

.05 101-3—Performance of nonattest services. Before a member or his or her firm ("member") performs nonattest services (for example, tax or consulting services) for an attest client, ⁴ the member should determine that the requirements described in this interpretation have been met. In cases where the requirements have not been met during the period of the professional engagement or the period covered by the financial statements, the member's independence would be impaired.

Engagements Subject to Independence Rules of Certain Regulatory Bodies

This interpretation requires compliance with independence regulations of authoritative regulatory bodies (such as the Securities and Exchange Commission [SEC], the General Accounting Office [GAO], the Department of Labor [DOL], and state boards of accountancy) where a member performs nonattest services for an attest client and is required to be independent of the client under the regulations of the applicable regulatory body. Accordingly, failure to comply with the nonattest services provisions contained in the independence rules of the applicable regulatory body that are more restrictive than the provisions of this interpretation would constitute a violation of this interpretation.

General Requirements for Performing Nonattest Services

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

⁴ A member who performs a compilation engagement for a client should modify the compilation report to indicate a lack of independence if the member does not meet all of the conditions set out in this interpretation when providing a nonattest service to that client (see Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements* [AR section 100.19]). [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee.]

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

3. Before performing nonattest services, the member should establish and document in writing **5** his or her understanding with the client (board of directors, audit committee, or management, as appropriate in the circumstances) regarding the following:
 - a. Objectives of the engagement
 - b. Services to be performed
 - c. Client's acceptance of its responsibilities
 - d. Member's responsibilities
 - e. Any limitations of the engagement

The documentation requirement does not apply to:

- a. Nonattest services performed prior to January 1, 2005.
- b. Nonattest services performed prior to the client becoming an attest client. **6**

General requirements 2 and 3 above do not apply to certain routine activities performed by the member such as providing advice and responding to the client's questions as part of the normal client-member relationship.

General Activities

The following are some general activities that would impair a member's independence:

- Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of a client or having the authority to do so
- Preparing source documents⁷, in electronic or other form, evidencing the occurrence of a transaction
- Having custody of client assets
- Supervising client employees in the performance of their normal recurring activities

5 A failure to prepare the required documentation would not impair independence, but would be considered a violation of Rule 202 – Compliance with Standards, provided that the member did establish the understanding with the client. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee. Footnote subsequently revised January 27, 2005.]

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

7 Source documents are the documents upon which evidence of an accounting transaction are initially recorded. Source documents are often followed by the creation of many additional records and reports, which do not, however, qualify as initial recordings. Examples of source documents are purchase orders, payroll time cards, and customer orders. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered and revised, September 2003, by the Professional Ethics Executive Committee.]

- Determining which recommendations of the member should be implemented
- Reporting to the board of directors on behalf of management
- Serving as a client's stock transfer or escrow agent, registrar, general counsel or its equivalent

Specific Examples of Nonattest Services

The examples in the following table identify the effect that performance of certain nonattest services for an attest client can have on a member's independence. These examples presume that the general requirements in the previous section "General Requirements for Performing Nonattest Services" have been met and are not intended to be all-inclusive of the types of nonattest services performed by members.

Impact on Independence of Performance of Nonattest Services

<u>Type of Nonattest Service</u>	<u>Independence Would Not Be Impaired</u>	<u>Independence Would Be Impaired</u>
Bookkeeping	• Record transactions for which management has determined or approved the appropriate account classification, or post coded transactions to a client's general ledger.	• Determine or change journal entries, account codings or classification for transactions, or other accounting records without obtaining client approval.
	• Prepare financial statements based on information in the trial balance.	• Authorize or approve transactions.
	• Post client-approved entries to a client's trial balance.	• Prepare source documents.
	• Propose standard, adjusting, or correcting journal entries or other changes affecting the financial statements to the client provided the client reviews the entries and the member is satisfied that management understands the nature of the proposed entries and the impact the entries have on the financial statements.	• Make changes to source documents without client approval.
Payroll and other disbursement	• Using payroll time records provided and approved by the client, generate unsigned checks, or process client's payroll.	• Accept responsibility to authorize payment of client funds, electronically or otherwise, except as specifically provided for with respect to electronic payroll tax payments.
	• Transmit client-approved payroll or other disbursement information to a financial institution provided the client has authorized the member to make the transmission and has made arrangements	• Accept responsibility to sign or cosign client checks, even if only in emergency situations.

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	for the financial institution to limit the corresponding individual payments as to amount and payee. In addition, once transmitted, the client must authorize the financial institution to process the information.	
	<ul style="list-style-type: none"> • Make electronic payroll tax payments in accordance with U.S. Treasury Department or comparable guidelines provided the client has made arrangements for its financial institution to limit such payments to a named payee. 8 	<ul style="list-style-type: none"> • Maintain a client’s bank account or otherwise have custody of a client’s funds or make credit or banking decisions for the client.
		<ul style="list-style-type: none"> • Sign payroll tax return on behalf of client management. • Approve vendor invoices for payment
Benefit plan administration ⁹	<ul style="list-style-type: none"> • Communicate summary plan data to plan trustee. 	<ul style="list-style-type: none"> • Make policy decisions on behalf of client management.
	<ul style="list-style-type: none"> • Advise client management regarding the application or impact of provisions of the plan document. 	<ul style="list-style-type: none"> • When dealing with plan participants, interpret the plan document on behalf of management without first obtaining management’s concurrence.
	<ul style="list-style-type: none"> • Process transactions (e.g., investment/benefit elections or increase/decrease contributions to the plan; data entry; participant confirmations; and processing of distributions and loans) initiated by plan participants through the member’s electronic medium, such as an interactive voice response system or Internet connection or other media. 	<ul style="list-style-type: none"> • Make disbursements on behalf of the plan.

8 Although this type of transaction may be considered by some to be similar to signing checks or disbursing funds, the Professional Ethics Executive Committee concluded that making electronic payroll tax payments under the specified criteria would not impair a member's independence. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered and revised, September 2003, by the Professional Ethics Executive Committee.]

9 When auditing plans subject to the Employee Retirement Income Security Act (ERISA), Department of Labor (DOL) regulations, which may be more restrictive, must be followed. [Footnote renumbered by the revision of interpretation 101-2, April 2003. Footnote subsequently renumbered by the Professional Ethics Executive Committee, September 2003.]

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	<ul style="list-style-type: none"> • Prepare account valuations for plan participants using data collected through the member’s electronic or other media. 	<ul style="list-style-type: none"> • Have custody of assets of a plan.
	<ul style="list-style-type: none"> • Prepare and transmit participant statements to plan participants based on data collected through the member’s electronic or other medium. 	<ul style="list-style-type: none"> • Serve a plan as a fiduciary as defined by ERISA.
Investment— advisory or management	<ul style="list-style-type: none"> • Recommend the allocation of funds that a client should invest in various asset classes, depending upon the client’s desired rate of return, risk tolerance, etc. 	<ul style="list-style-type: none"> • Make investment decisions on behalf of client management or otherwise have discretionary authority over a client’s investments.
	<ul style="list-style-type: none"> • Perform recordkeeping and reporting of client’s portfolio balances including providing a comparative analysis of the client’s investments to third-party benchmarks. 	<ul style="list-style-type: none"> • Execute a transaction to buy or sell a client’s investment.
	<ul style="list-style-type: none"> • Review the manner in which a client’s portfolio is being managed by investment account managers, including determining whether the managers are (1) following the guidelines of the client’s investment policy statement; (2) meeting the client’s investment objectives; and (3) conforming to the client’s stated investment styles. 	<ul style="list-style-type: none"> • Have custody of client assets, such as taking temporary possession of securities purchased by a client.
	<ul style="list-style-type: none"> • Transmit a client’s investment selection to a broker-dealer or equivalent provided the client has authorized the broker-dealer or equivalent to execute the transaction. 	
Corporate finance— consulting or advisory	<ul style="list-style-type: none"> • Assist in developing corporate strategies. 	<ul style="list-style-type: none"> • Commit the client to the terms of a transaction or consummate a transaction on behalf of the client.
	<ul style="list-style-type: none"> • Assist in identifying or introducing the client to possible sources of capital that meet the client’s specifications or criteria. 	<ul style="list-style-type: none"> • Act as a promoter, underwriter, broker-dealer, or guarantor of client securities, or distributor of private placement memoranda or offering documents.
	<ul style="list-style-type: none"> • Assist in analyzing the effects of proposed transactions including providing advice to a client during negotiations with 	<ul style="list-style-type: none"> • Maintain custody of client securities.

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	<p>potential buyers, sellers, or capital sources.</p> <ul style="list-style-type: none"> • Assist in drafting an offering document or memorandum. • Participate in transaction negotiations in an advisory capacity. • Be named as a financial adviser in a client's private placement memoranda or offering documents. 	
Executive or employee search	<ul style="list-style-type: none"> • Recommend a position description or candidate specifications. 	<ul style="list-style-type: none"> • Commit the client to employee compensation or benefit arrangements.
	<ul style="list-style-type: none"> • Solicit and perform screening of candidates and recommend qualified candidates to a client based on the client-approved criteria (e.g., required skills and experience). 	<ul style="list-style-type: none"> • Hire or terminate client employees.
	<ul style="list-style-type: none"> • Participate in employee hiring or compensation discussions in an advisory capacity. 	
Business risk consulting	<ul style="list-style-type: none"> • Provide assistance in assessing the client's business risks and control processes. 	<ul style="list-style-type: none"> • Make or approve business risk decisions.
	<ul style="list-style-type: none"> • Recommend a plan for making improvements to a client's control processes and assist in implementing these improvements. 	<ul style="list-style-type: none"> • Present business risk considerations to the board or others on behalf of management.
Information systems—design, installation or integration	<ul style="list-style-type: none"> • Install or integrate a client's financial information system; that was not designed or developed by the member (e.g., an off-the-shelf accounting package). 	<ul style="list-style-type: none"> • Design or develop a client's financial information system.
	<ul style="list-style-type: none"> • Assist in setting up the client's chart of accounts and financial statement format with respect to the client's financial information system. 	<ul style="list-style-type: none"> • Make other than insignificant modifications to source code underlying a client's existing financial information system.
	<ul style="list-style-type: none"> • Design, develop, install, or integrate a client's information system that is unrelated to the client's financial statements or accounting records. 	<ul style="list-style-type: none"> • Supervise client personnel in the daily operation of a client's information system.
	<ul style="list-style-type: none"> • Provide training and instruction to client employees on an information and control 	<ul style="list-style-type: none"> • Operate a client's local area network

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	system.	(LAN) system.

Appraisal, Valuation, and Actuarial Services

Independence would be impaired if a member performs an appraisal, valuation, or actuarial service for an attest client where the results of the service, individually or in the aggregate, would be material to the financial statements and the appraisal, valuation, or actuarial service involves a significant degree of subjectivity.

Valuations performed in connection with, for example, employee stock ownership plans, business combinations, or appraisals of assets or liabilities generally involve a significant degree of subjectivity. Accordingly, if these services produce results that are material to the financial statements, independence would be impaired.

An actuarial valuation of a client's pension or postemployment benefit liabilities generally produces reasonably consistent results because the valuation does not require a significant degree of subjectivity. Therefore, such services would not impair independence. In addition, appraisal, valuation, and actuarial services performed for nonfinancial statement purposes would not impair independence. **10** However, in performing such services, all other requirements of this interpretation should be met, including that all significant assumptions and matters of judgment are determined or approved by the client and the client is in a position to have an informed judgment on, and accepts responsibility for, the results of the service.

Internal Audit Assistance Services

Internal audit services involve assisting the client in the performance of its internal audit activities, sometimes referred to as "internal audit outsourcing." In evaluating whether independence would be impaired with respect to an attest client, the nature of the service needs to be considered.

Assisting the client in performing financial and operational **11** internal audit activities would impair independence unless the member takes appropriate steps to ensure that the client understands its responsibility for establishing and maintaining the internal control system **12** and

10 Examples of such services may include appraisal, valuation, and actuarial services performed for tax planning or tax compliance, estate and gift taxation, and divorce proceedings. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee.]

11 For example, a member may assess whether performance is in compliance with management's policies and procedures, to identify opportunities for improvement, and to develop recommendations for improvement or further action for management consideration and decision making. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee.]

12 As part of its responsibility to establish and maintain internal control, management monitors internal control to assess the quality of its performance over time. Monitoring can be accomplished through ongoing activities, separate evaluations, or a combination of both. Ongoing monitoring activities are the procedures designed to assess the quality of internal control performance over time and built into the normal recurring activities of an entity; they include regular management and supervisory activities, comparisons, reconciliations, and other routine actions.

directing the internal audit function, including the management thereof. Accordingly, any outsourcing of the internal audit function to the member whereby the member in effect manages the internal audit activities of the client would impair independence.

In addition to the general requirements of this interpretation, the member should ensure that client management:

- Designates an individual or individuals, who possess suitable skill, knowledge, and/or experience, preferably within senior management, to be responsible for the internal audit function;
- Determines the scope, risk, and frequency of internal audit activities, including those to be performed by the member providing internal audit assistance services;
- Evaluates the findings and results arising from the internal audit activities, including those performed by the member providing internal audit assistance services; and
- Evaluates the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures by, among other things, obtaining reports from the member.

The member should also be satisfied that the client's board of directors, audit committee, or other governing body is informed about the member's and management's respective roles and responsibilities in connection with the engagement. Such information should provide the client's governing body a basis for developing guidelines for management and the member to follow in carrying out these responsibilities and monitoring how well the respective responsibilities have been met.

The member is responsible for performing the internal audit procedures in accordance with the terms of the engagement and reporting thereon. The performance of such procedures should be directed, reviewed, and supervised by the member. The report should include information that allows the individual responsible for the internal audit function to evaluate the adequacy of the audit procedures performed and the findings resulting from the performance of those procedures. This report may include recommendations for improvements in systems, processes, and procedures. The member may assist the individual responsible for the internal audit function in performing preliminary audit risk assessments, preparing audit plans, and recommending audit priorities. However, the member should not undertake any responsibilities that are required, as described above, to be performed by the individual responsible for the internal audit function. The following are examples of activities (in addition to those listed in the "General Activities" section of this interpretation) that, if performed as part of an internal audit assistance engagement, would impair independence:

- Performing ongoing monitoring activities or control activities (for example, reviewing loan originations as part of the client's approval process or reviewing

Separate evaluations focus on the continued effectiveness of a client's internal control. A member's independence would not be impaired by the performance of separate evaluations of the effectiveness of a client's internal control, including separate evaluations of the client's ongoing monitoring activities. [Footnote added, effective December 31, 2003, by the Professional Ethics Executive Committee.]

customer credit information as part of the customer's sales authorization process) that affect the execution of transactions or ensure that transactions are properly executed, accounted for, or both, and performing routine activities in connection with the client's operating or production processes that are equivalent to those of an ongoing compliance or quality control function

- Determining which, if any, recommendations for improving the internal control system should be implemented
- Reporting to the board of directors or audit committee on behalf of management or the individual responsible for the internal audit function
- Approving or being responsible for the overall internal audit work plan including the determination of the internal audit risk and scope, project priorities, and frequency of performance of audit procedures
- Being connected with the client as an employee or in any capacity equivalent to a member of client management (for example, being listed as an employee in client directories or other client publications, permitting himself or herself to be referred to by title or description as supervising or being in charge of the client's internal audit function, or using the client's letterhead or internal correspondence forms in communications)

The foregoing list is not intended to be all-inclusive.

Services involving an extension of the procedures that are generally of the type considered to be extensions of the member's audit scope applied in the audit of the client's financial statements, such as confirming of accounts receivable and analyzing fluctuations in account balances, are not considered internal audit assistance services and would not impair independence even if the extent of such testing exceeds that required by generally accepted auditing standards. In addition, engagements performed under the attestation standards would not be considered internal audit assistance services and therefore would not impair independence.

Transition

Independence would not be impaired as a result of the more restrictive requirements of interpretation 101-3, provided the provision of any such nonattest services are pursuant to arrangements in existence on December 31, 2003, and are completed by December 31, 2004, and the member was in compliance with the preexisting requirements of this interpretation.

[Formerly paragraph .04, renumbered by adoption of the Code of Professional Conduct on January 12, 1988. Revised, effective June 30, 1990, by the Professional Ethics Executive Committee. Revised, effective May 31, 1999, by the Professional Ethics Executive Committee. Revised, effective April 30, 2000, by the Professional Ethics Executive Committee. Revised, July 2002, to reflect conforming changes necessary due to the revision of interpretation 101-1. Revised, effective December 31, 2003, with earlier application permitted, by the Professional Ethics Executive Committee. Revised, January 2005, by the Professional Ethics Executive Committee to clarify the applicability and intent of the interpretation.].