



## **AICPA Interpretation 101-3, *Performance of Nonattest Services* Guidance in Understanding General Requirement No. 2: Client Responsibilities**

AICPA Interpretation 101-3, *Nonattest Services*, General Requirement No. 2 (revised January 27, 2005) states:

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;*
  - d. *Accept responsibility for the results of the services; and*
  - e. *Establish and maintain internal controls, including monitoring ongoing activities.*

*The member should be satisfied that the client will be able to meet all of these criteria and make an informed judgment on the results of the member's nonattest services. In assessing whether the designated individual possesses suitable skill, knowledge, and/or experience, the member should be satisfied that such individual 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.*

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### **Q1. What does *suitable skill, knowledge, and/or experience* mean in the context of Interpretation 101-3?**

A1. Suitable skill, knowledge, and/or experience means that the individual designated to oversee the nonattest service has the ability to understand the nature, objective and scope of the nonattest service. Overseeing the service does not require the designated individual to supervise the member in the day-to-day rendering of the services. Rather the individual should agree on the nature, objectives and scope of the services, receive periodic progress reports where appropriate, make all significant judgments, evaluate the adequacy and results of the service, accept responsibility for the service results, and ensure that the resulting work product meets the agreed-upon specifications. The skill, knowledge, and/or experience needed will vary depending on the nature of the nonattest service. For example, the skill, knowledge, and/or experience needed to oversee a payroll service can be expected



to be different than the skill, knowledge, and/or experience needed to oversee a complex tax service. The requirement for the designated individual to possess suitable skill, knowledge and/or experience, does not, however, require that the individual possess the technical expertise that the member possesses or the ability to perform or re-perform the services.

**Q2. Is the requirement that the client possess suitable skill, knowledge and/or experience to oversee the nonattest services provided by the member a new provision?**

A2. No. Since the mid-1970s, Interpretation 101-3 has called for the attest client to undertake certain responsibilities in connection with the delivery of various nonattest services. For example, at various times the rule has called for the client to “be sufficiently knowledgeable,” “sufficiently informed,” and “have an informed judgment on the results of the nonattest service.” These requirements contemplated oversight by an individual with suitable skills, knowledge and/or experience to do so.

**Q3. Why does the rule require an individual who possesses suitable skill, knowledge and/or experience to oversee the nonattest services provided by the member?**

A3. If the individual designated by the client does not possess suitable skill, knowledge and/or experience to oversee the nonattest service, there would be no one (other than the member) to make the significant judgments that become necessary during the delivery of the service or to discharge the other client responsibilities under Interpretation 101-3. Performing those activities on behalf of the attest client would be inconsistent with the member’s requirement to be independent of the client.

**Q4. What are the underlying concepts that support the conclusion that a member’s independence would be impaired if an individual designated by the client with suitable skill, knowledge and/or experience does not perform the activities described in the interpretation?**

A4. Two threats to a member’s independence arise if the member assumes the client’s responsibilities under Interpretation 101-3. First a “self-review threat” arises when the member reviews, as part of an attest engagement (e.g., an audit), evidence that results from his or her own, or



his or her firm's, nonattest work. That could happen, for example, when the member makes significant judgments on behalf of the client during the performance of the nonattest service, or the designated client individual lacks suitable skill, knowledge and/or experience to evaluate the adequacy and results of the service and accept responsibility for those results. In that situation, the member has a disincentive to challenge the related financial statement amounts because doing so could call into question his or her (or his or her firm's) own work. That disincentive is inconsistent with the need for the member to be independent and objective with respect to the client. The second threat that arises is a "management participation threat." Making significant judgments on behalf of the attest client during the performance of the nonattest service causes the member to function as management in connection with the service. That also is inconsistent with the need for the member to be independent and objective with respect to the client. By ensuring that an individual designated by the client with suitable skill, knowledge and/or experience oversees the member's nonattest services and makes all management decisions, both threats are eliminated.

**Q5. How should a member assess whether the individual designated by the client to oversee the nonattest service possesses suitable skill, knowledge and/or experience?**

A5. In assessing whether the designated individual has suitable skills, knowledge and/or experience to oversee a nonattest service, the member might consider factors such as the individual's:

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

Some factors may be given more weight than others, depending on the nature of the service. For example, although the level of education attained by the individual can be one indicator of his or her skills and/or knowledge, it is not necessarily true that the more formal education the individual possesses, the more able he or she would be to oversee the nonattest service. If the individual



understands the nature of the service and possesses a sufficient knowledge of the client's business and industry, he or she may have the skills, knowledge and/or experience to oversee the service, *regardless of the level of education he or she possesses*. For example, most small business owners know their company's operations and financial position better than anyone, and they understand the services they need from the member and what those services are intended to accomplish. And, because they are the owners of the business, they regularly make important decisions about all matters affecting their business. Accordingly, members might conclude that those individuals would possess the necessary skills, knowledge and/or experience to understand the services being performed, make any management decisions, and determine whether the results of the services meet the agreed-upon specifications.

**Q6. Who at the client could serve as the designee?**

A6. The individual the client should designate to oversee the nonattest service will depend on the structure of the client's organization and the nature of the nonattest engagement being performed. In an owner-managed business, that person will often be the owner. However, depending on the nature of the nonattest services and the qualifications of other client employees, it could be the controller, bookkeeper, another employee, or a third-party not employed by the client provided that individual meets certain criteria as discussed in item No. 7.

For example, consider a nonattest engagement where the member has been asked to provide investment advisory services, to include recommendations on the allocation of funds that the client should invest in various asset classes based on the client's desired rate of return and risk tolerance. The owner of the company has knowledge of the company's investment objectives and therefore serves as the client designee. The owner makes all investment decisions concerning the allocation of funds and investment selections and accepts responsibility for the resulting investment plan. For purposes of this nonattest engagement, the member may conclude that the owner of the company possesses the skills, knowledge and/or experience to oversee the service. On the other hand, consider an engagement where the member is asked to install an off-the-shelf accounting package and set up the chart of accounts and financial statement format for a small business client. The owner of the company is traveling on business and designates the office manager to oversee the installation. The office



manager primarily performs routine clerical and receptionist functions for the business and has limited understanding of the company's operations. He has never used accounting or financial software such as the application being installed by the practitioner. In addition, because the company hires a part-time bookkeeper to maintain its general ledger and subsidiary records, the office manager has no understanding of the company's books or records and financial statements. For purposes of this nonattest engagement, it appears unlikely that the office manager would be in a position to understand the services being performed sufficiently to oversee them and accept responsibility for the resulting accounting system.

**Q7. May the client contract with a third-party who is not an employee of the client to oversee or advise on the member's performance of the nonattest service?**

A7. The client may contract with a third-party to advise management regarding the nature of the services and the evaluation of the adequacy and results of the services in order to enable management to effectively oversee the services, perform all management functions, make all management decisions, accept responsibility for the services, and maintain internal controls over the services.

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

**Q8. How can a member be satisfied that the client designee understands the nonattest services performed and the resulting work product?**

A8. Members are expected to utilize their professional judgment and experience to recognize which individuals are able and willing to fulfill the client responsibilities as set forth in the Interpretation. Through interaction with the client owner(s) or client employees, experienced practitioners should be able to assess whether the designated client individual possesses the skill, knowledge and/or experience to effectively oversee the nonattest service.



**Q9. What are some examples of nonattest services and the level of understanding that the client designee should possess in order to comply with Interpretation 101-3?**

***Bookkeeping Services***

A9. Where the member performs routine bookkeeping services for an audit, review or compilation client, the member should be satisfied that the designated individual understands the reason why the journal entries are being proposed and the effect they have on the financial statements. For recurring or standard journal entries (e.g., depreciation), the designated individual may require no explanation as to the reason for the entry (e.g., where the member has previously discussed these entries with the client), whereas for more complex journal entries (e.g., deferred taxes), the member may need to explain to the client the reason and basis for the entry and its impact on the financial statements. In any case, the individual should be in a position to approve the proposed journal entries and accept responsibility for the company's financial statements.

***Tax Services***

A9. For tax return preparation engagements, the individual designated by the client need not have an understanding of the applicable tax laws. However, the member should have the designated individual review the tax return with emphasis on the key tax positions taken and be satisfied that the individual understands the company's tax situation, has a general understanding of how the amounts on the tax return were determined, and makes all decisions regarding significant tax positions taken in the return.

***Valuation Services***

A9. For more complex engagements, such as permitted valuation services, the member may need to explain to the individual designated by the client the valuation methodologies used as well as all significant assumptions. The individual should then be in a position to approve all significant assumptions and accept responsibility for the resulting valuation.



**Q10. General requirements no. 2 and no. 3 under Interpretation 101-3 do not apply to certain routine activities performed by the member. What are considered to be routine activities for purposes of the Interpretation?**

A10. Whether an activity is routine should be determined considering all of the facts and circumstances surrounding the activity. Routine activities generally involve providing advice or assistance to the client on an informal basis as part of the normal client-member relationship. Routine activities typically are insignificant in terms of time incurred or resources expended and generally do not result in a specific project or engagement or in the member producing a formal report or other formal work product. Examples of routine activities may include:

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