients.

---

<sup>25</sup> Assessing client significance at the business or practice unit level may be a more meaningful measure for firms that structure their practices along industry lines (such as healthcare or financial services).

---

## Further Assistance

---

### *Where can I find further assistance with my independence questions?*

This guide does not address many subjects included in the AICPA rules. Readers are encouraged to view the online version of the *Code of Professional Conduct* at [www.aicpa.org/about/code/index.html](http://www.aicpa.org/about/code/index.html).

In addition, readers should refer to ET section 100.01 in evaluating whether a specific circumstance that is not addressed in the code would pose an unacceptable threat to independence.

As specific services and situations arise in practice, refer to the independence literature and consult those responsible for independence in your firm. If you need further assistance researching your question, contact one of the following organizations for guidance.

AICPA guidance is as follows:

- The Web site address for information about the AICPA's ethics standard-setting activities is [www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/Exposure+Drafts+-+Standard+Setting/](http://www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/Exposure+Drafts+-+Standard+Setting/).
- For resources related to understanding and applying nonattest services rules, see [www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/Resources+and+Tools/](http://www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/Resources+and+Tools/).
- For the Background and Basis for Conclusion document for nonattest services, see [www.aicpa.org/download/ethics/Basis\\_for\\_Conclusions\\_Non\\_Attest\\_Services.pdf](http://www.aicpa.org/download/ethics/Basis_for_Conclusions_Non_Attest_Services.pdf).
- The AICPA *Code of Professional Conduct* is available at [www.aicpa.org/about/code/index.html](http://www.aicpa.org/about/code/index.html) (see Rule 101; Rule 302, *Contingent Fees* (AICPA, *Professional Standards*, vol. 2, ET sec. 300); and Rule 503, *Commissions and Referral Fees* (AICPA, *Professional Standards*, vol. 2, ET sec. 500).
- For independence inquiries by phone, call (888) 777-7077. Send e-mail inquiries to [ethics@aicpa.org](mailto:ethics@aicpa.org).
- The AICPA interactive CD-ROM course on independence, titled *Independence*, teaches the AICPA and SEC independence rules and qualifies for eight hours of Continuing Professional Education (CPE) credits. See

[www.cpa2biz.com/AST/Main/CPA2BIZ\\_Primary/Ethics/PRDOVR~PC-739155HS/PC-739155HS.jsp](http://www.cpa2biz.com/AST/Main/CPA2BIZ_Primary/Ethics/PRDOVR~PC-739155HS/PC-739155HS.jsp).

SEC guidance is as follows:

- The SEC's January 2003 rules release is available at [www.sec.gov/rules/final/33-8183.htm](http://www.sec.gov/rules/final/33-8183.htm).
- Information for accountants, including independence, may be found at [Office of the Chief Accountant](http://www.sec.gov/about/offices/oca/ocaprof.htm) at [www.sec.gov/about/offices/oca/ocaprof.htm](http://www.sec.gov/about/offices/oca/ocaprof.htm).
- Independence reference materials can be found on the SEC Web site at [www.sec.gov/info/accountants/independref.shtml](http://www.sec.gov/info/accountants/independref.shtml).
- U.S. Securities & Exchange Commission, Office of the Chief Accountant  
100 F Street, NE, Washington, DC 20549; 202-551-5300 (Phone); 202-772-9252 (Fax)

The PCAOB has a Web site at [www.pcaobus.org](http://www.pcaobus.org). Standards may be found at [www.pcaobus.org/Standards/index.aspx](http://www.pcaobus.org/Standards/index.aspx).

GAO guidance is as follows:

- Obtain the GAO Yellow Book requirements at [GAO: Especially for the Auditing and Accountability Community](http://www.gao.gov/govaud/agagas3.pdf).
- Yellow Book Independence Standard (see [www.gao.gov/govaud/agagas3.pdf](http://www.gao.gov/govaud/agagas3.pdf)).
- Obtain answers to FAQs on independence (see [www.gao.gov/govaud/d02870g.pdf](http://www.gao.gov/govaud/d02870g.pdf)).
- Slide presentation on independence standard ([www.gao.gov/govaud/niaf021025.pdf](http://www.gao.gov/govaud/niaf021025.pdf)).
- Direct inquiries to Michael Hrapsky, Senior Project Manager, Government Auditing Standards, at (202) 512-9535 or e-mail [yellowbook@gao.gov](mailto:yellowbook@gao.gov).

DOL guidance is as follows:

- DOL Regulation 2509.75-9, *Interpretive Bulletin Relating to Guidelines on Independence of Accountant Retained by Employee Benefit Plan*
- Direct inquiries to the DOL at 1-866-4-USA-DOL

Banking regulators guidance is as follows:

Obtain the FDIC regulations (12 CFR Part 363), *Annual Independent Audits and Reporting Requirements*, at [www.fdic.gov/regulations/laws/rules/2000-8500.html#2000part363](http://www.fdic.gov/regulations/laws/rules/2000-8500.html#2000part363).

A 2006 advisory regarding the use of indemnification and limitation of liability provisions in engagement letters with public and nonpublic financial institutions is available at [www.federalreserve.gov/boarddocs/srletters/2006/SR0604a1.pdf](http://www.federalreserve.gov/boarddocs/srletters/2006/SR0604a1.pdf).